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ESTATE, GIFT AND GST TAX RELIEF IN THE 2010 ACT

This Dean Mead e-Alert provides you with important information about new legislation enacted: the *Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010*.

In a historic move, President Obama today signed into law the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (the "2010 Act"). The provisions concerning the Estate, Gift, and Generation-Skipping Transfer taxes are addressed and summarized herein.

ESTATE TAX

The Federal estate tax has been a source of much uncertainty throughout 2010 and in the years preceding due to the Economic Growth Tax Relief Reconciliation Action of 2001 ("EGTRRA"). EGTRRA provided for the estate tax exemption amount to increase and the estate tax rate to decrease from 2001 to 2009, culminating in a one year estate tax repeal for decedents dying in 2010. Under EGTRRA, the entire 2001 Act was scheduled to sunset on December 31, 2010 and the preexisting law would return for years 2011 and thereafter, resulting in an estate tax exemption amount of \$1,000,000 and a top estate tax rate of 55% in 2011! No one wanted the estate tax to go back to the pre-2001 levels but Congress fought for years about how to "permanently" reform the transfer tax rules. Further, there were proposals throughout the year for "retroactive" estate tax for decedents dying in 2010.

The 2010 Act gives us new rules for 2010, 2011 and 2012, after which the Estate, Gift and Generation-Skipping Transfer Tax laws will once again revert to pre-2001 levels unless Congress acts before then. Under the 2010 Act, the estate tax exemption amount is increased to \$5,000,000 for 2010 and 2011 and the top estate tax rate is 35%. Beginning in 2012, the estate tax exemption amount will be \$5,000,000 indexed for inflation since 2010 and the rate will remain at 35%. Further, the basis of assets included in a decedent's estates will receive a "step up" in basis equal to their value on date of death, as has traditionally been the case.

DECEDENTS DYING IN 2010

Under EGTRRA, there was no estate tax for decedents dying in 2010, and there was a change in the way the basis of assets received from a decedent was determined for income tax purposes. Before 2010, most assets in a decedent's estate received a "step up" in basis equal to their value on date of death. For 2010, the decedent's basis would be carried over with certain adjustments of up to \$4,300,000 as allocated by the decedent's personal representative (frequently referred to as "carryover basis"). So, under EGTRRA, there was no estate tax for decedents dying in 2010, but inherited assets received a carryover basis for income tax purposes.

Under the 2010 Act, estates of decedents dying in 2010 have an option to apply the law under EGTRRA (no estate tax but carryover basis) OR the law under the 2010 Act, which is estate tax with a \$5,000,000 estate tax exemption and a step up in basis of assets for income tax purposes. Therefore, for estates of decedents dying in 2010, an analysis will need to be made to determine which regime will afford the best results. Generally, if an estate is less than \$5,000,000, the 2010 Act will be preferable because the \$5,000,000 estate tax exemption will encompass the entire estate resulting in no estate tax and a step up in basis for income tax purposes. On the other hand, if the value of an estate of an individual dying in 2010 is over \$5,000,000, an analysis will need to be done to determine whether it is better to pay some estate tax in order to get a step up in basis or whether it is better to avoid paying estate tax and subjecting the assets to a carryover basis regime.

GIFT TAX

Under EGTRRA, the gift tax exemption was increased to \$1,000,000 for all years, which allowed individuals to gift up to \$1,000,000 during their lifetime in addition to any annual exclusion gifts (currently \$13,000 per donee, per year) without paying any gift tax. The 2010 Act has reunified the gift tax and the estate tax exemption amounts beginning in 2011. Thus, the lifetime gift tax exemption amount for 2011 will be \$5,000,000 and the maximum gift tax rate will be 35%. Additionally in 2012, the gift tax exemption will be subject to adjustment to account for inflation and the maximum rate will be 35%. The gift tax exemption amount is a cumulative amount that allows an individual to make gifts up to that amount over his or her lifetime. Thus, for an individual who has previously used his or her entire \$1,000,000 lifetime gift tax exemption, an additional gift of up to \$4,000,000 can be made without gift tax beginning in 2011.

Planning Point: Because the 2010 Act expires at the end of 2012, individuals might choose to make gifts in 2011 or 2012 of up to \$5,000,000 in order to lock in those exemptions. In 2013, unless Congress acts, the Gift Tax exemption will go back to \$1,000,000 per person, but if gifts have previously been made, those gifts will be grandfathered.

GENERATION-SKIPPING TRANSFER TAX

The 2010 Act makes several significant changes to the Generation-Skipping Transfer Tax (the “GST Tax”), which taxes gifts and bequests that skip the child’s generation. These changes affect generation-skipping transfers made in 2011 and 2012, and also cover such transfers made in 2010, both before and after the enactment of the 2010 Act.

The GST Tax which was repealed under EGTRRA along with the estate tax is restored for 2010 under the 2010 Act. To avoid any issues with the retroactive application of the GST Tax, the 2010 Act provides that GST Tax rate is zero for generation-skipping transfers made after December 31, 2009 and before January 1, 2011. Therefore, no GST Tax will be incurred on a generation-skipping transfer made in 2010.

