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Deborah M. Beers Donald Carlson
Keith A. Mong

Ricchetti, Inc.
Steve Ricchetti
Jeff Ricchetti

Federal Policy Group
Ken Kies
Matthew Dolan

Arnold & Porter LLP
Martha L. Cochran
David F. Freeman, Jr.

AALU

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Sarah Spear, *Director of Policy & Public Affairs*
Anthony Raglani, *Asst. Dir. of Policy & Public Affairs*

101 Constitution Avenue NW, Suite 703 East
Washington, DC
Toll Free: 1-888-275-0092 Fax: 202-742-4479
www.aalu.org

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Major References: [*"Tax Relief, Unemployment Insurance Authorization and Job Creation Act of 2010," \(December 8, 2010\)*](#)

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The tax "compromise" brokered by the White House and Senate Republicans has been reduced to legislative language in a bill entitled "Tax Relief, Unemployment Insurance Authorization and Job Creation Act of 2010." The bill extends - for an additional two years, through 2012 - most of the provisions of two major bills that were scheduled to expire at the end of 2010: the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA); and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) (known collectively as the "Bush tax cuts"). It also extends a number of provisions enacted as part of EGTRRA that were modified in the American Recovery and Reinvestment Act (the Obama "stimulus" bill). The compromise is scheduled for vote in the Senate within the next few days and, if eventually enacted into law, as expected, is estimated to cost approximately \$850 billion.

TITLE III: TEMPORARY ESTATE TAX RELIEF

Increased Exemptions; Lower Rates. Of paramount interest to AALU members is Title III of the bill, entitled "Temporary Estate Tax Relief." The bill would set the exemption at \$5 million per person and \$10 million per couple for the estate, gift, and generation skipping transfer taxes for two years, through

2012. The exemption amount is indexed for inflation, in increments of \$10,000 beginning in 2012. The bill also imposes a top tax rate of 35 percent (which is reduced from the 2009 top rate of 45%).

This exemption increase and marginal rate reduction provision can be characterized as somewhat surprising, given the fact that these more generous estate tax parameters were not thought until now to have sufficient "legs" to be carried through to legislative conclusion. This measure is a departure from the previous proposal advanced by the Administration, which was a permanent extension of 2009 law (\$3,500,000 exemption and 45% top tax rate), and its inclusion in the tax compromise agreement was thought to be a result of a broader series of negotiations between Congressional Republicans and the Administration, with the Administration amending its position on certain tax items in an effort to obtain support for other initiatives, such as a 13-month extension of unemployment insurance benefits and the new START treaty, which is pending consideration in the Senate.

Effective Dates of Estate and GST Tax Increased Exemptions. The increased (\$5 million) estate and GST exemptions and 35% rate are effective January 1, 2010 (making them the default option for 2010, i.e., in a sense, retroactive to the beginning of 2010), but the proposal allows an election to choose no estate tax and modified carryover basis for estates of decedents dying on or after January 1, 2010 and before January 1, 2011. No matter which option is chosen, the decedent could still treat any testamentary generation-skipping transfer as having a "transferor" for GST tax purposes, so that, for example, the "move down" rule (which moves the transferor of any GST transfer down one generation for the purpose of determining the taxability of future distributions and terminations) would apply.

Effective Dates of Gift Tax Increased Exemption. The increased gift tax exemption takes effect on January 1, 2011. Since the proposal sets a \$5 million generation-skipping transfer tax exemption and zero percent rate for the 2010 year, it should be possible to make direct skip gifts during the remainder of 2010 at no GST tax cost (although a gift tax would still be due for gifts in excess of \$1 million).

Two very important aspects of the proposal that have been a major focus of AALU's efforts over the last decade are included in the bill. These are:

Reunification of the Estate and Gift Taxes. Under EGTRRA, the estate and gift taxes were "decoupled," so that, by December 31, 2009, the estate and GST tax exemptions were equal to \$3.5 million per person (\$7 million per couple), while the gift tax exemption remained at \$1 million per person (\$2 million per couple). The proposal reunifies the estate and gift taxes, effective for gifts made after December 31, 2010.

Portability of unused exemption. Under current law, as it existed on December 31, 2009, in order to take full advantage of a husband's and wife's combined \$7 million estate tax exemption, the first spouse's exemption amount would have to be held in a "credit shelter" or "bypass" trust, thus requiring complicated estate planning. The proposal allows the executor of a deceased spouse's estate to transfer any unused exemption to the surviving spouse without creating a trust. It would appear that that portability provision applies only with respect to "the last such deceased spouse of [the] surviving spouse," thus eliminating the possibility of accumulating exclusion amounts from serial marriages. Planners should be aware, however, that a bypass-type trust may still be useful for sheltering appreciation in assets placed in the trust, as well as for all of the reasons that trusts are typically used, such as creditor protection and divorce/second marriage protection.

Extension of Time to File Returns. The proposal extends the due date for any estate and generation-skipping tax return for the estates of decedents dying (and generation-skipping transfers made) after December 31, 2009 and before the date of enactment, to 9 months after date of enactment.

"Pay-Fors." It should be noted that the proposal currently on the table contains none of the "pay-fors" that have been included in previous bills, such as limitations on GRAT terms and remainders,

restrictions on discounts for family-held entities, and uniformity of basis for estate and income tax purposes. None of the costs of the estate tax changes in the legislation will be offset.

