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November 10, 2010

## **TO ALL CLIENTS OF MINCEY-CARTER, PC**

It has been quite an interesting year in the world of estate planning. Congress' failure to enact new estate tax legislation prior to December 31, 2009 led us to a one-year repeal period of the estate and generation skipping taxes in 2010. Under the current law, if you die in 2010, you pay no estate tax. Instead, your estate is subjected to a complicated carryover basis regime which takes away some of the income tax benefits which were formerly in place.

We contacted you at the beginning of this year to alert you of these changes in the law and the need to "patch" your estate plans for this interim no estate tax period if you had certain formula clauses in your trust planning. If Congress does not act prior to the end of 2010, the estate and generation-skipping tax laws are scheduled to automatically re-emerge at a much lower exemption level (\$1,000,000 in 2011 compared to \$3,500,000 in 2009 with respect to estate taxes) and a higher top tax rate (55% in 2011 compared to 45% in 2009). It is unknown whether Congress will act prior to 2011 to provide relief in the form of a higher exemption level and tax rate similar to what we had back in 2009. Most practitioners now believe we will see a return to the \$1,000,000 estate tax exemption level. Note: The GST exemption in 2011 will likely be the 2006 exemption amount (\$1,000,000), indexed for inflation from 1997 to 2011 (this indexed amount would have been \$1,340,000 in 2010, so we can assume the 2011 GST exemption will be at least this amount).

As we navigate through these uncertain times, we wanted to bring the following topics to your attention:

### **GIFT OPPORTUNITIES IN 2010**

There are a few positive aspects of this current period of uncertainty. Although the estate and generation skipping transfer taxes are not in effect, the gift tax has remained in effect with a \$1,000,000 lifetime gift tax exemption. This means that to the extent your lifetime taxable gifts (i.e., gifts in excess of any allowable exclusion, such as the annual exclusion) exceed \$1,000,000 you are required to pay a gift tax. However, the gift tax rate is significantly lower at **35%** (in 2010) than the 45% gift tax rate in effect in 2009 and the expected gift tax rate of 55% in 2011. Accordingly, if you are considering making taxable gifts, you should make them during 2010 at the lower 35% tax rate.

It is also becoming increasingly unlikely that Congress will cause a generation-skipping transfer tax to be effective during 2010. This presents a unique opportunity for you to make generation-skipping transfer tax free gifts to grandchildren and lower generations.

### **ANNUAL EXCLUSION GIFTING**

Individuals who want to make annual exclusion gifts for 2010, and have not yet done so, should make those gifts **NOW**. Also, the most effective time to make annual exclusion gifts in 2011 is at the beginning of the year. Each person is currently able to make gifts of up to \$13,000 per donee each year with no gift or estate tax cost or consequences.

Important reasons support making annual exclusion gifts at the first of the year instead of at the end. If gifts are given early, the yearly income on those gifts can be earned for the donee and often at the donee's lower income tax rate. But more importantly, if a gift is not given early, the donor might die before year-end and never have the opportunity to make a planned year-end gift. A parent planning on making a \$13,000 gift to each of five children could incur \$35,750 in estate taxes if the parent died before making his or her planned gifts.

Gifts can be made to minors or beneficiaries who are not yet mature enough to manage funds. If funds are placed in a custodianship under the Uniform Transfers to Minors Act, the child will be entitled to the funds at age 21. If annual gifts are made, this may subject substantial assets to the whims and desires of a 21-year-old. Certain types of trusts can be utilized which both qualify for the annual exclusion and also tie the trust assets up until the beneficiary is older than 21.

### **EDUCATIONAL FUNDS**

Section 529 of the Internal Revenue Code provides a higher educational funding mechanism for parents and other donors to make gifts to a qualified state tuition program ("QSTP"). In 2002, Texas began offering its own Section 529 plan. These 529 plans can be considerably more flexible than the "Texas Tomorrow Fund," the prior Texas funding arrangement, but it is a different type of plan. Assuming donors are making no other annual gifts to a beneficiary (including, for example, gifts to an irrevocable life insurance or liquidity trust to pay insurance premiums), a married couple may contribute jointly a lump sum of up to \$130,000 per beneficiary to a QSTP and elect to have the contribution treated as separate annual exclusion gifts over a five-year period. The primary tax benefit of utilizing a QSTP is the deferral (and possible elimination) of income taxes on earnings attributable to the QSTP contributions. If the distributions are made for qualified higher education expenses of the beneficiary (which can include tuition, room, board, and necessary books and supplies), the distribution will be tax-free to the beneficiary. Several institutions are currently marketing QSTPs, and a number of states offer their plans to non-residents. The donor retains the ability to change the beneficiary of the plan to another family member, thus

retaining flexibility. Non-qualified withdrawals may even be made by the donor; but unless certain limited exceptions apply, the withdrawals will be subject to income taxes at the donor's income tax rates plus a 10% percent penalty on the earnings portion of the withdrawal. These plans may be set up directly through an institution; however, to insure that these plans are coordinated with other estate and gift planning, please contact us to review your 529 plan funding and your other gift plans. **Comment: A 529 Plan is a great way to save for college by parents, grandparents and other relatives. Check the website at [www.savingforcollege.com](http://www.savingforcollege.com) for additional information.**

If you contributed up to \$65,000 to a QSTP for a beneficiary, on your Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return, you may elect to have the contribution treated as separate annual exclusion gifts over a five-year period. During the five-year period of the election, you will only need to file Form 709 in the year or the contribution in order to make the election, and in any subsequent year when you are otherwise required to file a gift tax return.

