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Subject: **More on Estate and Gift Tax provisions of “Tax Relief, Unemployment Insurance Authorization and Job Creation Act of 2010”**

Major References: [**“Tax Relief, Unemployment Insurance Authorization and Job Creation Act of 2010,” P.L. 11-312, Title III, \(December 17, 2010\)**](#)

Prior AALU Washington Reports: 10-125; 10-112

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As reported in our Bulletin No. 10-125, the “Tax Relief, Unemployment Insurance Authorization and Job Creation Act of 2010,” which was signed by the President on December 17, extended - for an additional two years, through 2012 - most of the provisions of two major bills that were scheduled to expire at the end of 2010: the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA); and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) (known collectively as the “Bush tax cuts”). It also extends a number of provisions enacted as part of EGTRRA that were modified in the American Recovery and Reinvestment Act (the Obama “stimulus” bill). Included in the extension of EGTRRA was Title III of the new law, entitled “Temporary Estate Tax Relief.” This Washington Report addresses, in greater detail than previously addressed in other such Reports, Title III of the new law and its meaning for AALU members.

Increased Exemptions. The law sets the estate and generation-skipping tax exemptions at \$5 million per person and \$10 million per couple beginning retroactively on January 1, 2010. The gift tax exemption remains at \$1 million per person (\$2 million per couple) during 2010, but will be “reunited”

with the estate and GST exemptions in 2011 at the level of \$5 million per person and \$10 million per couple. The exemption amount is indexed for inflation, in increments of \$10,000 beginning in 2012. The bill also imposes a top tax rate of 35 percent (which is reduced from the current top rate of 45%), except for the rate of the GST tax during 2010, which is zero percent (0%).

Effective Dates of Estate and GST Tax Increased Exemptions; Carry-Over Basis Option. As noted above, the increased (\$5 million) estate and GST exemptions and 35% rate are effective January 1, 2010 (making them the default option for 2010, *i.e.*, the increases are retroactive to the beginning of 2010), but the proposal allows an election to choose no estate tax and modified carryover basis for estates of decedents dying on or after January 1, 2010 and before January 1, 2011. No matter which option is chosen, the decedent could still treat any testamentary generation-skipping transfer as having a “transferor” for GST tax purposes, so that, for example, the “move down” rule (which moves the transferor of any GST transfer down one generation for the purpose of determining the taxability of future distributions and terminations) would apply. For those decedents who died during 2010 with very large estates, the option to apply carry-over basis and avoid the estate tax may be an easy decision. Those decedents who died with estates closer to the \$5 million mark, however, may have a difficult decision to make, as the complications of carry-over basis may incline their executors to pay a small estate tax in exchange for a full step-up.

Effective Date of \$5 Million Gift Tax Exemption; GST Planning Opportunities in 2010. The increased gift tax exemption takes effect on January 1, 2011. Since the proposal sets a \$5 million generation-skipping transfer tax exemption and zero percent rate for the 2010 year, it is possible to make direct skip gifts during the remainder of 2010 at no GST tax cost (although a gift tax would still be due for gifts in excess of \$1 million). Transferors should, however, remember to elect out of the automatic allocation of GST exemption to 2010 direct skip transfers, since any such allocation would be wasted on a transfer to which zero tax applies. On the other hand, transferors should keep in mind that any “indirect skip,” transfer in 2010, such as a transfer to a trust that benefits both children and grandchildren, would not be subject to GST tax in 2010 in any event: such trusts are subject to GST tax only upon making distributions to skip persons or upon termination. It will be necessary, therefore, to allocate GST tax exemption to any such 2010 transfers in order to shield later distributions and terminations from tax, a process which should be eased by the fact that the exemption has been increased retroactively to \$5 million per person.

Reunification of the Estate and Gift Taxes. Under EGTRRA, the estate and gift taxes were “decoupled,” so that, by December 31, 2009, the estate and GST tax exemptions were equal to \$3.5 million per person (\$7 million per couple), while the gift tax exemption remained at \$1 million per person (\$2 million per couple). The proposal reunifies the estate and gift taxes, effective for gifts made after December 31, 2010. Even if the “reunification” ends on schedule on December 31, 2012, there will be a two-year window to transfer up to \$10 million per couple during life without further tax.

