KELLY, OLSON, MICHOD, DEHAAN & RICHTER, LLC

Volume 1, Issue 2
November 5, 2010

Federal Tax Update

INSIDE THIS ISSUE:

Current Tax Status	1
Time for GST Gifts?	1
Mechanisms for Gifting	2
What should you do?	3
Income Taxes in 2011	4

Current Tax Status

Congress has not made any major changes to the Transfer Tax Laws (Estate, Gift and Generation Skipping Taxes) since 2001. This results in there being no Estate or Generation Skipping Transfer Taxes applicable to decedents' estates or generation skipping transfers in 2010. However, gratuitous transfers in 2010 are still subject to a Gift Tax, although the maximum Gift Tax rate is 35% (an all-time low), and that only applies after your $1 million lifetime Gift Tax exemption.

It is doubtful any changes to the Transfer Tax laws will be made in 2010, especially to retroactively reinstate the Estate and Generation Taxes for 2010. If no changes to the Transfer Tax laws are made, then as of January 1, 2011, the Estate, and Generation Skipping Transfer Taxes return with a $1 million exclusion amount and a top marginal tax rate of 55%.

Congress also delayed action on extending or modifying the Bush income tax cuts. Thus, income and capital gain taxes will increase for everyone in 2011 unless Congress acts. What the "lame duck" Congress will do now, given the Republican control of the House, and increases in the Senate come January, is anyone's guess, but if the income tax cuts are addressed by the lame duck Congress, Transfer Tax changes may be included.

However, most estate planners still expect Congress, at some point in time, to return the Estate Tax to 2009 levels, a $3.5 million exclusion amount with a top marginal tax rate of 45%, but again, no one really knows. The current bottom line is that in 2011, the Estate and Generation Skipping Transfer Taxes will reappear at 55% with only a $1 million applicable exclusion amount.

Is Now the Time to Make Generation Skipping Transfers?

With retroactivity of the Generation Skipping Transfer Tax unlikely, 2010 may be the year to make generation skipping transfers, even transfers subject to Gift Tax, since there is no Generation Skipping Transfer Tax.

GST Tax

Normally, gifts to grandchildren, either during life or at death, incur an additional tax called the Generation Skipping Transfer Tax ("GST Tax"). This is on top of any Estate Tax or Gift Tax. In 2009, the GST Tax rate was 45%. This means that if you had given, for example, $50,000 to your grandchild in 2009, you would have paid $22,500 in GST Tax, in addition to any Gift Tax (assuming you had exhausted your

Continued on next page.

Kelly, Olson, Michod, DeHaan & Richter, LLC
333 West Wacker Drive
Suite 2000
Chicago, IL 60606-1288

Phone 312.236.6700
Fax 312.236.6706
Web www.komdr.com

Generation Skipping Transfers, continued.

lifetime GST Tax and Gift Tax exemptions).

Since there is no GST Tax in 2010, any gift to a grandchild would pass free of the GST Tax. So if you give the $50,000 to a grandchild in 2010, you will not pay the additional $22,500 GST Tax. Note that if the gift in 2010 is to a trust for a grandchild, when distributions are made from the trust in the future, those distributions may be subject to GST Tax at that time.

The current state of the Estate & Gift Tax regime provides unique opportunities to make gifts.

Gift Tax

Although there is no Estate Tax or GST Tax in 2010, there is still a Gift Tax. That said, the top Gift Tax rate in 2010 is an historically low 35%. Further, each person is allowed a $1 million lifetime exemption from Gift Tax.

Even if you have already exhausted your $1 million lifetime Gift Tax exemption, making a taxable gift in 2010 may still make sense. The Gift Tax rate is scheduled to increase in 2011, so if you think you may still want to make gifts, this year would be the time to pay the Gift Tax. Further, paying a 35% Gift Tax on asset transfers now is better than a 55% Estate Tax on asset transfers at your death.

While there is always the risk that the Estate Tax or Gift Tax will either decrease or disappear entirely in the future, given the economic straits of the federal government, an outright repeal is unlikely. Further, if the donor of the gift survives the transfer by three (3) years, then the Gift Tax paid on the transfer escapes estate taxation at the donor's death.

Mechanisms for Gifting

There are many ways to make gifts. The simplest, of course, is to make the gift outright. But there are ways to reduce the Gift Tax value of the transfer, like creating a Family Limited Partnership ("FLP") and then gifting interests in the FLP.

Gifts can also be made to trusts, which can provide you with income, but still remove the gifted asset from your estate. Further, discounted assets can be combined with trusts for a double discount.

In addition, gifts can even be made using formulas to provide for the risk of retroactive applicability of changes to the Estate or GST Tax regimes.

GRATs

Grantor Retained Annuity Trusts ("GRATs") have long been a favored advanced estate planning technique for removing assets from an individual's estate at a discounted Gift Tax value. Now, perhaps more than ever, GRATs should be considered as part of your estate plan.

With a GRAT, you transfer certain of your assets to a trust. For a set term, the trust pays you a fixed amount of income (an annuity). At the end of the term, the remaining assets in the trust pass to your children, or whoever you wish to designate as the remainder beneficiary. The value of the gift to your children is calculated as the

Continued on next page.

