

THE 2010 TAX RELIEF ACT IMPACT ON ESTATE AND GIFT TAX PLANNING

Estate and Gift Tax and Generation Skipping Tax (“GST”) Applicable Exclusion Amounts

The 2010 Tax Relief Act (the “Act”) sets the applicable exclusion (exemption) amounts for the estate and gift taxes and GST at \$5 million per person for 2011 and 2012 - reunifying the amount that can be given during lifetime or at death at the same amount. Therefore, from January 1, 2011 through December 31, 2012, a married couple together will be able to transfer \$10 million either during their lifetimes or at death, a substantial increase from the combined \$2 million lifetime giving and \$7 million at death giving that a couple could achieve in 2009. The applicable exclusion amount for lifetime giving remains \$1 million for gifts made in 2010, but increases to \$5 million for gift and estate tax and GST purposes for decedents dying or transfers made on or after January 1, 2011. The tax rate for GST transfers made in 2010 is zero, so an outright gift to a grandchild made prior to January 1, 2011 would not generate any GST, regardless of the amount.

Estate, Gift and GST Tax Rates

The top tax rate for estate and gift taxes and GST in 2011 and 2012 will be 35%, a reduction from the 45% rate that was in effect in 2009.

“Portability”

An important change made by the Act is that a surviving spouse may utilize the unused estate (but not GST) applicable exclusion amount of the first spouse to die, if that spouse’s Executor or other representative elects on an estate tax return (whether or not the estate is large enough to otherwise require the filing of an estate tax return) to allow the surviving spouse to utilize the unused applicable exclusion amount. A surviving spouse may use the unused applicable exclusion amount only of the deceased spouse he or she was most recently married to before the surviving spouse’s death.

Even with these new provisions, you should continue to plan with “credit shelter” or “bypass” type trusts as these will continue to provide benefits. While portability allows the unused applicable exclusion amount of the first spouse to die to be used by the survivor, the appreciation on the assets of the first to die may still be subject to estate tax on the death of the survivor unless a trust is used. Moreover, as mentioned above, a decedent’s GST and lifetime gift tax applicable exclusion amounts are not portable.

Treatment of those Dying in 2010

Step-up in basis is the commonly used term which references the ability, prior to 2010, of an estate to take the date of death value of a decedent’s assets as its new income tax basis. Under this mechanism, estates, whether paying estate taxes or not, could often immediately sell assets and pay no income taxes on such sales. Under prior law, for 2010, the step-up in basis was not allowed, except for very limited amounts under specific circumstances. Under the Act, the estate tax has been reinstated retroactively for 2010. However, for estates with decedents who die in 2010 there is an important option: (1) the Executor or other representative of the estate can do nothing and the estate will be subject to the estate tax with the new \$5 million applicable exclusion amount, the 35% tax rate and a basis step-up to date of death value for the decedent’s assets; or (2) instead, a special election can be made to opt out of the estate tax but forego the stepped-up basis so that all of the decedent’s assets will have a “carry-over” basis. Calculations will have to be made for each estate to determine which option creates the more advantageous tax result.

Estate tax payments and tax returns for estates of decedents dying in 2010 and not electing to opt out of the estate tax will be due nine months after date of enactment of the Tax Relief Act. It is not clear at this time the procedure that will have to be followed for estates electing to opt out of the estate tax, but that information will be out shortly with accompanying tax forms.

Planning Ideas

Gifts

You should consider making lifetime gifts in 2011 and 2012 to take advantage of the additional \$4 million of lifetime giving that can be made free from federal gift tax. Note that if you have previously exhausted your lifetime giving amount of \$1 million, you now have an “extra” \$4 million of tax-free gifting that can be made in 2011 and 2012. Not only will the amount transferred be free from federal gift and estate tax, but also any appreciation on gifted amounts will escape future estate taxes.

Although most clients will want to wait until 2011 to make gifts, clients who wish to transfer substantial amounts to grandchildren should consider taking advantage of the zero GST rate available until the end of 2010 to make gifts to grandchildren in 2010 even if those gifts may be subject to gift tax.

Even with the increased amounts available for lifetime giving, consideration should continue to be given to optimizing the amount that may be transferred through the use of grantor retained annuity trusts (“GRATs”) and valuation discounts, as well as inter-family sales, inter-family loans, family partnerships and freeze partnerships, to name a few, all of which planning tools are not affected by the Tax Relief Act.

Clients may want to consider making taxable gifts during 2011 and 2012, as it is possible that the gift and estate tax rates will increase above 35% after 2012.

Conclusion

The 2010 Tax Relief Act gave us more this holiday season than we expected, or hoped for, in the way of estate and gift planning. We have two years to make the most of these “gifts”. Please contact us to have your estate plans reviewed to ensure that your increased exclusions are best utilized. FGMK can assist in reviewing and updating your plan to take advantage of the valuable benefits provided by the Act. The earlier we begin the planning process in 2011, the more benefits you will preserve for your family.

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