Estate & Gift Tax Laws Provide Benefits For Now

By Jeffrey Kolender

In December 2010, the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act became law. It keeps the 2010 income tax rates in place for 2011 and 2012 and maintains many of the other so-called “Bush tax cuts.” The new legislation also makes several important (and surprising) changes to the federal estate tax laws. Unfortunately, most of the provisions of the new law expire after 2012 and those favorable changes will remain in place only if future legislation is passed.

Some of the most important changes to the federal estate, gift and generation-skipping transfer tax laws are explained below. We encourage you to check with us to see if these changes will impact your estate plan and what steps, if any, you should take in response to the new laws.

1. Changes in the amount you can pass free of federal estate tax. In 2009, most individuals could pass $3.5 million of assets free of federal estate tax (commonly referred to as the “estate tax exemption amount.”) In 2010, before the new law was enacted, there was no federal estate tax, but it was scheduled to return in 2011, with a $1 million estate tax exemption amount and estate tax rates as high as 55% on the excess. However, under the new law, the estate tax exemption will increase to $5 million for people who die in 2011 and 2012 (indexed for inflation in 2012), with a 35% estate tax rate. Absent further legislation, for people dying after 2012, the estate tax exemption will revert to $1 million, with a top estate tax rate of 55%.
2. *Changes in the federal gift tax exemption amount.* One of the biggest planning opportunities under the new law is that it increases the total amount of gifts you can make without having to pay a gift tax. From 2001 through 2010, the gift tax exemption amount - the maximum amount of gifts you can make without being subject to gift tax - was $1 million. The gift tax exemption amount is increased to $5 million for 2011 and 2012 (the latter again indexed for inflation) with a 35% tax on the excess. This substantial change allows an individual who has used up some or all of his/her $1 million gift tax exemption amount to make additional gifts, up to the new limit, without having to pay a gift tax. This is especially helpful for Maryland and D.C. residents who wish to reduce their local estate tax liability. For many people, gifting will become an even more important part of transfer tax planning.
3. *Portability of estate tax exemption.* Historically, a married couple could maximize the amounts passing free of estate tax - taking advantage of each spouse’s estate tax exemption - only with proper estate tax planning in their Wills or Revocable Trusts. This was generally done by creating and funding a trust upon the first spouse’s death, commonly referred to as a “By-Pass,” “Family” or “Non-Marital Deduction” Trust. The new law provides the opportunity to achieve some of these same tax savings without having to create such a trust.For several reasons, it may not be wise to rely on this “portability” provision to maximize the amounts you can pass free of estate tax. First, the law has certain limitations and requirements. In addition, as with the other provisions of the tax act, this law will expire in 2013, absent future legislative action. Finally, creating the tax savings trust upon the first spouse’s death still offers several other benefits (saving state estate taxes, providing potential asset protection benefits, maximizing generation-skipping transfers, providing for ultimate disposition of the assets upon the surviving spouse’s death, etc.) which cannot be realized without such a trust.
4. *Generation-skipping transfer tax changes.* For 2011 and 2012, the new law also increases to $5 million the amount you can pass to grandchildren free of the generation-skipping transfer tax. Creating “generation-skipping trusts” for grandchildren will continue to be a fundamental part of many estate plans due to the tax savings and asset protection features of the trusts.
5. *The tax act also introduces these changes:*

- Allows estates of people who died in 2010 to elect to be subject to either the original 2010 estate tax laws or the new estate tax laws. Which law to select will depend on a number of factors, including the size of the person’s estate and the cost basis in his/her assets.
- Extends, for people dying between January 1, 2010 and December 17, 2010, the deadline for filing the federal estate tax return, paying federal estate taxes and making disclaimers until September 19, 2011.
- Provides that the cost basis of property received by the beneficiary of an estate will be equal to the

date of death value of the property (a “stepped up basis”), rather than the decedent’s cost basis.

The changes made by the new tax laws are very favorable to many people. Each individual’s situation is unique, however, and the impact of the new laws will differ for everyone. We strongly encourage you to review your estate plan in light of the new laws.

Also, if it has been awhile since you executed your estate plan, it may be time to make sure it is up-to-date in all other respects. You want to confirm that your assets are properly titled to implement your estate plan, your fiduciaries are still appropriate, beneficiary designations have been filed, and other provisions in your estate planning documents still reflect your goals.