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ADVISORS

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## **THE TAX RELIEF ACT OF 2010: Implications for Estate Planning**

*The value of a team approach will only intensify in the next decade*

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When ***Financial Advisor Magazine*** called in February requesting some expert commentary for their upcoming article on the **Tax Relief Act of 2010**, they began a dialogue with our **Director of Financial Planning, John Przybylski, JD, LL.M., CFP®**. The following summarizes and expands on that dialogue.

***Financial Advisor: Has the new law impacted the advice you will be giving to clients after Jan. 1, i.e., are any of the provisions immediately actionable?***

The increase of estate, gift, and GST exemptions to \$5 million per spouse (\$10 million per couple) for 2011-2012 provides opportunities for increased lifetime transfers. Likewise, the use of long-term dynasty-type trusts provides the opportunity to protect assets from future transfer taxes. In case exemption amounts decrease starting in 2013, it will make sense to transfer as much of the exemption as possible during this window.

In addition, the low current interest rate environment provides an impetus to make changes now rather than waiting until the end of the two year tax window, since many estate planning vehicles (such as Defective Grantor Trusts and Charitable Lead Annuity Trusts) are optimized in a low interest rate environment. Transfers to DGTs are often accomplished by means of an installment sale from the Grantor. The lower the interest rate, the lower the hurdle rate (i.e., the less that has to be transferred back to the Grantor).

A Charitable Lead Annuity Trust involves a transfer to a trust, which in turn distributes a stream of payments to a charitable beneficiary. The remainder is distributed to noncharitable remaindermen (typically children). The lower the interest rate, the larger the present value of the stream of payments to the charitable beneficiary. Hence, a lower interest rate translates to a larger charitable deduction and a smaller taxable gift to the noncharitable remaindermen.

Given the nation's current focus on lowering the federal budget deficit, it is far from certain that current income and transfer tax rates will remain at 2011-2012 rates indefinitely. We believe that it makes sense to take advantage of the high exemptions and relatively low tax rates while we can.



*We take a team approach to the estate plan review process, involving the client's estate planning attorney as well as their accountant and life insurance broker as appropriate. This allows us to aggregate the knowledge of all of the various players in our clients' lives.*

**Financial Advisor: Are you having to undo any previous planning that was done based on the Bush tax cuts expiring?**

We made some small changes at the end of 2010, but nothing of note right now. It's not so much undoing previous planning as it is taking a fresh look at estate plans in light of the new tax rates and exemption amounts.

At Federal Street Advisors, we review each client's estate plan on a regular basis, with the frequency depending on the client's situation. Estate plans should be reviewed at least every five years, but more frequent reviews may be warranted if the client's health or financial situation has changed, or if new tax laws would have a significant impact on their existing plan.

We take a team approach to this review, involving the client's estate planning attorney as well as their accountant and life insurance broker as appropriate. The team approach adds value because it allows us to aggregate the knowledge of all of the various players in our clients' lives, leading to more comprehensive life and estate planning solutions.

**Financial Advisor: How are the estate tax changes going to impact your estate-planning business, particularly your charitable-giving practice? Will the lower estate tax rate reduce philanthropy? Are there other implications of a lower estate tax?**

Any significant estate tax change increases the importance of reviewing client estate plans. Since changes resulting from the Tax Relief Act of 2010 are undoubtedly temporary, it is even more important to conduct the reviews so as not to lose opportunities that may expire after 2012.

I mentioned earlier the opportunity for increased lifetime transfers - letting all future growth in those assets take place outside of the matriarch/patriarch's taxable estate. This could mean transferring significant pieces of the family business, other illiquid business or real estate assets, or simply marketable securities to the next generation or to the grandchildren.

With our clients, we don't foresee reduced charitable giving as a result of the lower estate tax rate, but the verdict is not yet in on that.



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**Financial Advisor:** It's always important to be in touch with clients about major events such as a tax law change. But we've had many major tax laws enacted over the last decade. Is this just another tax act to inform clients about in the usual way, or does this act warrant a change in the approach advisors take when communicating to clients about a tax-law change?

More and more you have to think of taxes as a fluid set of rules – and stand ready to take advantage of opportunities as they present themselves because those opportunities may not be there forever. For instance, the GST tax rate in 2010 was 0% (and we only had certainty about that for the last two weeks of the year). We have clients who have had great success moving assets at no transfer tax cost using two-year rolling Grantor Retained Annuity Trusts (GRATs), but the days of the zeroed-out short-term GRAT may be numbered. Similarly, we do not know if the \$5 million GST and gift tax exemptions will be around after 2012, so it may make sense to take advantage of them while you can.

The fluidity of the tax situation drives home the value of a proactive, team approach to estate planning. For example, we arranged an estate review with a \$200m client that involved the matriarch/patriarch, their children, estate planning attorney, accountant, and business advisor. In this meeting, the client agreed to proceed with several planning strategies (and in fairness, nixed a few as well). The power of a team approach was apparent. The estate planning attorney later told us that the client had agreed to take more action as a result of that meeting than over the previous 20 years.

In other estate planning team meetings, we have introduced several clients to the concept of a GRAT with the result that our clients have transferred literally tens of millions of dollars to the next generation with little to no tax cost using this strategy.

Not all of our planning causes clients to give more. In one situation, a client's other advisors had made an excellent recommendation involving the transfer of a commercial building which was a significant portion of the client's net worth to a DGT (Defective Grantor Trust) in exchange for a low interest rate note. After running projections, it was agreed by all that the transfer should still take place, but only using a 50% interest in the building.

A team approach to estate planning facilitates a big picture approach, and the cross-pollination of ideas and strategies. It ensures that clients make the optimal decisions given their circumstances – and the perpetually changing tax and interest rate environments.

Please [visit our website](#) to learn more about our Family Office Services.