GST Tax Allocation Issues. It would appear that the GST allocation issues for transfers to life insurance trusts during 2010, which has been a primary concern of AALU, may be resolved by the inclusion of Section 2664 (“This chapter shall not apply to generation-skipping transfers after December 31, 2009.”), which was added to the Internal Revenue Code by EGTRRA, in the group of provisions that are “reinstated” to read as if their amendment by EGTRRA “had never been enacted.” The “reinstatement” of pre-EGTRRA law in this regard is effective for “estates of decedents dying, and transfers made after December 31, 2009.” Presumably this means that the ability to allocate exemption (and to opt out of the automatic allocation of exemption) to 2010 transfers is reinstated as well.

Sunset. Section 304 of Title III of the proposal provides that the “sunset” provision of EGTRRA (Sec. 901) shall [*sic* - presumably this was intended to read “shall not”] apply to the amendments made by this section [*sic* - again, this presumably was intended to read “this title”]. While not entirely clear, it would appear that the EGTRRA sunset does not apply to the estate, gift, and GST tax proposals set forth in the bill, which will continue in effect through 2012. Whether this means that all other EGTRRA provisions not specifically addressed by the bill (such as the state estate tax deduction in lieu of credit) are subject to the “sunset” provision is problematical. We will continue to report on the effect of this provision as we gather more information.

OTHER PROVISIONS

The proposal is, of course, not limited to transfer tax changes, as monumental as these may be. There are also numerous income and employment tax provisions, most of which will result in the continuation through 2012 of the Bush tax cuts of 2001 and 2003. The provisions of primary interest to AALU include:

Temporary extension of the 10% (lowest) bracket.

Temporary extension of the 25%, 28%, 33%, and 35% brackets. If allowed to expire, these rates would become 28%, 31%, 36%, and 39.6% respectively.

Temporary repeal of the Personal Exemption Phase-out (“PEP”) and itemized deduction (“Pease”) limitation. EGTRRA repealed the phase-out of personal exemptions and limitations on itemized deductions for 2010. The proposal extends the repeal of PEP and Pease for an additional two years, through 2012.

Temporary extension of the 15% (and lower) capital gains and dividend rates. Under current law, the capital gains and dividend rates for taxpayers below the 25% bracket is equal to zero percent. For those in the 25% bracket and above, the capital gains and dividend rates are currently 15%. If allowed to expire, these rates would become 10% and 20%, respectively, and dividends would be subject to the ordinary income rates. This proposal extends the current capital gains and dividends rates for all taxpayers for an additional two years, through 2012.

Two-year AMT patch. The proposal increases the AMT exemption amounts for 2010 to \$47,450 (individuals) and \$72,450 (married filing jointly) and for 2011 to \$48,450 (individuals) and \$74,450 (married filing jointly). The proposal also allows the nonrefundable personal credits against the AMT. The proposal is effective for taxable years beginning after December 31, 2009.

Numerous other provisions are extended, including certain employment and investment incentives (including, in the latter category, “bonus” depreciation).

Extension of unemployment insurance and employee payroll tax cut. The unemployment insurance proposal provides a one-year reauthorization of federal UI benefits, coupled with a payroll/self-employment tax holiday during 2011 of two percentage points. This means employees will pay only 4.2 percent on wages and self-employment individuals will pay only 10.4 percent on self-employment income up to the threshold.

Expiring Provisions/ IRA Charitable Rollover. Among the expiring provisions that are extended are the IRA Charitable Rollover, which technically expired at the end of 2009. The bill extends for two years (through 2011) the provision that permits tax-free distributions to charity from an Individual Retirement Account (IRA) of up to \$100,000 per taxpayer, per taxable year. The bill also allows individuals to make charitable transfers during January of 2011 and treat them as if made during 2010.

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The foregoing is just a brief summary of the principal provisions of the bill. We undoubtedly will have more information to share with AALU members as this legislation makes its way through the legislative process. As of the time of writing of this Washington Report, the House Democratic Caucus reportedly still unhappy with the estate tax provisions of the bill (and has passed a nonbinding resolution to prevent bringing it to a vote before the full House), although whether this unhappiness ultimately will produce any changes to its provisions is doubtful.

From AALU's perspective, the inclusion of reunification of the estate and gift taxes in this legislation is an important provision. This particular item has been a top priority for AALU and a core component of our advocacy throughout the 111th Congress. Reunification, in the event that it is ultimately enacted by Congress as part of this tax compromise, will in our view significantly facilitate improved planning opportunities for our members' clients. Over the long-term, AALU will continue to advocate for sustainable estate tax reform. In light of the pressures that have arisen from growing debt and deficits, it is important that enacted estate tax law allows our members' clients to plan with certainty. AALU welcomes comments from our membership regarding our future course of action. Your input, as always, is appreciated.

Any AALU member who wishes to obtain a copy of the Tax Relief, Unemployment Insurance Authorization and Job Creation Act of 2010 may do so through the following means: (1) use hyperlink above next to "Major References," (2) log onto the AALU website at www.aalu.org and enter the *Member Portal* with your last name and birth date and select *Current Washington Report* for linkage to source material or (3) email Anthony Raglani at raglani@aalu.org and include a reference to this *Washington Report*.

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