### **COORDINATION WITH LIFE INSURANCE TRUSTS**

Due to the one-year repeal of the generation-skipping tax in 2010 and ongoing questions concerning the ability of a donor to allocate generation-skipping tax exemption in such a year, we believe it is currently advisable to treat any transfers made to your irrevocable life insurance trust in 2010 as loans rather than gifts. If you have made transfers to an irrevocable life insurance trust this year, please contact us so we can assist you in documenting these transfers as loans.

### **USE OF APPLICABLE CREDIT AMOUNT**

Currently, each person has the ability to gift up to \$1,000,000 (during lifetime) free of gift and estate taxes; however, any amounts given in prior years in excess of annual exclusion gifts reduce this amount. This amount is in addition to the annual exclusion gifts that can be made each year. For individuals who have the financial ability to give away significant amounts, and who have not made gifts of the applicable credit amount, it may be advantageous to consider making substantial gifts now. There are significant tax advantages to using this amount during lifetime, since the income and any appreciation on the gift will pass to beneficiaries free of additional gift or estate taxes.

### **TAKE ADVANTAGE OF LOW MARKET VALUES, LOW INTEREST RATES, AND VALUATION DISCOUNTS**

Notwithstanding the current period of repeal, the estate tax appears to be here to stay. The current climate of low market values, historically low interest rates and availability of valuation discounts makes this the perfect time to transfer wealth free of transfer taxes. Please do not let this opportunity get away from. The time to plan is **NOW**.

## **TAKE ADVANTAGE OF FAVORABLE CAPITAL GAIN AND DIVIDEND RATES**

Under the law currently in effect, qualified dividends and long term capital gains are taxed at a 15% rate. If Congress does not act prior to the end of the year, the top rate for long term capital gains is scheduled to increase in 2011 to 20% and dividends will once again be taxed at regular income tax rates (the top income tax rate is scheduled to be 39.6%). There has been some talk of a legislative compromise in this area, but it is currently uncertain whether these tax rates will be allowed to expire.

## **CONSIDER FUNDING YOUR FAMILY TRUST DURING YOUR LIFETIME**

When you die and your will is probated in Texas, any assets remaining in your probate estate at death must be reported on an Inventory which is available for public inspection. If privacy is of concern, consider funding your revocable Family Trust during lifetime. Assets which are moved into such a Family Trust structure are not subject to the probate process. In addition, if you own property which is located outside of Texas, re-titling the property in the name of your Family Trust will enable you to avoid ancillary probate in other jurisdictions.

## **CONSIDER CONVERSION TO A ROTH IRA**

Prior to 2010, many taxpayers were not eligible to convert to a Roth IRA due to certain limits on gross income. Beginning in 2010, these income limitations no longer apply and conversions are generally available to all taxpayers. If a taxpayer converts in 2010, he or she can receive special tax treatment by electing to spread the income over a two-year period (i.e., the 2011 and 2012 tax years). For conversions made after 2010, the income will be included entirely in the year of conversion. Determining whether conversion is right for you is a complex task and should be based upon comprehensive financial analysis. In general, conversion is recommended for those taxpayers who (i) have other funds to pay the tax; (ii) anticipate being in the same or higher marginal income tax brackets in the future; (iii) do not need to make withdrawals from the IRA to meet living needs; and (iv) desire to leave an asset to beneficiaries income tax free.

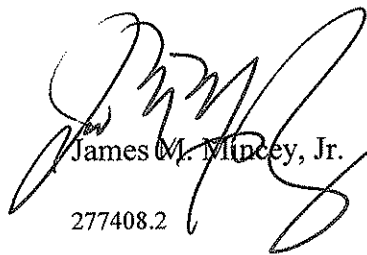
## **CHARITABLE PLANNING**

If you have charitable inclinations, consider accelerating the income tax benefits of your annual giving by setting up one of the following: (i) a private foundation; (ii) a donor advised fund; or (iii) a charitable lead trust.

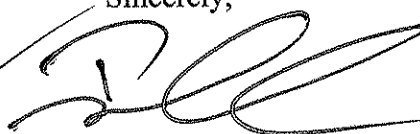
**RENEGOTIATE PROMISSORY NOTES TO LOWER INTEREST RATE**

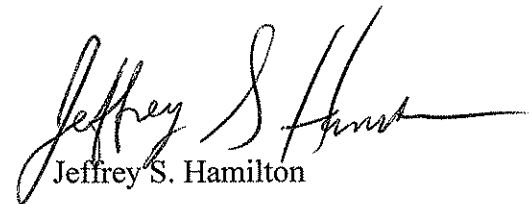
You may want to consider renegotiating the outstanding balance on any promissory notes to lower the current interest rate, thus saving the maker a substantial interest payment. As a part of this note renegotiation, we recommend that a principal prepayment be made to induce the noteholder/payee to renegotiate. **Note: The November interest rate for a nine-year promissory note is only 1.59%.**

**Tax planning is important; But When You Act is just as important. SO PLAN AND ACT NOW.**



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Sincerely,  
  
I. Scott Carter



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