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Alaska Bar Estate Planning and Probate Section Meeting
Temporary Repeal of Estate and GST Tax
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What should our clients do in 2010 relating to GST Planning?

1. GST Tax Background

   - What is the GST Tax?
   - Rate
     - 2001: 55%
     - 2009: 45%
     - 2010: inapplicable (Chapter 13 does not apply)
     - 2011: 55%
   - Exemption
     - 2001: $1,060,000 ($1 million indexed for inflation after 1998)
     - 2009: $3.5 million
     - 2010: inapplicable (Chapter 13 does not apply to GST transfers)
     - 2011: $1,340,000

2. GST Rules Applicable in 2010 and beyond

   - "This chapter shall not apply to GST transfers after December 31, 2009." (IRC Sec. 2664).
   - Sunset ("Bobby Ewing") Rule - Section 901 Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA):

     a. IN GENERAL. All provision of, and amendments made by, this Act shall not apply – (1) To taxable, plan or limitation years beginning after December 31, 2010, or (2) in the case of title V, to estates of decedents dying, gifts made or generation skipping transfers, after December 31, 2010.

b. *APPLICATION OF CERTAIN LAWS. The Internal Revenue Cod of 1986 shall be applied and administered to years, estates, gifts, and transfers described in subsection (a) as if the provisions and amendments described in subsection (a)* ***<u>had never been enacted</u>*** (emphasis added).

- When does a GST occur?
  - *Not upon the transfer to most trusts*
  - Direct Skip
  - Taxable Distribution
  - Taxable Termination
  - *Temporary repeal and sunset are especially problematic for GST tax because GST trust planning spans several years*

3. Application of GST Rules to Specific Situations in 2010

   a. Should we make direct skip gifts or bequests outright to skip persons?

      - Yes, subject to retroactive legislation, direct skips are smart move in 2010.
      - Guard against retroactive legislation with formula gift or bequest:

        I transfer a fraction of my interest in FLLC, the numerator of which is the lesser of the value of my interest in FLLC or the maximum amount that I may transfer free of GST tax, and the denominator of which is the value of my interest in FLLC;

        I give my grandchild the lesser of $_____ or the maximum amount that can pass to a grandchild free of GST tax.

      - Gift Tax Limitation: Gift tax annual exclusion; applicable exclusion amount; or pay gift tax @ 35%.

   b. Should we make direct skip gifts in trust?

      - Probably not – because the "move-down" rule (IRS Sec. 2653(a)) probably does not apply.
      - Result: Taxable distributions will occur in the future.
      - Might the sunset rule permit the move down rule to retroactively apply?
      - Exception: Distributions in 2010 or for tuition or medical costs would not be subject to GST tax.

- Gift under the UTMA is treated as a gift in trust.
- Consider an outright gift of a limited FLP or FLLC interest.

c. Should we make gifts to new trusts that are not direct skips?

- No significant benefit to creating such a trust. – probably not able to allocate GST exemption to the trust.
- Would be subject to GST tax upon distribution to skip person.

d. Should we make testamentary transfers to new long-term trusts?

- Unsure. Perhaps never subject to GST tax because no "transferor," so great planning opportunity.
- "Transferor" is defined as the decedent or donor with respect to whom the property transferred in trust is subject to estate or gift tax (Sec. 2652(a)).
- Perhaps use a formula clause to guard against the risk.

e. Should we make distributions from existing trusts?

- Non-Exempt: Big planning opportunity to make distributions to skip persons in 2010 free of GST tax (subject to risk of retroactive legislation). If desire non-tax trust benefits, consider distributions in further trust or decanting.
- Exempt: Probably do nothing, but if grantor allocated more than $1.34M of GST exemption, then consider making distributions to skip persons.

f. Should we make contributions to existing trusts?

- Non-Exempt: Probably no problem – inclusion ratio remains one.
- Exempt: Risk of making a contribution to the trust because GST exemption may not be allocated to the trust – this would result in an inclusion ratio of greater than one.
    - But perhaps GST exemption can be allocated because this is not a GST transfer, and "this chapter shall not apply to GST transfers after December 31, 2009."
    - Safe course of action would be to (i) establish a new separate trust that later can be merged; (ii) make a loan to the trust; or (iii) both.

4. Application of GST Rules after Sunset in 2011 and beyond

- If the Sunset rule really means as if EGTRRA had never been enacted:
  - GST exemption is $1,340,000 – allocation of GST exemption during 2001-2009 retroactively reduced to $1,340,000?
  - No automatic allocation of GST exemption – automatic allocations of GST exemptions during 2001-2009 retroactively rescinded?
  - Others EGTRRA GST Rules: Retroactive GST allocations; qualified severances; relief for late GST exemptions.