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November 30, 2010

TO OUR CLIENTS AND FRIENDS:

2010 YEAR-END PLANNING – OPPORTUNITIES & CONCERNS

In our last transfer tax update we reported that what was once considered inconceivable had happened – Congress had adjourned for 2009 without addressing the question of estate, gift and generation-skipping transfer taxes and two months into 2010 Congress still had not acted. We invite you to review our letter from last March, “*As Certain as Death and Taxes?*” which appears on our website under Hot Topics (www.gswlaw.net). We have now moved from “inconceivable” to “preposterous.” Once again, we waited to write to you until we had some news to impart, only to discover that the news is that nothing has happened.

Usually tax law changes require Congress to act. However, as you are no doubt aware, the 2001 Tax Act had a built-in termination date, so that, unless Congress acts during the current Lame Duck session, as of January 1, 2011 the federal transfer tax laws will apply for the most part “as if [certain of the provisions and amendments of the 2001 Tax Act] had never been enacted.” Precisely what that means is as much an open question as whether Congress will act to change the law now on the books, and if so, when the new rules will go into effect.

Nevertheless, because it is looking less and less likely (but not impossible) that Congress will make a change that applies in 2010, there are some actions you might want to consider, such as gifts to take advantage of what may be an all-time low tax rate of 35% and outright generation-skipping transfers to take advantage of what appears to be a hiatus in that tax.

Estate Tax Changes. The federal estate and generation-skipping transfer (“GST”) taxes are not applicable to assets transferred at a decedent’s death in 2010. As of January 1, 2011, these taxes will return, at higher rates than were in effect on December 31, 2009 (with a 55% or 60% top rate as opposed to 45%). The estate tax exemption will be scaled back to the \$1 million, which is the exemption currently in effect for gift tax purposes (as opposed to the \$3,500,000 estate tax exemption in effect in 2009). Because estate taxes after 2010 are likely to be much higher, you may want to consider year-end planning options such as the gifting techniques discussed below.

Lifetime Gifting Opportunities. Currently, each individual taxpayer has the ability to make cumulative gifts of up to \$1 million without incurring federal gift tax (in addition to the \$13,000 per person annual exclusion gifts and unlimited direct payments of medical and tuition expenses). Gifts in 2010 that exceed these exemptions will incur tax at a rate of 35%, due on April 15, 2011.

As of January 1, 2011, the top gift tax rate jumps to 55% on gifts of up to \$10 million (and a whopping 60% on gifts between \$10 million and \$17,184,000). If Congress were to reinstate the rates that were effective in 2009, the top gift tax rate would return to 45%.

Generation-Skipping Gifts and Trust Distributions. Gifts and trust distributions to grandchildren and other younger-generation beneficiaries are not subject to GST tax in 2010. Moreover, if such distributions are made outright (not in trust or an UTMA custodian account), they will be permanently exempted from the GST tax. As of January 1, 2011, gifts and distributions to such individuals from “unprotected” trusts that are not covered by the GST exemption (scheduled to be \$1,360,000 in 2011) or “grandfathered” from the tax under the effective date rules will be subject to GST tax at a rate of 55% -- in addition to the higher gift tax rates mentioned above. There are many situations in which it may make sense to make outright gifts to grandchildren during the remaining weeks of 2010 and pay the 35% gift tax now in order to avoid an anticipated increase in the gift tax rate and the return of the GST tax at 55%. It may also be advisable to make distributions from unprotected trusts to grandchildren or other younger-generation beneficiaries now instead of incurring GST tax on later distributions or on the termination of the interests of individuals in older generations.

Grantor Retained Annuity Trusts. In addition to transfer tax opportunities discussed above, which might disappear on January 1, 2011 by reason of the sunset of the 2001 tax law, there is a popular estate planning technique that has been targeted for modification and happens to be particularly attractive when interest rates are low -- the grantor retained annuity trust (“GRAT”). A GRAT is a trust that pays its grantor an annuity each year for a fixed number of years, with a remainder to family members outright or in trust. The value of the remainder is determined by an assumed IRS rate, which changes monthly and is 1.8% for gifts made in December 2010. If the grantor survives the term of the GRAT, and assets in the GRAT appreciate or earn income in excess of 1.8%, the excess passes to the remainder beneficiaries as a tax-free gift. If the GRAT fails to outperform the assumed rate, the grantor will receive the contributed assets back in payment of the retained annuity, and if the grantor dies within the term of the trust, a portion of the contributed assets will be included in the grantor’s estate. However, if the GRAT has been structured so that the value of the remainder is very low, the GRAT places only a very small amount of gift tax or lifetime gift tax credit at risk. Congress and the White House have identified this technique as one that is, perhaps, too successful from the standpoint of lost tax revenue. Accordingly, legislation has been proposed to set a mandatory minimum term for GRATs of 10 years, which if enacted would greatly reduce the attractiveness of this technique. In recognition of this pending legislation and the historically low assumed rate of 1.8%, we are convinced that, at least with respect to GRATs, there is no time like the present.

If you would like us to review your personal situation to consider whether any of the year-end planning options described in this letter might result in significant tax savings for you or your

family, please let us know. We look forward to hearing from you and offer our best wishes during the 2010 holiday season.

Sincerely yours,



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