Portability of unused exemption. Under current law, as it existed on December 31, 2009, in order to take full advantage of a husband’s and wife’s combined \$7 million estate tax exemption, the first spouse’s exemption amount would have to be held in a “credit shelter” or “bypass” trust, thus requiring complicated estate planning. The proposal allows the executor of a deceased spouse’s estate to transfer any unused exemption to the surviving spouse without creating a trust. The portability provision applies only with respect to “the last such deceased spouse of [the] surviving spouse,” thus eliminating the possibility of accumulating exclusion amounts from serial marriages. The portable amount also is not indexed for inflation. Planners should be aware, however, that a bypass-type trust may still be useful for sheltering appreciation in assets placed in the trust, as well as for all of the reasons that trusts are typically used, such as creditor protection and divorce/second marriage protection. For these reasons, among others, a bypass trust should always be included as an option that can be elected, via disclaimer, even with portability. We note that the “portability” election must be made on a return, which means that even estates that are not subject to tax will probably want to file a return to make the election.

Extension of Time to File Returns. The proposal extends the due date for any estate and generation-skipping tax return for the estates of decedents dying (and generation-skipping transfers made) after December 31, 2009 and before the date of enactment, to 9 months after date of enactment, giving those estates and transferors time to evaluate the effect of the new law and to make needed adjustments, including by disclaimer, during the interim.

“Pay-Fors.” As noted in our earlier Bulletin on the new law, it contains none of the revenue offsets have been included in previous bills, such as limitations on GRAT terms and remainders, restrictions on discounts for family-held entities, and uniformity of basis for estate and income tax purposes. This will make the heretofore uncertain advantages of short-term GRATs in the current low-interest rate environment more certain, and hence more appealing. It should also increase the availability of other “freeze” transactions, such as sales to intentionally defective grantor trusts, that rely heavily on valuation discounts.

GST Tax Allocation Issues. Virtually all of the GST tax allocation issues for transfers to life insurance trusts during 2010, which had been a primary concern of AALU’s and had been the subject of an AALU meeting with representatives of Treasury’s Office of Tax Legislative Counsel (*see* our Bulletin No. 10-112) are resolved satisfactorily by the inclusion in the Revenue Code of Section 2664 (“This chapter shall not apply to generation-skipping transfers after December 31, 2009.”). That section was added to the Code by EGTRRA, in the group of provisions that are “reinstated” to read as if their amendment by EGTRRA “had never been enacted.” The “reinstatement” of pre-EGTRRA law in this regard is effective for “estates of decedents dying, and transfers made after December 31, 2009.” This means that the ability to allocate exemption (and to opt out of the automatic allocation of exemption) to 2010 transfers is reinstated as well.

Sunset. In our earlier Bulletin we indicated that the effect of the new “sunset” provisions was not entirely clear. It is now certain, however, that the provisions of EGTRRA that were not positively amended by Title III were simply extended for two years (to December 31, 2012), so that provisions such as the state estate tax deduction in lieu of credit and the expanded deduction for certain qualified conservation easements that were included in EGTRRA will be available through 2012. On December 31, 2010, the entirety of the 2010 amendments will again “sunset,” and we will, at least in theory, revert to pre-2001 estate, gift, and GST tax law, although the chances of such draconian reductions in available exemptions and increases in rates probably will not, as an overriding political matter, be allowed to happen.

Any AALU member who wishes to obtain a copy of the Title III of P.L. 111-312, “Tax Relief, Unemployment Insurance Authorization and Job Creation Act of 2010” may do so through the following means: (1) use hyperlink above next to “Major References,” (2) log onto the AALU website at www.aalu.org and enter the *Member Portal* with your last name and birth date and select *Current Washington Report* for linkage to source material or (3) email Anthony Raglani at raglani@aalu.org and include a reference to this *Washington Report*.

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