Estate Tax Law Update

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December 21, 2010

Federal Estate Tax Reinstated at New Exemption Levels

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As a result of an eleventh-hour compromise between President Obama and Congressional Republicans regarding the Bush Tax Cuts, the federal Estate Tax will continue for years 2010 through 2012, with a new exemption amount and a new top tax rate. Additionally, the federal Gift Tax and GST Tax will be reunified with the Estate Tax after 2010.

Background to New Estate Tax Levels The Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") repealed the federal Estate Tax (the "Estate Tax") and the less discussed federal Generation-Skipping Transfer Tax (the "GST Tax") for calendar year 2010. EGTRRA also replaced the income tax basis rules with respect to the assets of decedents dying in 2010. For 2010 decedents the "stepped-up basis" rules (which provided that the basis of assets received from a decedent was the value of such assets on the date of the decedent's death) were replaced with modified "carryover basis" rules (which provide that, subject to certain adjustments, the basis of such assets is the adjusted basis of the assets in the hands of the decedent at the time of death).

Under the sunset provisions of EGTRRA, both the Estate Tax and the GST Tax were to have been reinstated automatically on January 1, 2011, at their 2001 levels ($1 million exemption and top tax rate of 55%). Furthermore, the income tax basis rules were to have reverted automatically to the "stepped-up basis" regime for decedents dying on January 1, 2011 or later.

In early December President Obama and Congressional Republicans reached a compromise regarding the broader "Bush Tax Cuts," which included reinstating the Estate Tax and the GST Tax effective immediately at new levels ($5 million applicable exclusion amount and 35% maximum tax rate). Despite significant objections from House Democrats, the United States Congress passed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the “2010 Tax Relief Act”), which President Obama signed on December 17, 2010.

The provisions of the 2010 Tax Relief Act relating to Estate, GST, and Gift Taxes are applicable for only two years. After that time the sunset provisions of EGTRRA will apply. Consequently, a renewed discussion of the Estate Tax and GST Tax prior to 2013 is virtually guaranteed.

Significant Estate, Gift, and GST Tax Features of the 2010 Tax Relief Act The 2010 Tax Relief Act reinstates provisions of the prior transfer tax laws and integrates new provisions intended to deal specifically with the extraordinary circumstance of decedents who died in 2010. Additional provisions are included in the 2010 Tax Relief Act that provide taxpayers with previously unavailable benefits, at least until December 31, 2012.

The major provisions of the 2010 Tax Relief Act are as follows:

For Decedents Who Have Died in 2010

- The Estate Tax is reinstated retroactively to estates of decedents dying during 2010. However, these estates may elect not to be subject to estate tax, as described below.
- If estates don’t elect out of the Estate Tax, the exclusion from Estate Tax in 2010 is $5 million, and the maximum tax rate is 35%.
- The modified "carryover basis" rules do not apply to the estates of decedents dying in 2010. Thus assets acquired from a decedent who died in 2010 will receive an income tax basis equal to the date of death value of the assets.
- Notwithstanding the foregoing, in the case of a death in 2010, the executor may elect out of the 2010 Tax Relief Act. There would therefore be no estate tax on the decedent’s estate, but the estate would be subject to the “carryover basis” rules. In

exercising this option, the executor will need to evaluate the size of the decedent’s estate and the adjusted basis of the estate's assets.

Other 2010 Transfers

- The Gift Tax exclusion for gifts made in 2010 remains at $1 million with a 35% tax rate.
- The GST Tax is reinstated retroactively to transfers made during 2010. The exclusion amount for generation-skipping transfers made in 2010 is $5 million; however, the GST Tax rate for transfers made directly to grandchildren in 2010 only is zero. Thus no GST Tax is due with respect to such transfers. ***This provides individuals with unique GST Tax gift planning opportunities before January 1, 2011.*** However, such transfers may be subject to a 35% gift tax, and, further, will be subject to GST Tax when assets are passed from grandchild to lower generations, so there is a cost to this opportunity.

The 2011-2012 Rules

- The Estate Tax exclusion amount for deaths occurring in 2011 and 2012 is $5 million per person, and the maximum Estate Tax rate is 35%.
- During these two years the exclusion amount for the Gift Tax is unified with the exclusion amount for the Estate Tax at $5 million per person and the tax rate in excess of that amount is 35%.
- Also during these two years the GST Tax exclusion for generation-skipping transfers is $5 million per person, and the tax rate for transfers in excess of that amount is 35%.
- The exclusion amount of $5 million for each of the Estate Tax, GST Tax, and Gift Tax will be indexed for inflation after 2011.

These new rules provide significant planning opportunities for 2011 and 2012.

- **"Portability."** A new concept introduced by the 2010 Tax Relief Act allows for the portability of the Estate Tax exclusion amount between spouses (thus truly providing for a combined Estate Tax exclusion amount of $10 million for a couple).
- If a spouse (the "deceased spouse") dies during 2011 or 2012, any portion of the deceased spouse's Estate Tax exclusion amount remaining unused by the deceased spouse's estate may be used by the surviving spouse in addition to the surviving spouse's own exclusion amount.
- To take advantage of this portability, the executor of the decedent's estate must make an irrevocable election on a timely filed Estate Tax return (regardless of whether the value of the estate of the deceased spouse is such that the filing of an estate tax return otherwise would not be required).
- The portability rules, however, contain significant restrictions that make them less effective than using a traditional Bypass Trust to pass a deceased spouse's exemption amount to his surviving spouse.
- Unlike the Estate Tax exclusion amount, the GST Tax exclusion amount is not portable.

Extended Due Dates*.* For decedents dying between January 1 and December 17, 2010 (the date of enactment of the 2010 Tax Relief Act), the due date for (1) filing an Estate Tax return, (2) paying the Estate Tax, and (3) making a disclaimer of an interest in property passing by reason of a decedent's death is not earlier than nine months after December 17, 2010. Corresponding deadline rules apply with respect to generation-skipping transfers made between January 1 and December 17, 2010. For decedents dying, and transfers made, after December 17, 2010, the usual deadlines and rules for filing tax returns, paying taxes due, and making disclaimers applies (generally speaking, nine months from the death or transfer).

Sunset. The provisions of the 2010 Tax Relief Act are subject to the sunset provisions of EGTRRA. Consequently, without further legislation, as of January 1, 2013, the Estate and Gift Tax exemption will be a cumulative $1 million per person, and the GST Tax exemption will also be a cumulative $1 million per person. Amounts transferred in excess of these exemption amounts will be subject to a top tax rate of 55%.

Conclusion The new Gift Tax and GST Tax exemptions of $5 million per person, combined with a tax rate of only 35% over those amounts, provides significant planning opportunities in 2011 and 2012. In addition, there is a one-time-only opportunity during the remainder of 2010 for grandparents to make gifts to grandchildren free of GST Tax without using up their new $5 million GST Tax exemption, although this opportunity is subject to the caveats described above.

Just as when EGTRRA was enacted in 2001, there remains considerable uncertainty about the future of the Estate Tax. It is unclear whether the two sides of the congressional aisle will be able to agree upon a permanent Estate Tax regime prior to 2013, when the Estate, Gift, and GST Tax exemptions will revert to 2001 levels. Further complicating the analysis are the economic and political ambiguities that face the nation. The economic forecast is unclear, it is unknown whether deficit-reduction efforts will be a priority two years from now, and 2012 is a presidential election year. Given the significant level of uncertainty, we advise you to consult your professional advisors about the planning opportunities during 2011 and 2012 created by the 2010 Tax Relief Act.