

New Estate Tax Law Impacts Estate, Gift and Generation-Skipping Transfer Taxes

On December 17, merely two weeks before the federal estate tax was scheduled to be reinstated with a \$1,000,000 exemption and a 55% tax rate, President Obama signed sweeping new estate tax legislation into law. This new law has a deep impact on estate, gift and generation-skipping transfer taxes and tax planning. This is the first in a series of E-Alerts that addresses how this new law impacts you.

Most notably, the new law increases the estate, gift and generation-skipping transfer tax exemptions.

- The estate tax exemption is increased to \$5,000,000 for decedents who die in 2010, 2011 and 2012. The new law gives the executors of the decedents who died in 2010 an option to administer the estate for federal tax purposes under the new law, or under the prior tax regime. Such a decision can have a dramatic impact on both estate tax liability as well as future income tax liabilities, and all options and consequences should be carefully analyzed prior to any decisions being made.
- The generation-skipping transfer tax is likewise increased to \$5,000,000 for generation-skipping transfers made in those three calendar years.
- The lifetime gift tax exemption remains \$1,000,000 for 2010, but will be once again unified with the estate tax exemption at \$5,000,000 for lifetime gifts made in 2011 and 2012. It is important to note that this increase in the gift tax exemption in 2011 means that any individual who is planning on making substantial taxable gifts in excess of \$1,000,000, resulting in a gift tax, would generally be better served waiting until he or she can take advantage of the larger exemption in 2011.
- Of equal importance, the estate, gift and generation-skipping transfer tax rate will be 35% of assets transferred in excess of

the exemption amount in 2010, 2011 and 2012, with one notable exception – the generation-skipping transfer tax rate remains 0% for transfers in 2010 in excess of \$5,000,000.

	2010	2011	2012	2013
Estate Tax Exemption*	\$5,000,000	\$5,000,000	\$5,000,000**	\$1,000,000
Gift Tax Exemption	\$1,000,000	\$5,000,000	\$5,000,000**	\$1,000,000
GST Tax Exemption	\$5,000,000	\$5,000,000	\$5,000,000**	\$1,000,000**
Estate Tax Rate*	35%	35%	35%	55%
Gift Tax Rate	35%	35%	35%	55%
GST Tax Rate	0%	35%	35%	55%

* Executors of decedents who died in 2010 may elect to treat the estate under the new law or prior law

**Subject to inflationary increases

The new tax law introduces a new concept which practitioners and legislators have discussed in the past, but until now was never incorporated into tax law. The new law allows “portability” of a decedent’s unused estate and gift tax exemption to a surviving spouse. This means that the executor of the first spouse to die may elect to add any unused estate and gift tax exemption to the surviving spouse’s exemption, for use toward transfers made by the surviving spouse. While this portability provision may at first blush appear as a viable replacement for planning with the so-called “by-pass trust”, it may be better viewed as a tool for postmortem planning. First, placing the amount which the first spouse may transfer free of estate tax into a by-pass trust (also called credit shelter, family or residuary trust), rather than transferring it outright to the surviving spouse with the portable exemption, shelters not only the principal amount from taxation in the survivor’s estate, but also all of the future growth in the

by-pass trust. Second, while minimizing estate taxes is often a primary goal of many clients, there are other non-tax reasons to utilize a by-pass trust to retain assets, such as protection of those assets upon remarriage or incapacity of the surviving spouse. Third, many states, including Massachusetts and Rhode Island, do not follow the new federal tax law, and allow relatively modest exemptions (\$1,000,000 for a Massachusetts decedent, \$850,000 for a 2010 Rhode Island decedent, and \$859,350 for a 2011 Rhode Island decedent). Planning with by-pass trusts allows for full shelter of the state exemption amount in the survivor's estate. Finally, the newly enacted portability provisions do not apply to the generation-skipping transfer tax exemption. Therefore, married individuals who wish to pass the maximum amount of their assets to grandchildren free of generation-skipping transfer taxes are best served doing so through the use of a by-pass trust.

The law is scheduled to sunset in 2012, at which time the amounts and rates which were initially scheduled to come back in 2011 - \$1,000,000 estate, gift and generation-skipping transfer tax exemption and a 55% tax rate - will return. Therefore, any aggressive gift tax planning should be contemplated over the next 2 years.

The Probate, Trust and Personal Planning Group at Partridge Snow & Hahn LLP is dedicated to fully informing you on the impact of this important legislation. We will continue to analyze these and other issues, and are always available for a consultation to discuss how these issues impact your personal situation.

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