

Important 2010 Year-End Planning Strategies

With lingering uncertainty as to the economy and the federal estate tax, many clients and their advisors are wondering what planning they should do now, if any. This issue of the *MMB Outlook* explains why now is an ideal time to take advantage of unique wealth transfer opportunities while they are still available.

The Federal estate tax was repealed in 2010. Additionally, the gift tax rate (which has historically matched the estate tax rate) dropped to 35% in 2010, the lowest it has been in recent history. If Congress does not act by December 31, the federal estate tax exemption will revert to its previous level of \$1 million and the estate tax will be reinstated at a rate of 55% as of January 1, 2011. The gift tax rate will also rise to 55% to once again match the Federal estate tax rate.

In light of the recent election results, it may be tempting to take a “wait and see” approach and hope for a resolution prior to the end of the year. This is not an advisable strategy. Though nobody can predict the future, there is a significant chance that the estate tax issue will not be resolved by December 31. Consequently, it may be wise for wealthy individuals to take advantage of one or more tools currently available to them to reduce the size of their estate and transfer wealth at lower tax rates, or even tax free.

Grantor Retained Annuity Trusts

One of the most common wealth transfer strategies is a grantor retained annuity trust (GRAT), particularly a type of GRAT known as a “zeroed-out GRAT,” which seeks to reduce or completely eliminate gift tax. With a zeroed-out GRAT, the grantor contributes a certain dollar amount (or other asset, such as stock or real estate) to the trust. At the end of the trust term, the grantor takes back the initial contribution plus a specific percentage of the income earned on the contribution. The percentage is set by the IRS and is known as the Section 7520 rate. Any income earned on the contribution that is over and above the Section 7520 rate goes to the beneficiaries of the GRAT (either outright or in trust) **free of gift tax**. The current Section 7520 rate is only 2%. Depending upon investment performance, this could allow a significant amount of wealth to be transferred to beneficiaries free of gift tax. (If the investment performance of the GRAT contribution is less than the Section 7520 rate, all of the GRAT assets will simply be repaid to the grantor. The only downside to the GRAT “not working” is the grantor is out the cost of establishing the GRAT.)

It is important to note that a recent proposal presented to Congress would eliminate GRATs with a term of less than 10 years. Since GRATs with shorter terms (i.e., one to five years) generally work best, such a proposal (if adopted into law) would make GRATs a less effective wealth-transfer option. The low Section 7520 rate, combined with the possibility that short-term GRATs will be eliminated in the near future, make this an exceptional time to take advantage of this wealth transfer option while it is still available.

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Gifts

Another common wealth transfer strategy is gifting. An individual may gift up to \$13,000 to any one person each year without paying gift tax. Any amounts over \$13,000 per person are applied to the taxpayer's lifetime gift tax exclusion (currently \$1 million). After the lifetime gift tax exclusion has been exhausted, gift tax must be paid, but as noted above, the 2010 gift tax rate is at a long-time low of 35% and is likely to increase by as much as 20% as of January 1, 2011. Individuals who have already used their lifetime gift-tax exemption (or who could use it up this year) may wish to consider making taxable gifts before the end of the year to take advantage of the lower gift tax rate. Moreover, since the generation-skipping transfer tax was also repealed in 2010, taxpayers have a unique opportunity to give gifts to their grandchildren without paying the additional generation-skipping transfer tax.

For more information about these and other planning opportunities that exist for your clients, please feel free to contact us.

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This newsletter is intended for financial professionals.



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