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Please contact any of the attorneys in our **Tax and Wealth Planning Group** if you have any questions regarding this alert.

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Gifting and Other Tax Planning Opportunities in 2011

Estate, Gift and GST Tax Laws in 2011 and 2012

As many of you already are aware, on December 17, 2010, Congress passed the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (the "Act"). The Act provides for the following:

- For 2011, there is an estate, gift and generation-skipping transfer ("GST") tax exemption of $5 million per person and $10 million per couple, which increases on January 1, 2012 to $5.12 million per person and $10.24 million per couple for calendar year 2012.
- The top tax rate of 35% for estate, gift and GST taxes will continue through December 31, 2012.
- The gift tax annual exclusion for 2011 and 2012 is $13,000 per donee per year from each (single or married) individual or $26,000 per donee per year from a married individual (if the non-gifting spouse consents to gift-splitting).
- The executor of the estate of an individual who passes away in 2011 or 2012 has the ability to transfer any unused estate tax exemption to the surviving spouse, which is referred to as "portability". This allows the surviving spouse to make larger gifts and there is no "wasting" of a deceased spouse's unused estate and gift tax exemption. There is no portability of the GST tax exemption.
- If Congress does not extend the Act, on January 1, 2013, the estate and gift tax exemptions will automatically be reduced to $1 million per person and $2 million per couple and the GST tax exemption will automatically be reduced to $1.4 million per person and $2.8 million per couple.

The increased gift and GST tax exemptions provided by the Act afford a unique opportunity to move considerable wealth to younger generations.

While the Act provides for the increased gift, estate and GST tax exemptions through the end of 2012, there is a rumor that the 12-member Congressional Super Committee may reduce this exemption sooner, even as soon as January 1, 2012. The Super Committee is working on legislative proposals to reduce a $1.5 trillion deficit over a 10-year period. Thus, there is a concern that some part, if not all, of the $5 million exemption may be reduced, resulting in missed opportunities for making gifts. Based on discussions with persons on Capitol Hill, Venable's legislative team believes there is no basis for this rumor.

There is a separate estate tax for residents of DC and Maryland for estates in excess of $1,000,000. There is no portability of the $1 million DC or Maryland estate tax exemption. Virginia does not have a separate estate tax. In addition, gifts made by residents of DC, Maryland or Virginia are not subject to gift tax at the state level. For residents of DC and Maryland, this allows for a reduction of the estate for state estate tax purposes without any state gift tax cost.

Low Interest Rates

Loans and Sales

The current economic environment provides other opportunities for transferring wealth to family members through loans and sales. *Valuation discounts for minority interests and lack of marketability currently are available, but could be drastically reduced or altogether eliminated in calendar year 2012 or thereafter by legislation*. In addition, interest rates continue to remain historically low. For example, loans made during November 2011 with a term of 3 to 9 years can utilize a rate as low as 1.20%. Loans with a term of 9 years or more can utilize a rate of 2.67%

GRATs

Another IRS-sanctioned estate planning technique very favorably impacted by today's historically low interest rates is the Grantor Retained Annuity Trust ("GRAT"). A GRAT is an estate planning tool that allows an individual to transfer interests in appreciating assets to an irrevocable trust at a lower transfer tax cost and retain an annuity interest in trust for a term of a specified number of years. At the end of this trust term, the property remaining passes to the remainder beneficiaries of the trust. Because of the retained annuity interest, the value of the gift is reduced.

To illustrate, assume that a 60-year-old individual transfers $1,000,000 to a GRAT and retains a 10% annuity for 10 years. The value of the gift of the remainder interest is approximately $73,000.

Generally, a GRAT succeeds (that is, property remains in the trust for the benefit of the remainder beneficiaries) when the investment return on the property exceeds the IRS established interest rate for valuing the annuity.

The IRS established interest rate for November of 2011 is 1.4%. Therefore, if the investments perform at a rate greater than 1.4%, the GRAT is likely to succeed as a wealth transfer tool. Thus, in the example above, if the principal in the GRAT grows at 5% per year, there will be $371,000 for the remainder beneficiaries at the end of 10 years. As a result, in this example the remainder beneficiary will receive $371,000 even though the gift tax was based on a gift of only $73,000.

A GRAT also can be structured with virtually no taxable gift. This technique is referred to as a "zeroed-out GRAT". The reason there is no taxable gift is that the donor's retained annuity causes the donor to receive back the entire amount contributed to the GRAT, plus interest thereon. Any appreciation on such property above the annuity payments then passes to the remainder beneficiaries of the trust, free of gift tax. *The elimination of zeroed-out GRATs has been targeted by the Administration and Congress as a possible revenue-raiser, so we recommend that clients interested in this type of giving act now.*

Charitable Giving with IRAs

In 2006, Congress passed the Pension Protection Act of 2006 (the "PPA"). Under the PPA, individuals may utilize funds in their Individual Retirement Accounts (IRAs) to make charitable contributions.

Typically, most withdrawals from an IRA are subject to Federal income tax. Under the PPA, individuals over age 701/2 may withdraw up to an aggregate of $100,000 per year from their IRAs tax free, so long as such amount is contributed to certain qualified tax-exempt organizations before the end of the year of withdrawal. The withdrawal amount may be used to satisfy the individual's minimum required distribution. Although the charitable contribution is not tax deductible, the amount withdrawn is not included in the IRA participant's income.

This provision offers a significant planning opportunity for individuals over 701/2 who wish to make charitable contributions in 2011. (Note: The individual must be over 701/2. Thus, if the person reached age 70 on May 31, 2011, the withdrawal cannot occur until after December 1, 2011.) The provision does not apply to withdrawals from qualified retirement plans, such as 401(k) accounts. However, an individual may convert a 401(k) account to an IRA to take advantage of this provision. *This provision now expires on December 31, 2011, and may not be extended, so individuals should plan accordingly.*

We will certainly keep you updated with any changes that arise. With all of the opportunities and possible changes in the law, we encourage you to review your short- and long-term gifting goals now. If you are interested in discussing these gifting opportunities and other planning, please contact a member of Venable's **Tax and Wealth Planning Group** to arrange a meeting.

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