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Clients&FriendsMemo

Important Gift and Generation-Skipping Transfer ("GST") Tax Planning Opportunities

November 9, 2010

It was expected that Congress would enact legislation pertaining to the U.S. Federal estate, gift and GST tax laws for transfers in 2010, and, possibly, make such legislation retroactive to January 1, 2010. To date, Congress has not taken any such action. As matters now stand, there is no U.S. Federal estate or GST tax imposed on transfers in 2010, but the U.S. Federal gift tax still applies. The current state of affairs has given rise to tax planning opportunities that may be available, *but only through the end of 2010*.

1. Direct gifts. For gifts made in 2010, the highest U.S. Federal gift tax rate is currently 35%, and the gift tax exemption is $1,000,000. The gift tax rate has not been this low in over seventy years. If Congress does not amend the U.S. Federal gift tax laws, the highest U.S. Federal gift tax rate for transfers after 2010 will be 55%.

    - You may wish to make large taxable gifts this year to take advantage of the historically low gift tax rate.

    - However, it might be advisable to wait until near the close of 2010 to make such gifts. As there is currently no U.S. Federal estate tax for persons dying in 2010, generally it is advisable not to incur a gift tax if the donor's death should occur in 2010.

2. Direct gifts to grandchildren. At the moment, there is no GST tax for transfers made in 2010. If you have grandchildren or great-grandchildren, you should consider making outright gifts to them. While such gifts would be subject to the U.S. Federal gift tax, there would not be the second layer of GST tax. If Congress does not amend the GST tax laws, in 2011 the GST tax rate will be 55% and the GST exemption will be $1,000,000 indexed for inflation.

3. Trust distributions to grandchildren. Distributions in 2010 from trusts that are not exempt from the GST tax to a grandchild or great-grandchildren of the grantor are currently not subject to the GST tax. If Congress does not amend the GST tax laws, distributions from such trusts to a grandchild or a great-grandchild of the grantor in 2011 will be subject to a GST tax of 55%.

Caveat: It is unclear whether Congress will or can take any actions to enact legislation retroactively increasing the gift tax rate or reinstating the estate and GST taxes for 2010. While it seems unlikely at this late stage that Congress will implement retroactive legislation, it is not certain that Congress will not attempt to do so.

4. Grantor retained annuity trust (GRAT). A GRAT is a tax efficient way to make tax free gifts, and is particularly effective in the current low interest rate environment. There are legislative proposals to reduce the attractive features of GRATs. One proposal is to require that a GRAT must have a term of at least 10 years. That would make GRATs less useful for individuals with shorter life expectancies as the grantor's death before the expiration of the GRAT term causes inclusion of the trust assets in the grantor's estate. Such proposal would also put an end to the popular practice of creating successive two-year GRATs to take advantage of appreciation during each two-year term. If you are considering creating a short term GRAT, you should do so as soon as possible.

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