Family MATTERS

January 2011 [***Forward to a Friend***]

New Year, New Estate Tax Rules

Happy New Year to you and your families! This year has already been an exciting one for estate planners. For example, are you aware that the Bush-era tax cuts have been extended for two years? Do you know what the new estate, GST, and gift tax rules are for 2011-2012? If not, read on ...

On December 17, 2010, President Obama signed the Tax Relief Unemployment Insurance Reauthorization and Job Creation Act of 2010 (the "2010 Act"), which extends the Bush-era tax cuts for an additional two years and liberalizes estate and gift tax rules.

The 2010 Act significantly increased the estate tax exemption and generation-skipping transfer (GST) tax exemption from $3.5 million to $5 million in 2011 and 2012, and decreased the top tax rate to 35%. Even more unexpectedly and dramatically, the 2010 Act increased the gift tax exemption from $1 million to $5 million (the gift tax and estate tax exemptions have become unified again for the first time since 2003), and retained a tax rate of 35% through 2012. (This rate starts to apply to gifts in excess of $500,000.) The estate, GST, and gift tax exemptions are further increased for inflation for 2012. These high exemption levels mean that people have a two-year window in 2011 and 2012 to protect significant portions of their estates from taxation for generations. It is like a giant "gift tax" sale for the next two years, at least for the wealthy.

One of the surprise provisions of the 2010 Act makes the new $5 million estate tax exemption and 35% tax rate retroactive to January 1, 2010. In other words, the heirs of those dying in 2010 will have a choice between applying the new rules or electing to be covered under the rules that have applied in 2010 - no estate tax but only a limited step-up in the cost basis of inherited assets. (See April - June, 2010 newsletters for further explanation of the unique cost basis rules for 2010.) This would benefit the heirs of tens of thousands of more modest estates which, under current rules applying for 2010, are subject to capital gains taxes on inherited assets above a certain threshold.

In another surprising move, the 2010 Act also includes a provision making the estate tax exemption "portable" between spouses. This is like roll over minutes on a family plan. Specifically, if the first spouse to die does not use all of his or her $5 million exemption, the surviving spouse can add the unused portion to his or her exemption amount and use it for gifts during the surviving spouse's lifetime or make it available at death for estate tax purposes. However, a timely election must be made on the first spouse's estate tax return (which means that an estate tax return will have to be filed after the first spouse's death where it might otherwise have not been filed). Despite its buzz, the portability provision is narrow in its application because it cannot be utilized unless both the first and second spouses die in 2011 or 2012 (unless Congress decides to extend the 2010 Act).

Two long-anticipated changes are notably missing from the 2010 Act. The first is that there is no "denial of discounting" rules. Minority discounts and lack of marketability discounts for family limited partnerships and similar entities are therefore still available as before. Second, the long-threatened extension of the GRAT term of years never materialized. Shorter, two-year GRATs are therefore still available, which is great news in this low-interest rate climate.

All of these changed exemptions and rates are temporary and will once again "sunset" at the end of 2012. Barring contrary legislation, we will see the return in 2013 of a $1 million exemption and a 55% tax rate. The following chart summarizes the changes under the 2010 Act:

Estate Tax Timeline: Summary

2010	2011	2012	2013
Estate Tax •35 % top tax rate or election to forego tax •$5mm exemption	•35% tax rate •$5mm exemption	•35% tax rate •$5mm exemption (to be indexed for inflation)	•55% top tax rate •$1mm exemption
GST Tax •0% tax rate •$5mm exemption	•35% tax rate •$5mm exemption	•35% tax rate •$5mm exemption (to be indexed for inflation)	•55% top tax rate •$1.4mm exemption (currently indexed for inflation; this is a rough estimate)
Gift Tax •35% taxrate •$1mm exemption	•35% taxrate •$5mm exemption	•35% tax rate •$5mm exemption (to be indexed for inflation)	•55% top tax rate •$1mm exemption

How do these new rules affect you? Should you keep your Exemption Trust in place or draft a new Disclaimer Trust? How can you take advantage of the new gifting rules? Stay tuned for next month's newsletter . . .

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