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NEW ESTATE TAX LAW BRINGS MANY CHANGES!

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On December 17, 2010, President Obama signed into law the "Tax Relief, Unemployment Insurance Authorization, and Job Creation Act of 2010" referred to as the "Tax Relief Act." This Tax Relief Act contains numerous tax law changes, but this article will concentrate solely on the major provisions impacting the federal estate, gift and generation skipping tax law.

The impact of the Tax Relief Act on the reader's existing estate plan can be very significant. Consulting with your tax/estate planning professional may be in order once you have decided if this new law impacts your estate plan.

Here are the most significant provisions of the Tax Relief Act.

- Two year life. These changes are only in effect for 2 years i.e. through the year 2012! It is expected that this entire issue will be revisited before 2012. However, this is the law now but unless something else happens it will not be the law at the end of 2012.

- Exemptions.

  - Estate Tax: The estate tax exemption goes to $5 million per person.

  - Gift Tax: Gift tax exemption goes to $5 million per person starting in 2011(it remains at $1 million for gifts in 2010).

  - Generation Skipping Tax: The GST exemption goes to $5 million per person.

  - Indexing: Indexed from 2010 to the nearest $10,000 beginning in 2012.

- Rates.

  - The rate for estates, gifts and generation skipping transfers above the exemption is 35% beginning in 2010 (the reader will recall that in 2009 the rate had been 45%).

- Decedents dying in 2010.

  - Applicability. The estate tax applies to decedents who died in 2010. The exemption is $5 million and the rate is 35%. However, executors are permitted to make an election to not pay the estate tax but instead have the modified carry-over basis rules apply as discussed later in this article. It is anticipated that large estates, i.e. those that exceed the $5 million dollar exemption will likely opt for this election instead of paying estate tax. The decision to make this election or not is not as clear cut as it may first appear as there are many factors that will come into play. If this election is not made then the default rule is that the estate tax applies.

  - Time to file extended. The time to file the return, normally nine months from date of death, has now been extended to nine months after date of enactment.

- Disclaimers. If an estate beneficiary is thinking about disclaiming an inheritance the current federal law requires the beneficiary to disclaim within nine months from date of death. This extension now gives the disclaimant nine months from date of enactment (this can be a complicated issue as other factors come into play that are beyond the scope of this article.)

- Portability.

  - This is a new and unique concept that allows the surviving spouse to use the unused portion of the last deceased spouse's exemption. In essence, a married couple could have the benefit of $10 million of exemption even without by-pass trust arrangements. A word of caution is in order here. There are many considerations and nuances that should be discussed before deciding to abandon one's existing estate plan which uses a two-trust arrangement.

  - Example. Husband dies with $3 million of unused exemption. When Wife dies her exemption amount is $8 million (her $5 million + $3 million from her deceased husband).

  - Note also that portability does not apply for generation skipping tax purposes.

  - Portability does apply for gift tax purposes.

- Modified Carry-Over Basis. As noted above, an executor for a decedent dying in 2010 can elect to not pay the estate tax but instead have the modified carry-over basis rules apply. This means that the assets passing from the estate to the beneficiaries will have as their basis the same basis as in the hands of the decedent or the fair market value of the asset as of date of death whichever is lower. However, after determining the basis of the asset the executor is permitted to allocate up to $1.3 million of appreciation to the assets to raise the asset to fair market value as of date of death. In addition, assets passing to surviving spouses are entitled to an additional $3 million of appreciation allocation. If an estate does not elect modified carry-over basis and instead files an estate tax return, then the assets passing to the beneficiaries will receive a new basis equal to fair market value as of date of death. This is the familiar "stepped-up" basis rule that had been in the law up until January 1, 2010.

- What to do? This new law is complex and may have an impact on all estate plans. You should consult your estate planning professional to determine whether your existing estate plan is still in order.

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