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Topic for the Month

Taxing Situations

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The 2010 Tax Relief Act - Estate Planning for 2011, 2012 and Beyond...

Evan Lin

On December 17, 2010, President Obama signed into law the bipartisan legislation titled the "Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010" (the "2010 Tax Relief Act") to extend until December 31, 2012 all Bush-era tax cuts passed under the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"). EGTRRA was scheduled to "sunset" on December 31, 2010 and, if Congress and President Obama had not acted, beginning on January 1, 2011, the estate tax would have been reinstated with a top estate tax rate of 55% and an estate tax exemption amount of $1,000,000.

The 2010 Tax Relief Act made sweeping changes to the federal estate and gift tax laws. The following is intended to give a brief overview of the 2010 Tax Relief Act's key changes to the federal estate and gift tax laws:

(i) ***2011 and 2012 Estate Tax Rates& Exemption Amount.*** For 2011 and 2012, the top estate tax rate will be 35% and the estate tax exemption amount will be $5,000,000 (indexed for inflation beginning in 2012). At these levels, the vast majority of estates (all but an estimated 3,500 nationwide in 2011) will not be subject to any federal estate tax.

(ii) ***Portability of Exemption Amount.*** Up until the 2010 Tax Relief Tax Act, prior law required implementation of estate tax planning to guard against married couples "wasting" the estate tax exemption amount of the first spouse to die. In other words, the old estate tax laws did not provide for "portability" of the estate tax exemption amount and thus, the estate tax exemption amount of the first spouse to die would be "lost" if proper estate tax planning was not put in place. Beginning in 2011, the estate tax exemption amount of the first spouse to die will be "portable" without any type of estate tax planning being implemented whatsoever. Thus, any unused estate tax exemption amount remaining from the estate of the first spouse to die may be applied to the surviving spouse's estate to be used upon his or her death, provided the second death occurs before 2013. The "portability" of the estate tax exemption requires that an affirmative election be made on the deceased spouse's estate tax return, even if an estate tax return would not otherwise be required to be filed.

(iii) ***Return of "Step-up" In Basis.*** The "step-up" in basis for income tax purposes for assets inherited from a decedent returns for 2011 and 2012. Whereas, the "carryover" basis method that was in effect for 2010 provided that a decedent's cost basis in an asset "carried over" to the beneficiary, potentially resulting in significant capital gains tax upon subsequent sale of the asset. In addition, the "carryover" basis regime, although short-lived, was both cumbersome and time-consuming. The return of the "step-up" in basis is welcome relief for taxpayers and practitioners.

(iv) ***Reunification of Estate and Gift Taxes.*** Prior to EGTRRA, the federal estate and gift taxes were unified, creating a single graduated estate and gift tax rate with a single exemption amount that could be used against transfers during lifetime (i.e. gifts) or at death. EGTRRA "de-coupled" the federal estate and gift tax systems, limiting the gift tax exemption to $1,000,000 while incrementally increasing the estate tax exemption amount. The 2010 Tax Relief Act "reunifies" the estate and gift taxes and permits the use of the full $5,000,000 exemption during one's lifetime or at death.

Conclusion / Review:
Similar to EGTRRA's "sunset" that was set to occur on December 31, 2010, the 2010 Tax Relief Act is set to "sunset" on December 31, 2012, which means that as of January 1, 2013 the estate and gift tax laws will revert back to a $1,000,000 estate tax exemption and 55% estate and gift tax rate. Although the 2010 Tax Relief Act provides some immediate tax relief, the uncertainty regarding its "sunset" necessitates having an estate plan that, in most cases, will be flexible enough to change as your life and the tax laws change.

If you are concerned with how the 2010 Tax Relief Act will affect your current estate plan, we would recommend that you review your estate plan in order to insure that your estate plan makes the best use of the new estate and gift tax laws.

If you would like to discuss any aspect of your estate plan in further detail or if you have any questions with regard to the issues addressed in this letter, please do not hesitate to contact us at (920) 336-5766.