

2010 Tax Relief Act

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The estates of wealthy individuals who died in 2010 were not subject to federal estate tax, but that situation is about to change. As I am sure you are aware, Congress has passed and President Obama has signed into law an extension of 2010 tax rates. This legislation, known as the "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010" (also referred to as the "2010 Tax Relief Act"), restores the federal estate tax, **BUT only for a period of two (2) years - 2011 and 2012. During those two years, the estate tax rate is 35% and estates up to \$5 million are exempt from paying any tax (\$10 million for married couples).** If Congress does not act prior to December 31, 2012, on January 1, 2013, the federal estate tax will revert to what it was scheduled to be in 2011 – a 55% tax rate and a \$1 million exemption. *Accordingly, a good estate plan designed to incorporate any future changes to the estate tax in 2013 is essential.*

The 2010 Tax Relief Act makes several other significant changes to the wealth transfer taxes:

- ***The \$5 million estate tax exemption is "portable" between spouses.*** This means that if the first spouse to die fails to use all of his or her \$5 million exemption, then the surviving spouse can use it (in addition to his or her own \$5 million exemption) so that married couples can shield \$10 million of their total combined assets from federal estate taxes. However, in order to take advantage of this new tax provision, BOTH spouses must die after December 31, 2010 and before January 1, 2013 unless Congress makes further revisions to the estate tax in 2011 or 2012.
- ***The law unifies the federal estate and gift tax exemptions at \$5 million.*** Under the new law, the \$5 million estate tax exemption will also be available for lifetime gifts. This high exemption level (along with the GST exemption discussed below) means that there is now a two-year window in 2011 and 2012 in which to shield large amounts of wealth from taxation for generations. There is **no change** in the \$13,000 exclusion for annual gifts.
- ***The exemption from the generation-skipping tax (GST) – the additional tax on gifts and bequests to grandchildren and lower generations (great grandchildren, etc.) when their parents are still alive – will also rise to \$5 million*** from the \$1 million it would have been without the new law.
- ***The new law also gives heirs of decedents who died in 2010 a choice of which estate tax rules to apply – 2010's or 2011's.*** That's important because although there is no estate tax in 2010, some inherited assets are subject to capital gains tax under the 2010 rules, a situation that actually raises the tax burden for some heirs. Inherited assets under the 2010 rules have a tax basis equal to the price at which they were purchased by the deceased individual (referred to in tax parlance as "carryover basis") - with some modifications. Under the 2011 rules, by contrast, heirs will be allowed to inherit assets with a "stepped-up basis" (increased basis to the asset value as of the deceased individual's date of death).