Tax Update
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HOLLAND & HART LLP

ESTATE, GIFT AND GST TAX LAW UPDATE

The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (the "2010 Tax Act"), signed into law on December 17, 2010, extended the tax cuts originally enacted under the Bush Administration and made favorable changes to the federal gift, estate and generation-skipping transfer ("GST") tax laws. This update summarizes key tax law changes applicable to individuals and highlights certain tax planning opportunities under the new law. These tax law changes expire on December 31, 2012. As a result, unless the 2010 Tax Act is extended or a new law is enacted prior to January 1, 2013, the tax rates and exemptions outlined below will revert to higher tax rates and lower applicable exemptions. Thus, the 2010 Tax Act provides opportunities over the next two years to implement transactions that could significantly reduce federal income, estate, gift and GST taxes.

Transfer Tax Changes for 2011 and 2012

The 2010 Tax Act lowered estate, gift and GST tax rates and substantially increased the relevant exemption amounts for the next two years. In addition, the 2010 Tax Act "reunified" the gift and estate tax exemptions, with both set at $5 million starting in 2011. The "exemption amount" is the amount an individual can transfer without paying a transfer tax. The tax rates and exemptions available under current law are as follows:

	2011	2012	2013
Estate Tax Exemption Amount	$5 million	$5 million*	$1 million
Gift Tax Exemption Amount	$5 million	$5 million*	$1 million
GST Exemption Amount	$5 million	$5 million*	$1 million
Highest Estate Tax Rate	35%	35%	55%
Highest Gift Tax Rate	35%	35%	55%
GST Tax Rate	35%	35%	55%

* plus inflation adjustment (indexed from 2010 starting in 2012)

Any prior use of gift and GST tax exemption during an individual's lifetime reduces the amount of gift and GST exemption remaining during the individual's lifetime and the estate tax exemption available at the individual's death. For example, if an individual has already made $1 million in lifetime taxable gifts prior to 2011, her remaining gift and estate exemption amount in 2011 would be $4 million.

Impact on Existing Estate Planning Documents. The changes in the estate and GST tax exemption amounts could impact certain estate plans with formula provisions that reference the exemption amounts. For example, a common plan for a married couple provides for funding a family trust with the amount of the decedent's remaining estate tax exemption and leaving the balance of the estate to the surviving spouse. Because the exemption amounts are now higher, more assets will be allocated to the trust, as

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opposed to the surviving spouse, than under prior law. While in many cases funding the trust with more assets is desirable, in some cases this may have unintended financial consequences.

Portability. The 2010 Tax Act introduces "portability" of a spouse's estate tax exemption amount. If one spouse dies in 2011 or 2012 and fails to use his or her entire $5 million estate tax exemption amount, the surviving spouse may use the deceased spouse's remaining estate tax exemption amount, if an estate tax return is timely filed with the IRS. Thus, theoretically, the surviving spouse's estate tax exemption could be increased to $10 million without the use of trusts or other planning techniques. This provision is intended to reduce or eliminate the need to transfer assets between spouses in order to "equalize" their estates, as well as to obviate the need to use trusts to take advantage of both spouses' estate tax exemption amounts. It may be premature to rely upon portability as a planning solution, however. If the 2010 Tax Act is not extended, portability could be eliminated for a surviving spouse dying after 2012. In addition, the portability rules do not extend to the GST tax exemption, and the loss of the deceased spouse's GST exemption could result in greater estate taxes for future generations.

Basis Step-Up. Under the 2010 Tax Act, the assets of a decedent dying in 2011 or 2012 will receive an income tax basis equal to their fair market value at the decedent's death. This basis adjustment has the effect of eliminating any built-in gain or loss in the decedent's assets as of the decedent's date of death.

Estate Tax for 2010 Estates. The 2010 Tax Act resolved uncertainty surrounding the estate tax liability for decedents who died in 2010 by allowing executors to choose between two different tax regimes:

- The executor may choose to have the estate be subject to estate tax with a $5 million exemption and a maximum rate of 35%, as well as a stepped-up income tax basis for appreciated assets (thereby reducing the beneficiaries' future income tax liabilities). This regime is automatic unless the executor elects out of it.
- Alternatively, the executor may elect to have a carry-over basis regime, rather than the estate tax, apply to the estate. The carry-over basis regime generally sets a beneficiary's basis in inherited property at an amount equal to the decedent's basis in such property.

Key Income Tax Changes for 2011 and 2012

The 2010 Tax Act extends income tax cuts that would have expired at the end of 2010. Individual tax rates, as well as capital gain and dividend rates, remain at 2010 levels for 2011 and 2012. The tax rates and exemptions under current law are as follows:

	2011	2012	2013
Top Ordinary Income Tax Rate	35%	35%	39.6%
Top Long-Term Capital Gains Tax Rate	15%	15%	20%
Top Qualified Dividend Income Rate	15%	15%	39.6%

In addition, the repeal of the personal exemption phase-out and itemized deduction limitation has been extended for two years, the social security payroll tax has been reduced by 2% for 2011, and the alternative minimum tax exemption amounts have been increased. Availability of the IRA charitable rollover was extended for 2010 (distributions to charity made prior to January 31, 2011 may be counted toward 2010) and 2011. This provision allows individuals over age 70 1/2 to transfer up to $100,000 per year directly from an IRA to a qualified public charity. The transfer counts toward the required minimum distribution but is not treated as a taxable withdrawal from the IRA.

Planning Opportunities

Because favorable provisions in the 2010 Tax Act expire in 2013, there is a two-year window to maximize use of the provisions to implement wealth transfer planning. Potential opportunities include:

Non-Taxable Gifts. With the increase in gift tax and GST tax exemptions, additional non-taxable gifts can be made during lifetime to heirs (outright or in trust). A couple could potentially give as much as $10 million to heirs without triggering transfer tax. If the gift were made to a trust, for example, the trust could then leverage the gift by purchasing additional assets from the couple's estate. The sale would have the effect of "freezing" the value of the purchased asset in the couple's estate for estate tax purposes, while shifting the asset's future growth to the trust, transfer tax free. Such a trust could also shelter the trust assets from estate tax for many generations.

Taxable Gifts. The tax rate for gifts above the exemption amount is 35%. Thus, there could be instances in which an individual would want to take advantage of this low rate to transfer additional assets out of his or her estate.

Income Tax Planning. The extension of lower income tax rates also presents planning opportunities, including:

- Selling appreciated assets, such as a business or stock, before the income and capital gains rate increase in 2013;
- Transferring up to $100,000 from an IRA directly to a qualified public charity without incurring income tax on the IRA withdrawal (as discussed above, the IRA charitable rollover is available only to individuals over age 70 1/2); and
- Converting traditional IRA assets to Roth IRA assets prior to the projected increase in income tax rates.

Review of Estate Plan

Generally, the 2010 Tax Act includes some advantageous provisions. Because of the increased exemption amounts, however, your estate planning documents may need to be updated to ensure that your wishes are met. You may also wish to consider transactions that take advantage of the potential tax planning opportunities while the 2010 Tax Act remains in effect. We are providing this summary to you as general background. However, because the tax laws change often, we encourage you to contact

us periodically to review your individual situation and to ensure that your estate planning documents are up to date. If you have questions about these or other tax law changes and their impact on your estate plan, please contact us.

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