

ESTATE PLANNING LEGAL ALERT

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It Finally Happened: Certainty in Estate and Gift Tax Laws (sort of)

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This *Legal Alert* is intended to serve as a broad overview of the new Congressional tax legislation that passed with regard to estate and gift taxes. However, keep in mind that there is still a considerable amount of uncertainty since the new legislation is effective for only two years (2011 and 2012).

2010

Highlights

- **Estate Tax Exclusion Amt.:** \$5 million.
- **Maximum Estate Tax Rate:** 35%.
- **Carryover Basis:** Option to Elect Carryover Basis instead of paying estate taxes. Carryover basis applies only if an estate elects out of the federal estate tax. But there is still the elective basis increase of \$1.3 million, plus a \$3 million basis election increase available for property that passes to a surviving spouse.
- **Gift Tax Exclusion Amount:** \$1 million.
- **Maximum Gift Tax Rate:** 35%.

Review

In the past, the estate tax exemption was called the *applicable exclusion amount*. Now it is

called the *basic exclusion amount*. The unified tax credit is \$1,730,800. The 35% federal estate tax rate begins at \$500,000, but there is no estate tax until the taxable estate, plus the value of any lifetime gifts, exceeds \$5 million.

The income tax basis is a full step-up unless an estate elects out of the federal estate tax. The state death tax deduction remains as it has been for the last five years.

The due date for any federal estate tax is nine months after the date of the enactment of this legislation.

The penalty for the failure to report to the IRS is \$10,000 per failure. If there is an intentional disregard of the tax laws, the penalty is 5% of the fair market value of the property that was not reported on an estate tax return.

2011 and 2012

Highlights

- **Estate Basic Exclusion Amt.:** \$5 million. In 2012 this amount is indexed for post-2010 inflation.
- **Estate and Gift Tax Credit:** There is a unified credit of \$1,730,800, plus 35% of the increase to \$5 million due to indexing, but that is only for calendar year 2012.

- **Maximum Estate Tax Rate:** 35%, which begins at \$500,000, but there is no federal estate tax until the taxable estate, plus gifts, exceeds \$5 million.
- **Portability:** Something new is the use of a deceased spouse's unused exclusion. This is a popular change, because it provides for the "portability" of a deceased spouse's unused basic exclusion amount. This portability exclusion is only available for the estate of a spouse who dies in 2011 or 2012. The portability exclusion is available only from the last deceased spouse. Accordingly, the exclusion could be lost if the surviving spouse remarries and then becomes "re-widowed." It permits the surviving spouse to use any unused basic exclusion amount on the first spouse's death. But it will require the filing of a federal estate tax return (Form 706) on the first spouse's death to document the unused exemption.
- **Gift Tax:** The gift tax exclusion amount is \$5 million, plus any portable exclusions, meaning the same as the estate tax applicable exclusion amount. The unified credit is \$1,730,800, plus 35% of the deceased spouse's unused exclusion amount, again the same for the estate tax. In effect, the federal estate tax and the federal gift tax exemption are now "reunited" back to where they were in 2001.
- **"Stacking":** One interesting twist is that the portability exclusion is the same for the gift tax as it is for the estate tax, except that a donor can use the "deceased spousal unused exclusion amount" from multiple deceased spouses during the donor's lifetime, i.e., "stacking" them. This means that substantially large lifetime gifts can be made without any gift tax if there were several deceased spouses of the donor.
- **Effective Date:** January 1, 2011.

Review

Generally, the law now means that estate taxes will not be the "tail that wagged the dog" as they have for so many decades.

Many married clients will opt for a joint trust due to its simplicity, although second marriages and those who have creditor concerns will still gravitate towards credit shelter type trusts for asset protection purposes.

Expect the state to get far more active in their own estate and inheritance tax regimes, since they have lost money over the last decade with the evolving federal estate tax rules and the conversion from a state death tax credit against the federal estate tax, to only a deduction used in calculating the federal estate tax. It's almost as if the federal government has abandoned the estate tax "playing field" to the states.

Fewer worries exist with the generation-skipping transfer tax since it is tied to the federal estate tax basic exclusion amount (\$5 million to each taxpayer.)

Liquidity provided by life insurance for middle-Americans is less needed, as is the need to exploit some of the wealth shifting "gimmicks" of the tax code like GRATs, CRUTs, QPRTs, and valuation discounting with FLPs or LLCs.

This legislation is a big winner for folks who have worried about federal estate and gift taxes. The unfortunate aspect is that this good news might be short lived given the two year period for which this legislation applies.

Questions regarding this new legislation can be directed to George Bearup who practices in the areas of estate planning, retirement planning, business law, and divorce law. He can be reached directly at 231-486-4510 or gbearup@shrr.com. Alternatively, you may contact any of the estate planning attorneys at Smith Haughey.