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To Our Clients and Other Friends

When we last communicated with you through our November 2010 Client Alert, there was a great deal of uncertainty regarding the application of the estate tax, gift tax and generation-skipping transfer tax both during 2010 and after 2010. As most of you know by now, on Friday, December 17, 2010, President Obama signed the "Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010" (the "Act"), which addresses many of those uncertainties. The purpose of this Client Alert is to summarize the Act's impact on estate planning matters in general and to emphasize its impact on a number of 2010 situations.

We have posted this Client Alert (as well as our November 2010 and January 2010 Client Alerts) on our website, www.htts.com.

The impact of the Act must be considered in light of each client's unique circumstances. However, we urge each of you to review the below summary and to contact us if you have any questions or you would like to discuss the Act's impact on your particular situation.

1. 2010 Gifts: As we outlined in our November 2010 Client Alert, there were two separate but interrelated major planning opportunities for making gifts in 2010. The Act has made the first opportunity somewhat less attractive and has clarified and probably encouraged consideration of the second opportunity.
 - a. Because the gift tax rate for 2010 gifts is 35% and the rate was scheduled to increase in 2011, possibly to 55%, making taxable gifts in 2010 (gifts in excess of the \$1 million gift tax exemption) to children and other recipients presented an opportunity to take advantage of the anticipated tax rate differential. However, the Act changed the gift tax rate for 2011 to the same 35% and, more importantly, increased the gift tax exclusion starting in 2011 from \$1 million to \$5 million. While there still may be good reasons to make taxable gifts (such as removing future appreciation on gifted assets from the taxable estate and removing gift tax from the taxable estate if the person paying the tax survives the gift by three years or more), there no longer is a "rate differential" benefit from doing so in 2010. **If you are considering making such a gift, it is very important for you to consider the various factors going into the decision. We will of course be available to discuss these factors with you.**
 - b. Because the generation-skipping transfer tax ("GST") was temporarily repealed for gifts made in 2010 to grandchildren and lower generation recipients, 2010 presented an additional tax-saving opportunity for those interested in making such gifts. However, as we pointed out in our November 2010 Client Alert, there was some uncertainty as to

whether the GST “holiday” would apply if the gifts were made to trusts for the benefit of such recipients instead of outright to them. That uncertainly understandably discouraged some clients from taking advantage of this opportunity. With the passage of the Act, we now have certainty regarding 2010 transfers subject to GST. In particular:

- i. For transfers in 2010 that are or could be subject to GST, the tax has been reinstated but at a 0% rate. In addition, there is a new \$5 million GST exemption that can be applied to 2010 transfers which otherwise might give rise to GST at a future date (for example, a 2010 transfer to a trust that would give rise to GST upon a trust distribution to a grandchild in 2011), thereby avoiding the future imposition of GST. **Keep in mind that the gift tax exemption for 2010 is still \$1 million.**
 - ii. This means that clients may make transfers into trusts for the benefit of children and grandchildren or just grandchildren, and elect to apply GST exemption of up to \$5 million to those transfers, thus exempting the trust from GST for as long as the trust continues.
 - iii. Alternatively, clients may make 2010 transfers directly to grandchildren or others who would be treated in that generation under the IRS rules (skip persons) and elect **not** to apply their \$5 million exemption, thus imposing a GST at a 0% rate.
- c. **The decision as to whether or not to make taxable gifts by the end of 2010 is very complicated. For gifts that do not involve the GST, it may make the most sense to wait until 2011 when the gift tax rate is 35% and the gift tax exemption is \$5 million. For those with GST implications, it may still make sense to make gifts in 2010 to take advantage of the 0% GST rate.**
2. 2010 Distributions from Existing Trusts: For existing trusts that are not exempt from the GST, clients, including trustees, may want to consider making distributions to grandchildren or other skip persons that otherwise would be subject to GST in the future, or taking steps to eliminate the interests of children or other non-skip persons, in order to take advantage of the 0% rate applicable in 2010.
 3. 2010 Estates: Prior to the Act, the federal estate tax was also repealed for those who died in 2010. However, a very complex set of income tax basis rules applied to those estates, replacing the traditional income tax basis “step up” for most inherited assets. The Act has replaced the “no estate tax” regime with a new structure in which executors are given a choice:
 - a. Absent an election by the executor, 2010 estates are subject to the federal estate tax and the GST. In place of the estate tax exclusion of \$3.5 million (applicable in 2009) the exclusion is now \$5 million. In place of the 2009 rate of tax of 45%, the tax rate is now 35%. All other estate tax rules apply such as the marital and charitable deductions, special valuation and tax payment rules for certain assets. There will be a full basis step-up for income tax purposes. As noted above, the GST also has been reinstated but the rate is 0% for taxable transfers in 2010.
 - b. Executors of 2010 estates now can elect either to have the new \$5 million exemption and 35% rate apply to their decedents or to have the “no estate tax” regime (with which we have been working throughout 2010) including the complex carry-over income tax basis rules, apply instead.

- c. For the many 2010 estates being settled with our firm's help, we are working with our executor clients to consider the impact of these alternatives. Because the election does not need to be made until September 17, 2011, there is no year-end rush to make the election. Determining which alternative is more advantageous can be quite complicated, so the issues must be thoughtfully addressed.
4. **Direct Distributions From IRAs:** The Act also extends a rule which allows certain taxpayers, those who have attained age 70 ½, to make gifts of up to \$100,000 each year directly from his or her individual retirement accounts (IRAs) to charity without including the amount of the gift in the taxpayer's gross income for the taxable year. This was part of the law that expired on December 31, 2009, but the Act extends this treatment through December 31, 2011. **Taxpayers who have attained age 70 1/2 can take advantage of this rule in 2010 as well as in 2011.**
5. **Impact on Planning Going Forward:** The Act has a two year effective period, so it is quite likely that we will face similar uncertainty at the end of 2012. In the meantime, there are a number of planning issues that arise from the new \$5 million estate, gift and GST exemptions and the flat common 35% rate. While there are no real year-end deadlines for these issues, here are some of the issues we are thinking about:
- a. **Efficient Use of Estate Tax Exclusion by Spouses.** Many of our clients have wills or revocable trusts that are designed to take maximum advantage of each spouse's estate tax exclusion, whatever the amount of the exclusion may be in their respective years of death. The existing "formula" language designed to accomplish that also generally will apply to take advantage of the new \$5 million exemption, so there is no immediate need to adjust the language of these documents in most cases. However, it may be necessary to consider how your assets are owned in connection with the formula language. Some clients may want to consider simplifying their planning documents as a result of the higher exemption, although, as noted above, the new law is only applicable for 2011 and 2012.
- b. **Gift Programs and the \$5 Million Gift Tax Exemption.** The 2011 increase in the gift tax exemption from \$1 million to \$5 million will cause many clients to consider making significant gifts after the first of the year. These may be in the form of outright gifts or gifts to trusts, forgiveness of indebtedness owed by children and others, or more involved planning techniques such as creating qualified personal residence trusts, grantor retained annuity trusts and irrevocable life insurance trusts. Undoubtedly the increased gift tax exemption will present opportunities not available when the exemption was \$1 million.

Please let us know immediately if you believe that any of these planning options or issues apply to you.

Sincerely yours,

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