



## **is it time to update your estate plan?**

With April 18 freshly behind us, now may be a good time to focus on your estate plan. On December 17, 2010, President Obama signed into law the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (the "Act"). The Act extended the Bush-era individual income tax rates for a two-year period and made significant changes to the federal gift, estate and generation skipping transfer tax rules. Below is a high-level overview of several key provisions. Please note that this discussion strictly focuses on federal tax issues; we encourage you to explore with your estate planning advisor the extent to which state law impacts your situation.

## **the prior law.**

For persons passing away in the year 2010, the estate tax was repealed but was scheduled to be reinstated in 2011. A trade off for repeal in 2010 was that assets owned at death only received a very limited step-up in basis. The gift tax remained in place in 2010 with an exemption amount of \$1 million per person and a 35% gift tax rate. The generation skipping tax ("GST Tax") was also repealed in 2010 but scheduled to be reinstated in 2011.



BY SHARI HARVEY MARTIN  
*Principal, Diversified Trust*



BY ROBERT E.W. LINEBERGER  
*General Counsel and Principal,  
Diversified Trust*

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## IMPORTANT NOTES AND DISCLOSURES

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If the Act had not been passed and signed into law, the 2011 federal estate tax would have reverted to a \$1 million estate tax exemption per individual and a top rate of 55%. The 2011 gift tax exemption would have remained at \$1 million with an increase in the top rate to 55%. The GST would have been reinstated with an exemption slightly higher than \$1 million with a rate of 55%.

The passage of the Act changed the rules. Set forth below are the new rules which will be in effect until December 31, 2012, unless extended or changed by Congress prior to 2013.

### **the new law.**

The Act provides an exemption amount of \$5 million per person (\$10 million for a married couple) for the federal estate, gift and GST for the years 2011 and 2012. This exemption amount is indexed for inflation beginning in 2012. The Act provides a flat 35% rate for federal estate, gift and GST taxes for the years 2011 and 2012. For persons dying in 2011 or 2012, the full income tax basis step-up to fair market value for assets owned at death has been reinstated.

A major change is the unification of the estate and gift exemptions. This will allow a person to make gifts in 2011 or 2012 in an amount up to \$5 million (taking into account prior gifts made by the donor) without paying a federal gift tax. Married couples will be able to make gifts of a combined amount up to \$10 million during these years (taking into account prior gifts made by each donor) without paying a gift tax. Split gifts between husband and wife are still allowed, providing flexibility in gifting for married couples. Some states have exemption amounts for gift, estate or inheritance tax purposes which are lower than the federal exemption amounts.

The Act also introduces a new concept of estate tax exemption portability to the estate planning process. The concept works as follows: the estate of a deceased spouse who dies in 2011 or 2012 can elect (the personal representative will affirmatively make this election on the estate tax return for the deceased spouse's

estate) for the surviving spouse to utilize the unused portion of the deceased spouse's estate tax exemption amount upon the survivor's death. This planning opportunity enhances the ability for couples to utilize their respective exemption amounts up to a total of \$10 million if no prior gifts have been made. Currently, the concept of portability only lasts until December 31, 2012 and only allows the unused exemptions of decedent's dying in 2011 or 2012 to be utilized by the surviving spouse.

Additionally, for estates of decedents who passed away in 2010, the Act provides an exemption amount of \$5,000,000. However, the estate can elect to apply the "no estate tax law" of 2010 and pay no estate tax. If such election is made, the estate is required to use the modified carryover basis for assets owned by the decedent at death. If assets greatly exceed the \$5 million exemption amount, the no estate tax route may likely be the best alternative but each situation must be evaluated individually.

The changes made by the Act apply only in years 2011 and 2012. Congress will need to act before December 31, 2012 and either extend the changes, make them permanent or alter them.

## what should I consider doing now?

**have your current estate planning documents reviewed.** Given the increase in the estate tax exemption and the ability to take advantage of "estate tax exemption portability," you may be able to simplify your estate plan. Likewise, most wills have also utilized some sort of "formula" to reduce or eliminate estate tax at the death of the first spouse to die. With an increase in the exemption amount, there may be some instances where the amount passing to the surviving spouse is significantly reduced from the amount that would pass under prior law. Potentially, depending upon the terms of the will and the size of the estate, if a spouse dies in 2011 or 2012, the children could receive all the assets and the surviving spouse be left in an unintended circumstance. Talk with your estate planning advisor to assess the suitability of your current estate plan.

**consider opportunities with higher exemptions.** Consider making gifts in 2011 or 2012 to children or grandchildren, either outright or in trust. The gift tax exemption amount has been raised to \$5 million as has the GST exemption. Wise use of GST allocation to gifts in trust should be considered. It is worth noting that if the estate tax exemption is reduced in the future to an amount less than that of the cumulative gifts made, the excess may be subject to estate tax. However, from a tax perspective, this is no worse a result than if the gifts had never been made.

**evaluate 2010 "no estate tax" election.** Estates of decedents who died in 2010 should consider whether to make the "no estate tax election". If assets are less than \$5 million, it may not make sense to make this election. The estate will pay no estate tax with the \$5 million exemption allowed for 2010 by the Act, and the

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## ATLANTA

400 Galleria Parkway, Suite 1820  
Atlanta, GA 30339

*Phone:* 770.226.5333



## GREENSBORO

300 N Greene Street, Suite 2150  
Greensboro, NC 27401

*Phone:* 336.217.0151



## MEMPHIS

6075 Poplar Avenue, Suite 900  
Memphis, TN 38119

*Phone:* 901.761.7979



## NASHVILLE

3102 West End Avenue, Suite 600  
Nashville, TN 37203

*Phone:* 615.386.7302

assets will receive a full step-up in basis. The new portability laws will not apply to the estate of a decedent dying in 2010.

**GRATs.** One significant result of the Act's passage was despite much speculation and public commentary predicting their demise, the use of short-term Grantor Retained Annuity Trusts ("GRATs") was not restricted or limited. In a low interest rate environment, GRATs still remain a very attractive estate planning tool. Section 7520 rates have remained low but have risen in recent months. It is a great time to consider short term GRATs, especially if you have assets which you believe may appreciate rapidly and generate an income stream from which the annuity could be paid. Longer term GRATs may be considered as well in a rising interest rate environment.

## what else?

While we have focused primarily on estate planning issues, the Act's impact is much more far reaching. For example income tax rates, charitable distributions through IRAs and payroll taxes should also be considered. The Act extends the federal income tax rates in effect for 2010 through December 31, 2012. The highest marginal income tax rate remains 35%. The phase out of personal exemptions for high income taxpayers has been repealed through December 31, 2012. The maximum tax rate on long-term capital gains and qualified dividends remains at 15%. It also allows donors over age 70½ to make distributions (up to a maximum of \$100,000) directly from their IRAs to a public charity, and reduces by 2% the non-Medicare portion of the social security tax for an employee. This reduction also applies to self-employment tax.

At Diversified Trust, our professionals have significant experience in the multi-faceted world of wealth management. A periodic overall assessment of an estate plan is generally very constructive and often helps avoid negative surprises which can arise when wealth plans are incomplete or become outdated. The successful execution of an effective plan involves dynamic communication and collaboration among your wealth management team of advisors — estate attorney, CPA, financial advisor, etc. working together on your behalf. As always, we welcome your questions and are available to assist you. ■