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MEMORANDUM

TO: Clients of the Law Offices of Robert H. Glorch

FROM: Robert H. Glorch. Esq. and Jeffrey R. Gottlieb, Esq.

RE: Estate, Gift and GST Tax Changes Under the 2010 Tax Act

2010 TAX ACT

After more than nine years of failing to act on estate tax legislation, Congress has finally taken action and passed a new tax act, which was signed into law by President Obama on December 17, 2010 (the "Act"). There are many interesting details, implications and new planning considerations created by this Act. Unfortunately, however, one thing this new law does not do is provide a permanent set of rules. Possibly the most important point to keep in mind while reviewing all of the new provisions is that the entire Act, by its own terms, is merely temporary. The law provides a two-year delay of the changes that would have taken effect had Congress failed to act before the end of 2010. The problem is that all of the changes, every single one of them, will expire in two years, after December 31, 2012, if Congress does not act to further extend them, and the law will revert back to the laws in effect prior to the 2001 Tax Act (including a $1 million estate tax exemption at a 55% rate). Thus, Congress is sure to once again have the great estate tax debate in late 2012. As political and economic realities are sure to differ in two years, it is impossible to predict the result of such a debate. Proper estate planning should now take into account the reality that this is a two-year law only, tempered with the possibility that the law may be either extended or once again changed in two years time.

I. Summary of Key Estate and Gift Tax Provisions under the 2010 Tax

A. Changes applicable only to 2010 deaths and gifts. There was substantial debate throughout 2010 as to whether Congress would make any changes retroactive for the 2010 tax year, and if so, whether it would pass constitutional muster. Briefly, the Act does retroactively reinstate the Estate Tax for 2010 with a $5 million exemption and 35% rate, but allows executors the option to elect out of the estate tax and into the carryover basis regime. Those administering estates of 2010 decedents should review the option carefully to determine which option is more beneficial to that estate.

B. Increase of Estate Tax Exemption. The Act increases the estate tax exemption for decedents in 2011 to $5 million, with a flat tax rate of 35%. For 2012, the rate is also 35% and the exemption is $5 million plus an amount indexed for inflation rounded to the nearest $10,000. The Act also for the first time introduces a brand new concept called "portability". Under prior law, if you died without using your exemption, it was lost. The surviving spouse could not make use of the predeceased spouse's exemption without prior planning. Portability is designed to allow the surviving spouse to elect to add the unused estate tax exemption of his/her predeceased spouse to his/her own, thereby allowing the surviving spouse an exemption of up to $10 million. Unfortunately, all of these changes, including portability, are only temporary and is due to "sunset" on December 31, 2012. Absent prior congressional action, the exemption will snap back to $1 million in 2013 with a top rate of 55%, and portability will disappear as well. More thoughts on portability discussed below.

C. Increase of Gift Tax Exemption. Under the new law, the gift tax is "unified" with the estate and GST tax, providing for a $5 million lifetime gift tax exemption and 35% rate for 2011 and 2012. The "annual exclusion" remains at $13,000 per donee (or $26,000 per donee for married couple who split gifts). The increased lifetime gift tax exemption gives donors a unique, but possibly short-lived, opportunity to move larger amounts of wealth to their intended beneficiaries. Advanced gifting techniques, such as GRAT's, QPRT's and Charitable Trusts continue to be viable options and have not been restricted under the new laws.

D. Generation-Skipping Transfer ("GST") Tax. The GST tax exemption also matches the estate and gift tax exemptions for 2011 and 2012 at $5 million with a 35% rate. This presents a unique opportunity for those looking to maximize lifetime gifts to grandchildren.

E. State (Illinois) Estate Tax. The Act allows for a deduction for state estate taxes, rather than a credit for states estate taxes. Those states with laws that remain tied to the state death tax credit no longer have an estate tax. As a result, Illinois quickly acted to amend its law to "decouple" from the federal estate tax regime. Illinois now has its own separate estate tax allowing for a maximum exemption of only $2 million. Estates between $2 million and $5 million will owe Illinois estate tax, even though the Federal Estate Tax does not apply. The rates vary, but the tax on the $3 million gap for 2011 is approximately $300,000. Some other states are expected to take up similar legislation. Illinois estate tax now warrants significant attention and planning emphasis to avoid or minimize unnecessary state estate tax. Clients with trusts that were created without taking the gap between federal and state estate taxes into account (generally before 2007) should consider promptly updating their estate plan to effectively plan for this scenario while minimizing both Federal and Illinois (or other states') estate tax.

II. Observations and Implications of the Tax Act

A. Temporary. As emphasized above, the Act is merely a temporary patch, which is due to expire on December 31, 2012. The likelihood is that the estate tax (aka "death tax") will once again become a hot-button issue late in 2012. It is extremely difficult to predict the outcome of that debate, particularly given that 2012 is an election year and economic and fiscal realities may be very different from today. If Congress fails to act, the exemption will revert in 2013 to $1 million with a 55% top rate.

B. Increased Exemptions for Two Years. The increased exemption and lowed rate for 2011 and 2012, despite its temporary nature, is very favorable. It is particularly useful for those looking to make substantial lifetime gifts, including gifts to grandchildren. While there had been discussion of limiting certain planning techniques, such as GRAT's, for now those techniques remain viable and those considering such planning should consider putting that into action sooner rather than later.

C. Portability. The most dramatic change in the Act is a new provision allowing for the unused portion of a decedent's exemption to be transferred to, and utilized by, the surviving spouse. Presumably this is intended to reduce the need for "credit shelter trust" planning by married couples. Unfortunately, along with the rest of the Act, portability is only temporary and will expire on December 31, 2012 (absent further congressional action). Consequently, both spouses must die before 2013 to utilize this provision. In addition to the uncertain future of portability, there are a number of other reasons why we are recommending continued use of credit shelter trust planning for most clients, including:

- Lack of portability for the Illinois estate tax (which currently has a reduced $2 million exemption)
- Eliminating tax on the appreciation of assets in the credit shelter trust
- Protecting assets from claims of subsequent spouses and children, and from creditors of the surviving spouse,
- Sheltering the GST exemption, which is not portable

Given that portability is scheduled to expire after 2012, in addition to the reasons stated above, we are advising our clients to continue to utilize trust-based planning with credit shelter trusts, coupled with special provisions the account for varying state estate taxes. It is also important to note for those who do lose a spouse in 2011 and 2012, regardless of the size of the estate, we recommend the timely filing of a Federal Estate Tax Return in order to elect to transfer any unused exemption. If a return is not timely filed, the unused exemption will be lost.

D. Illinois Estate Tax Planning. As noted in (I)(E) above, Illinois has enacted a separate estate tax, with a reduced exemption amount. For this reason, it is very important to review any tax formulas in your trusts to take this mismatch into account. If you have not updated your trust in the last four to five years, please contact us for a review of your trusts to determine whether an update is appropriate. The cost of failing to update outdated estate planning documents could be more than $300,000 in tax paid by the surviving spouse.

III. Conclusion

Please do not hesitate to contact us with any questions you might have about these new laws or how they might effect your estate plan. This is a good opportunity to review not only the tax aspects of your estate plan, but also the non-tax aspects to ensure that your plan continues to fit with your planning needs and goals.