For the years 2011 and 2012, the GST Tax rate is equal to the maximum Federal estate tax rate, and, therefore, is a flat 35%.

There is an exemption (the “GST Exemption”) that an individual can allocate to the individual’s generation-skipping transfers to avoid incurring the GST Tax. The GST Exemption is tied to the exemption against the estate tax. Because the estate tax exemption was increased to \$5,000,000 for 2010, the GST exemption is also \$5,000,000 in 2010, and continues at that level for 2011 and 2012.

Planning Points

❖ The significant change under the 2010 Act concerns gifts made in trust for grandchildren or more remote descendants. Since January 1, 2010, gifts to grandchildren and more remote descendants could be made free of GST Tax, but such gifts could not be made in trust without risking the application of GST Tax to future distributions from the trust. The 2010 Act now allows for generation-skipping gifts to be made in trust because future trust distributions will not be subject to GST Tax provided they are made to individuals at the same generation level as the oldest beneficiary. For example, a gift can be made to a trust for a grandchild without incurring GST Tax. Also, distributions from the trust to the grandchild will not be subject to GST Tax. Only upon the death of the grandchild (or a distribution to a great-grandchild) will GST Tax be incurred. Therefore, in 2010 and only in 2010, an individual can establish a trust for a grandchild (or more remote descendant) without utilizing the individual’s GST Exemption¹ and without incurring GST Tax.

❖ Under the 2010 Act, the GST Exemption, which has been increased to \$5,000,000, may now be allocated to generation-skipping transfers made in 2010. Individuals may therefore make gifts to generation-skipping trusts in 2010 and allocate the GST Exemption provided to them.

¹ Note that the taxpayer must opt out of the allocation of GST Exemption to such gifts on a gift tax return.

❖ Individuals can also make generation-skipping gifts outright and free of trust to grandchildren or more remote descendants without incurring GST Tax in 2010.

❖ If there is a trust which has not been exempted from the GST Tax (a “GST Non-Exempt Trust”), distributions from a GST Non-Exempt Trust to a grandchild or more remote descendant will be free of GST Tax if distributed in 2010.

❖ The GST Exemption has been increased to \$5,000,000 in 2010, but the gift tax exemption remains at \$1,000,000 in 2010. Therefore, most individuals will probably utilize the additional GST Exemption in 2011 when their gift tax exemptions also increase to \$5,000,000.

2010 Act

Chart of Exemptions and Rates

	Estate Tax Exemption / Rate	Gift Tax Exemption / Rate	GST Exemption / Rate
2010*	\$5,000,000 / 35%	\$1,000,000 / 35%	\$5,000,000 / 0%
2011	\$5,000,000 / 35%	\$5,000,000 / 35%	\$5,000,000 / 35%
2012	\$5,000,000 Indexed for inflation since 2010 / 35%	\$5,000,000 Indexed for inflation since 2010 / 35%	\$5,000,000 Indexed for inflation since 2010 / 35%
2013**	\$1,000,000 / 55%	\$1,000,000 / 55%	\$1,000,000 Indexed for inflation since 2001 / 55%

* Subject to option to be exempt from estate tax with carryover basis for income tax purposes.

** Subject to Congressional change.

ADDITIONAL PROVISIONS:

Portability: In addition to the exemption and rate changes, the 2010 Act contains a new concept called “portability”. In the past, estate and gift tax exemptions were personal to individuals and thus were lost if someone died without utilizing his or her estate or gift tax exemption. Portability, however, would allow a decedent to pass his or

her unused estate tax or gift tax exemption to a surviving spouse. As an illustration if a husband dies in 2011 utilizing only \$3,000,000 of his \$5,000,000 estate tax exemption, the surviving wife will then have \$7,000,000 of total exemption, consisting of \$5,000,000 of her own exemption and the \$2,000,000 of her deceased husband's unused exemption. The wife can utilize this exemption to make gifts or to pass assets at the wife's death without paying tax. Portability must be affirmatively elected or it is lost. This election must be made on an estate tax return when the first spouse dies. This is a very important development and will allow for a lot of flexibility in planning. However it should be noted that the GST Exemption is not portable. Thus, if it is desired to create trusts for children and grandchildren, planning must be done upon the first spouse's death in order to utilize the GST Exemptions of both spouses.

Returns: For individuals dying during 2010 before the passage of the 2010 Act, there are a few important deadline extensions relating to tax returns for the 2010 year. All due dates for disclaiming interests in property by reason of death, paying estate tax and filing estate tax returns have been extended and are due nine months after the date of enactment (December 17, 2010).

CONCLUSION

The 2010 Act provides significant tax relief and eliminates many uncertainties for the coming two years. It also resolves many complications created by the 2010 sunset of EGTRRA. There are significant planning opportunities available through 2012 which many individuals may want to take advantage of.

If you would like to discuss this further with the attorneys of the Dean Mead Estate Planning and Succession Department, we are familiar with all aspects of the estate gift and generation-skipping tax changes adopted by this bill and are able to discuss the application of these changes with you.

A link to the Web page about Dean Mead's Estate and Succession Planning department is provided here:

<http://www.deanmead.com/PracticeAreas/EstatePlanning.asp>