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Trusts & Estates Department Alert

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INCREASED GIFT AND GST TAX EXEMPTIONS TO EXPIRE SHORTLY

The gift, estate and generation-skipping transfer (“GST”) tax exemptions are currently \$5,120,000. If Congress does not act, the gift and estate tax exemptions will revert to \$1 million after 2012 and the GST exemption will revert to \$1 million indexed for inflation since 1997.

If you wish to use the increased exemption amounts available this year, you should do so as soon as possible. Please do not hesitate to contact us to discuss the optimum use of these exemptions.

Historically Low Interest Rates

The “hurdle” interest rate that applies to grantor retained annuity trusts (“GRATs”) and charitable lead annuity trusts (“CLATs”) is currently 1.4%, which is an historic low.¹ Now is an excellent time to create GRATs or CLATs in order to transfer appreciation in excess of the hurdle rate free of gift or estate tax (provided, in the case of a GRAT, that the grantor survives the fixed term).

Similarly, the minimum interest rates required for intra-family loans are at historic lows of 0.19% for term loans of three years or less, 1.08% for term loans of between three and nine years, and 2.63% for term loans of more than nine years (assuming, in each case, semiannual compounding). Consequently, now is an excellent time to make or refinance intra-family loans.

Please feel free to discuss any aspect of this alert with your regular Milbank contacts or with any of the members of our Trusts and Estates Group, whose names and contact information are provided herein.

In addition, if you would like copies of our other alerts, please visit our website at www.milbank.com and click on the News link.

This alert is a source of general information for clients and friends of Milbank, Tweed, Hadley & McCloy LLP. Its content should not be construed as legal advice, and readers should not act upon the information in this alert without consulting counsel.

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¹ A GRAT is a trust in which the grantor retains the right to a fixed series of annual payments for a term of years. A CLAT is a trust in which one or more charities are given the right to a fixed series of annual payments for a term of years or for the life or lives of certain individuals. The remainder of a GRAT or CLAT can pass free of gift tax to descendants to the extent that the trust earns returns that exceed the “hurdle” interest rate.

Proposals to Eliminate Discounts and Estate Tax Planning Strategies

President Obama and some members of Congress continue to support legislation to eliminate valuation discounts for family-owned entities and curtail the use of popular estate tax planning strategies, including GRATs and perpetual GST-exempt trusts. The Treasury Department recently announced that the White House also wishes to subject all “grantor trusts” (i.e., trusts that are treated for income tax purposes as if they are owned by the grantor) created after the date of enactment to estate tax. Grantor trusts can be very efficient vehicles for reducing a family’s estate tax burden. The possibility that grantor trusts and other strategies will be eliminated heightens the importance of implementing these strategies sooner rather than later.

Enhanced Reporting Requirements for Foreign Accounts and Foreign Assets

Individuals who in 2011 held foreign financial assets may be required to report such assets with their income tax returns. The IRS has recently published regulations implementing this requirement, which is an example of a broader regulatory trend towards greater disclosure of foreign accounts and investments. Please contact us if you have any questions about your reporting responsibilities with respect to any foreign accounts or foreign assets.

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Statement About Circular 230

A Treasury Department regulation, known as Circular 230, requires lawyers and accountants to follow strict rules in issuing a written statement about a Federal tax issue. The most onerous rules of compliance under §10.35 of the Circular involve written advice about so-called Listed Transactions, arrangements that have tax avoidance as their principal purpose and what are called Marketed Opinions. We do not believe any issue discussed in this memorandum relates to a Listed Transaction. We believe the tax benefit sought is consistent with the Internal Revenue Code of 1986 as amended (Code) and Congressional purpose. That means the principal purpose is not tax avoidance. We also believe no issue discussed herein is a significant Federal tax issue – meaning that we believe the IRS does not have a reasonable basis for a successful challenge on the overall Federal tax treatment of the issues discussed in this memorandum. That means we do not think this memorandum must comply with §10.35 of the Circular. Nevertheless, we add the following statements to ensure compliance with said §10.35. Notwithstanding these statements, we believe the conclusions reached herein are correct.

1. The written advice contained in this memorandum is not intended or written by us to be used, and it cannot be used, by any taxpayer for the purpose of avoiding penalties.
2. No one may use any part of this memorandum in promoting, marketing or recommending an arrangement relating to any Federal tax issue to any taxpayer.
3. Nothing herein shall be construed to impose a limitation on disclosure by any person of the tax treatment or tax structure of any transaction that is addressed herein.

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