

Temporary changes in federal estate and gift tax rules



Jeffrey Williamson
*Estate Planning,
Elder Law,
Taxation Expert*

The recently enacted Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "2010 Tax Relief Act") provides only temporary relief from federal transfer taxation. Among other changes, it reduces estate, gift, and generation-skipping transfer (GST) taxes for 2011 and 2012. It preserves estate tax repeal for 2010, but estates wanting zero estate tax for 2010 must elect that option, along with the less favorable modified carryover basis rules that were set to apply for 2010. Otherwise, by default, the estate tax is revived for 2010, with a \$5 million exemption, a top tax rate of 35%, and a step-up in basis. Also, for estates of decedents dying after December 31, 2010, a deceased spouse's unused exemption may be shifted to the surviving spouse.

For estates of individuals dying in 2009, the top estate tax rate was 45% and there was a \$3.5 million exemption. The top rate was scheduled to rise to 55% for estates of individuals dying after 2010, and the exemption was to be only \$1 million. For 2011 and 2012, the 2010 Tax Relief Act reduces the top rate to 35% and increases the exemption to \$5 million for 2011 with a further increase for inflation in 2012. But these changes are

temporary. Absent further legislation, the top rate will increase to 55%, and the exemption will drop to \$1 million beginning in 2013.

The 2010 Tax Relief Act allows estates of decedents who died in 2010 to choose between estate tax (based on a \$5 million exemption and 35% top rate) and a step-up in basis, or no estate tax and modified carryover basis. You may wonder what the difference is between carryover and step-up basis, and why it is so important. With a step-up in basis, pre-death gain is eliminated because the basis in the heir's hands is increased to the date of death value of the asset. On the other hand, with a modified carryover basis, an heir gets the decedent's original basis, although certain increases are allowed. So, if the decedent had a relatively low basis and significant assets (such as many acres of farmland acquired decades ago) some pre-death gain may be taxed when the heir sells the property. Such concerns factor into the special choice for 2010. The executor should make whichever choice would

produce the lowest combined estate and income taxes for the estate and its beneficiaries. This would depend, among other factors, on the decedent's basis in the assets immediately before death and how soon the estate beneficiaries may sell the assets.

Years ago, the gift tax and the estate tax were unified — i.e., they shared a single exemption and were subject to the same rates. This has not been the case in recent years. For example, in 2009, the estate tax exemption was 3.5 million, but the gift tax exemption was \$1 million. For gifts made after December 31, 2010, the gift tax and estate tax are reunified and an overall \$5 million exemption applies.

Another feature of the new law is portability of the exemption. Under the 2010 Tax Relief Act, any exemption that remains unused as of the death of a spouse who dies after December 31, 2010, and before January 1, 2013, is generally available for use by the surviving spouse in addition to his or her own \$5 million exemption for taxable transfers made during life or at death. Under prior law, the exemption of the first spouse to die would be lost if not used. This could happen where the spouse with resources below the exemption amount died before the richer spouse.

One way to address that was to set up a trust for the poorer spouse. Now, the portability rule may make setting up a trust unnecessary in some cases, but there still may be other reasons to employ credit shelter trusts. For example, a credit shelter trust may protect appreciation occurring between the death of the first spouse and the death of the second spouse from being subject to estate tax. Such a trust also can protect against creditors. Additionally, the transferred exemption may be lost if the surviving spouse remarries and is again widowed.

The most important point the reader should remember is that estate tax relief in the new law is substantial but temporary. Much harsher rules are slated to return after 2012. Estate planning to reduce taxes remains an important consideration. Even if taxes are not a concern because an estate is below the exemption level, it is important to have a proper estate plan to ensure that the needs of intended beneficiaries are met.

Jeffrey Williamson is the founding partner of J. L. Williamson Law Group, LLC. He may be contacted via phone at 912-489-5573 or via email at jlw@jhlwlawgroup.com.