



UPDATE Planning Pointers

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The Estate and Gift Tax Window of Opportunity Has Reopened—But Only for Two Years

After years of uncertainty about whether the federal estate tax repeal would survive, whether the 2009 rules would be extended, or whether the pre-2001 rules would be restored, Congress finally acted in late 2010, only to provide an entirely different set of rules. The Tax Relief, Unemployment Insurance Authorization, and Job Creation Act of 2010 (the Act), signed on December 17, 2010, clarifies the tax impact on gifts made in 2010 and on the estates of persons who died that year, while also changing the rules for 2011 and 2012. Unfortunately, the Act sunsets on December 31, 2012.

EXEMPTIONS AND RATES

For estates of decedents dying in 2010, 2011, and 2012, the federal estate tax is reinstated with an exemption of \$5,000,000. The exemption will be indexed for inflation in 2012. The rate of estate tax on assets over \$5,000,000 is 35 percent. (See below for special rules relating to estates of decedents who died in 2010.)

The federal gift tax exemption is raised from \$1,000,000 to \$5,000,000 for 2011

and 2012. The tax rate on taxable gifts in excess of \$5,000,000 is 35 percent.

The federal generation-skipping transfer (GST) tax exemption is raised to \$5,000,000. This exemption can be allocated to gifts made from January 1, 2010, through December 31, 2012. The GST tax rate for any transfer made in 2010 remains at 0 percent. As of January 1, 2011, a rate of 35 percent applies to transfers in excess of the GST exemption amount. Transfers to trusts in 2010 may be insulated from future GST tax liability.

SPECIAL RULES FOR 2010 ESTATES

The estate tax laws discussed above (\$5,000,000 exemption and 35 percent rate) apply to all estates of individuals who died in 2010. Executors may elect out of applying the new law to their estates and instead may apply the carryover basis rules in effect prior to passage of the Act.

In general, estates with taxable assets below \$5,000,000 should allow the new rules to apply. They will pay no estate tax,

and the assets will receive a full step-up in basis, thus eliminating all predeath capital gains.

Larger taxable estates, over \$5,000,000, might consider applying the former rules to avoid a 35 percent estate tax on assets in excess of \$5,000,000. Executors need to analyze a complex set of factors to determine if the former carryover basis rules will produce lower taxes than under the new estate tax rules. For estates of decedents who died prior to the Act, the time to file the necessary tax returns has been extended until September 17, 2011.

PORTABILITY

This new concept in estate tax law allows a surviving spouse to take advantage of the unused federal estate tax exemption of his or her deceased spouse. The executor of the first spouse to die must file an estate tax return and elect to transfer the unused exemption to the surviving spouse. As of now, "portability" is available only if both spouses die in 2011 and/or 2012. The GST tax exemption is not portable between spouses.



STATE TAX EXEMPTIONS AND RATES

Estates continue to be subject to separate state-based estate tax rules.

The Connecticut estate tax exemption is \$3,500,000, with a top tax rate of 12 percent. By comparison, Massachusetts and New York both have an exemption of \$1,000,000 and rates up to 17 percent.

Other states, such as Florida, have no estate tax.

PLANNING CONSIDERATIONS

With the adoption of a bold new federal transfer tax system, opportunities for planning should abound. Unfortunately, the fact that the law is in place for only two years creates as much uncertainty as ever. Though it is tempting to assume that the new law will be extended

beyond 2012, it may not be advisable to do so. These are unusual times, and efforts already are underway in Congress to repeal this law. Moreover, estate plans still must take into account state-based estate tax laws, which have lower exemptions and no portability of exemption between spouses.

In light of the foregoing considerations, the basic structure of most estate plans implemented in the past five years may remain appropriate. Most estate plans, however, should be reviewed. It is possible that those plans could be simplified or revised to add flexibility.

Also, the substantial increases in the federal gift and GST tax exemptions offer some significant tax planning

opportunities. Large gifts made now will insulate those assets from taxes in the event the law changes to a lower exemption amount.

Further, the Act reinstates the ability in 2010 and 2011 to direct mandatory distributions, up to \$100,000, from IRAs directly to a public charity. Any such distribution made from an IRA through January 31, 2011 can be treated as having been made in 2010.

We recommend consulting your estate tax advisor to evaluate whether any changes to your estate and/or gifting plans are appropriate at this time.

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