Mechanisms for gifting, continued.

present value of the child's future interest in the assets and can even be structured to be zero.

Congress recently began discussing limitations on GRATs, such as setting a minimum term and a minimum remainder amount. Given that some of the benefits of GRATs may disappear in the near future, you should consider taking advantage of the current, favorable GRAT rules. In addition, the rate used to calculate the value of the future interest, set by the IRS each month, is historically low. This means more assets can be transferred at a lower Gift Tax value.

Creditor protection is an additional benefit of GRATs. Since GRATs are irrevocable and you, as the beneficiary cannot demand additional distributions beyond the annuity amount, your creditors cannot reach anything more than your annuity stream; thus the assets held in the GRAT are protected from your creditors.

Even with the uncertainty of Congressional action, certain planning opportunities still exist.

Charitable Gifts

If you are charitably inclined, now is a great time to create Charitable Lead Trusts ("CLTs") thanks to the current low rates. CLTs are trusts that pay a designated charity a set amount each year for a set term. At the end of the term, the balance in the trust is distributed to whomever you designate as the remainder beneficiaries.

For example, you could set up a CLT to pay $10,000 a year to the Salvation Army or United Way for five years, after which time the balance of assets in the CLT would be distributed to your children, completely outside your estate.

With a CLT, you would pay no Estate Tax on these assets passing to your children. You would, however, pay a Gift Tax on the amount expected to pass to your children, what is called the remainder. However, with rates as low as they are, the Gift Tax value of that remainder could be very small depending on the amount paid to the charity and how long it is paid.

What should you do?

There are many ways to make gifts and they each can provide different benefits. The FLP, GRAT and CLT techniques briefly discussed above are just three of the many ways to make discounted leveraged gifts that would reduce your overall Transfer Tax burden.

If you are thinking of making gifts, especially to grandchildren, now may be the best time to do so. Or if you are in a secure financial position and want to reduce your future estate, again, now may be the best time to do so. The current state of the Estate and Gift Tax regime provides unique planning opportunities in 2010.

Please contact us to discuss your individual situation.

Income Taxes in 2011

Transfer Taxes are not the only taxes affected by the sunset provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"). Income Tax rates are also set to change in 2011. This year, the individual marginal Income Tax rates are 10, 15, 25, 28, 33, and 35 percent. In 2011, the individual marginal Income Tax rates will revert to their pre-EGTRRA levels of 15, 28, 31, 36, and 39.6 percent.

If you expect to be in a higher Income Tax bracket next year, you should consider moving as much income as possible to 2010 instead of 2011. Ways to move income into 2010 include Roth IRA conversions, selling appreciated property, and billing sooner – especially for those of you who own S Corporations or LLCs. You may also be able to defer certain deductions until 2011, thereby reducing your taxable income next year. However, be careful deferring deductions because the phase out limitations for itemized deductions return in 2011. You will not want to defer too many deductions to 2011 only to see them wasted.

Finally, the Capital Gains tax rate will increase from 15 to 20 percent (or 18 percent for assets owned more than 5 years). Similarly, qualified dividends will be taxed at ordinary income rates. If you are considering a sale of a capital asset, you may want to sell in 2010 before the capital gain rate increases in 2011.

Please contact us to discuss your individual situation.

KELLY OLSON MICHOD DEHAAN & RICHTER, L.L.C.

David S. Adduce .... dadduce@komdr.com
Marc J. Chalfen .... mchalfen@komdr.com
Stephen B. Cohen .... scohen@komdr.com
Mark A. Costa .... mcosta@komdr.com
Ronald M. DeHaan .... rdehaan@komdr.com
Paul J. Doucette .... pdoucette@komdr.com
Jason T. Johns .... jjohns@komdr.com
Alvin L. Kaplan .... akaplan@komdr.com
John A. Kelly, Jr. .... jkelly@komdr.com
Steven A. Koga .... skoga@komdr.com
Kimberly A. Mahan .... kmahan@komdr.com
Charles L. Michod, Jr. .... cmichod@komdr.com
Paul J. Richter .... prichter@komdr.com
Frank G. Siepker .... fsiepker@komdr.com
James L. Stephenson .... jstephenson@komdr.com

© 2010 KELLY, OLSON, MICHOD, DeHAAN & RICHTER, L.L.C.

KELLY, OLSON, MICHOD, DeHAAN & RICHTER, L.L.C. provides legal services to individuals, including employment, severance and independent contractor agreements, banks, including loan documentation and loan workouts, and closely held U.S. and foreign businesses in the area of business contracts, licensing, distribution and other business legal issues, real estate, including real estate tax appeals and the representation of developers and contractors, estate planning and probate, and commercial litigation. This publication is part of the marketing of professional services of KELLY, OLSON, MICHOD, DEHAAN & RICHTER, L.L.C.

CIRCULAR 230 DISCLOSURE: Pursuant to Regulations Governing Practice Before the Internal Revenue Service, any tax advice contained herein is not intended or written to be used and cannot be used by a taxpayer for the purpose of avoiding tax penalties that may be imposed on the taxpayer.