



## **ESTATE PLANNING FOR 2011 AND 2012 AND ESTATES OF DECEDENTS DYING IN 2010, 2011 OR 2012**

On December 17, President Obama signed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. Although the primary feature of this legislation is a two-year extension of the Bush-era income tax cuts, the Act also addresses the repeal of the estate tax for 2010 and its reinstatement in 2011. The legislation reenacts the estate tax for 2010 (but grants an option to elect back into the repeal) and provides generous estate and gift tax exemptions and rates for 2011 and 2012. The Act is only a temporary measure - in 2013, the pre-2001 estate and gift tax provisions will return, with the potential to impose a much greater tax burden on estates and gifts unless there is further action in Washington. Following is a summary of the provisions of the new Act, with a discussion of the opportunities and pitfalls that it presents for your personal estate planning.

- For 2011 and 2012, the estate, gift and generation skipping tax exemption is \$5 million and the rate is 35% (subject to indexing for inflation after 2011).
- After 2012, the exemption will revert to pre-2001 levels without further action by Congress and the President.
- The estate tax exemption is "portable," meaning that, subject to certain requirements and limitations, a surviving spouse receives the amount of the deceased spouse's unused exemption without the need for a trust.
- The "stepped up" basis rules are restored, meaning that, subject to certain exceptions (such as retirement accounts), the tax basis of assets held at death is equal to the then fair market value, reducing or eliminating capital gains.
- Transfers to U.S. citizen spouses continue to be free of gift or estate tax.
- The gift tax annual exclusion remains at \$13,000.
- The Act only applies to federal taxes. The Connecticut gift and estate tax exemption remains at \$3.5 million. New York has no gift tax, but has only a \$1M estate tax exemption. State gift and estate tax exemptions are not portable.

### Estate and Gift Taxes in 2011 and 2012

For decedents dying in 2011 and 2012, the Act greatly reduces the reach of the estate tax by granting estates a \$5 million exemption for property subject to the tax. In 2009, the last year in which there was an estate tax, the exemption was \$3.5 million, so this is a significant increase. In addition, the Act introduces the concept of exemption "portability" between spouses - if one spouse does not use all of his or her \$5 million

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exemption and dies in 2011 or 2012 (and if his or her executor elects portability on a timely filed estate tax return), then the unused exemption may be used by the surviving spouse during life or at death (subject to some conditions and limitations), effectively creating a \$10 million exemption for married couples without the need for any planning with credit shelter trusts or equalizing of assets between spouses. Estates that exceed this \$5/\$10 million threshold will be subject to a new 35% tax rate, considerably lower than the 45% rate that prevailed before 2010.

Gift taxes are also lighter. Since 2001, taxpayers have had only a \$1 million lifetime exemption for gift tax purposes. That exemption is increased to \$5 million for gifts made in 2011 and 2012, and the tax rate on 2011 and 2012 gifts in excess of that amount is 35%.

Congress has indexed the \$5 million gift and estate tax exemptions for inflation starting in 2012. However, in 2013, estate and gift taxes will revert to a \$1.0 million exemption and a 55% tax rate unless Congress passes legislation otherwise.

#### Estates of Decedents Dying in 2010

The 2001 Bush era legislation had repealed the estate tax for persons dying in 2010, but it also imposed a modified carryover basis regime so that for some estates, there was the potential for increased capital gains taxes. Before 2010, most inherited property had received a full basis step-up at death.

Congress has now repealed carryover basis and reinstated the estate tax for 2010, but with the \$5 million exemption and 35% tax rate that are also available in 2011 and 2012. The new law also provides that estates of persons dying in 2010 can elect out of the estate tax, provided that they accept the carryover basis regime. In most cases, it will make sense to accept the estate tax.

#### Generation-Skipping Transfer Tax

The Act makes a number of changes to the generation-skipping transfer (GST) tax, which, to simplify things a bit, is an additional tax imposed on gifts and bequests to grandchildren and great-grandchildren. The 2001 legislation repealed the GST tax for 2010 only. The Act provides that the GST tax was in effect in 2010, but with a 0% tax rate. This means that any generation-skipping transfers that occurred in 2010 were tax-free, but there is now more clarity as to the effect of such transfers in future years. In 2011 and future years, the GST exemption and tax rates are the same as the estate tax exemption and tax rates.

#### Planning

Where does all of this leave your estate plan? In most cases, your documents will work without any changes. However, if the amount passing to a beneficiary (usually the credit shelter trust) was based on the federal exemption amount (and if there is no language limiting the amount to the Connecticut exemption), then the amount passing to that beneficiary will be much higher in 2011 and 2012, and the amount passing to the other beneficiaries will be lower. In addition, if the federal exemption amount passes to a

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beneficiary other than to a spouse or to a trust that would qualify for the marital deduction, then there would be Connecticut estate tax due if you died in 2011 or 2012 (approximately \$122,000 if the federal exemption is \$5 million and the Connecticut exemption is \$3.5 million. For New York residents, New York estate tax would be approximately \$392,000 since the exemption is only \$1 million).

The new law presents opportunities for gifting in 2011 and 2012 because the gift tax exemption will be \$5 million (less any exemption used) plus, if applicable, any exemption from your deceased spouse. Now is also an especially good time to make gifts since some asset values are depressed and Congress has not enacted President Obama's proposals to limit some advantageous gift techniques. Keep in mind that gifts are subject to carryover basis unlike assets transferred at death. Also, gifts over \$3.5 million (including prior gifts) will be subject to Connecticut gift tax (same rates as the Connecticut estate tax). Gifting is especially advantageous for New York residents (or those who wish to gift New York real estate) because there is no state gift tax, and the gifts are not taxed at death. A New York resident who gifts \$5 million in 2011 or 2012 instead of retaining this property until his death will save approximately \$392,000 in New York estate tax (as New York law presently stands). If the federal estate tax exemption goes down and the donor dies after 2012, estate taxes may be due since taxable gifts are brought back into the estate.

Even with portability, there are reasons to continue using credit trusts: (i) the trust shelters from estate tax the appreciation in value between the first and second spouse's death (although such appreciation would not receive a step-up in basis); (ii) portability does not apply to state estate taxes - a trust will shelter assets from state estate taxes otherwise payable on the second spouse's death; (iii) portability does not apply to the GST exemption, so any amounts passing to grandchildren in excess of the \$5 million exemption would not be sheltered from the GST tax; (iv) portability is in place only through 2012 (unless Congress extends it); (v) there are non-tax reasons for using trusts, such as protecting assets from future creditors, providing management for the surviving spouse, and protecting assets for children in case the surviving spouse remarries; and (vi) since portability is between you and your last deceased spouse, it will not apply if you remarry and your second spouse also predeceases you. If you have a trust only for saving estate tax and want to give your spouse flexibility, you can leave your assets to your spouse and give your spouse the right to "disclaim" those assets within nine months of your death so that they pass into a trust. (This option has certain restrictions which we can explain in more detail.)

Congress will revisit the estate, gift and GST taxes in late 2012, and we cannot predict what action it will take at that time. Nevertheless, many of you have been reluctant to do any estate planning in light of the legislative uncertainty and the possibility of estate tax repeal. Now that we know that the estate tax will be with us, the time is ripe to do the planning that you have been putting off. We would be glad to discuss your options.



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