

Practice in focus

Estate Tax Changes—a Planning Opportunity

On December 17, 2010, President Obama signed the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (the "Act"). The Act significantly changes the federal estate tax and grants unprecedented estate planning opportunities. The new law is temporary, however, as the changes made by the Act expire on December 31, 2012.

Temporary Estate Tax Relief. Before the passage of the Act, the federal estate tax exemption – the amount that an individual can pass to his or her beneficiaries tax-free – increased in steps from \$675,000 per individual in 2001 to, ultimately, \$3.5 million per individual in 2009. In 2010, the federal estate tax was eliminated. Under prior law, the federal estate tax was scheduled to return in 2011 with a maximum tax rate of 55 percent and a \$1 million exemption, meaning any amount of a decedent's estate in excess of \$1 million would be taxed at a 55% rate.

Now, with the passage of the Act, the federal estate tax returns in 2011, but with a significantly higher exemption amount of **\$5 million**, and a lower maximum tax rate of **35 percent**. Absent Congressional



action, the 55 percent maximum estate tax rate and the \$1 million exemption will be reinstated on January 1, 2013.

"Reunification" of Exemptions and Increased Gift Tax Exemption. In a change that offers a tremendous estate planning opportunity, the Act provides for the "reunification" of the estate and gift tax exemption for individuals at **\$5 million**. The prior law provided each individual with a \$1 million lifetime gift tax exemption and a \$3.5 million estate tax exemption at death. The \$3.5 million estate tax exemption was reduced by any lifetime gifts that an individual made up to the \$1 million gift tax exemption, meaning that if you made \$1 million worth of lifetime gifts, you would only

have a \$2.5 million estate tax exemption available upon your death.

Reunification means that individuals may now make lifetime gifts and transfers on death totaling \$5 million in value without incurring gift or estate taxes. Therefore, individuals can make lifetime gifts up to \$5 million without paying a gift tax. To the extent the \$5 million gift tax exemption is not used during an individual's lifetime, it will be available at death to offset any estate tax liability. A married couple, by combining their exemptions, can make gifts of up to **\$10 million** without paying a gift tax. Thus, for the next two years, the Act grants taxpayers with larger estates an unprecedented opportunity to move substantial amounts of wealth out of their estates tax-free.

"Portability" of Estate Tax Exemption. Possibly the most unique feature of the new law is that it provides for "portability" of the gift and estate tax exemption between spouses. Under prior law, each spouse had a gift and estate tax exemption that was lost if it was not used at his or her death. In contrast, under the Act, any exemption amount that re-

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mains unused upon the death of the first spouse may be added to the exemption available to the surviving spouse. This provision is intended to avoid the need for sophisticated trusts in estate planning documents. Nonetheless, there are still good reasons to establish such a trust at the first spouse's death.

One reason to establish such a trust is that "portability" does not apply to the New Jersey estate tax, which taxes individual estates in excess of \$675,000. Therefore, for married couples who reside in New Jersey, credit shelter trusts and similar planning techniques are still prudent to preserve the New Jersey estate tax exemption of the first spouse to die. Otherwise, this credit is unavailable to the surviving spouse. In other words, establishing a \$675,000 trust on the first spouse's death ensures that both credits (\$1,350,000) can pass free of New Jersey estate taxes.

Another reason to establish the trust on the first spouse's death is to ensure that the surviving spouse cannot change the agreed upon testamentary disposition. In other words, such a trust may be used to protect an inheritance for children of the marriage in case the surviving spouse remarries.

Finally, there is always the possibility that the law may change, and "portability" could be revoked. Having



the trust in place should avoid this risk.

The Act constitutes a significant change to the current law and will likely impact most taxpayers. As discussed above, certain aspects of the law could especially impact the estate plans of married couples and the choices of those considering large lifetime transfers.

Please do not hesitate to contact us with any questions that you might have or if you would like to discuss your estate plan in light of the Act.

Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (the "Act")

Passed by the United States Congress
on December 16, 2010.

Signed into law by President Barack
Obama on December 17, 2010.

The "Act" is a two-year reprieve from the sunset provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and the Jobs Growth Tax Relief Reconciliation Act of 2003 (JGTRRA), together known as the "Bush tax cuts."

Taxation/Trusts & Estates

We can represent you with respect to your estate planning needs, as well as tax and business planning, including the transfer of businesses to family members, tax exempt organizations, (including charitable trusts and private foundations) and tax controversies with the Internal Revenue Service.

If you have a problem or question related to New Jersey or federal tax laws, contact Einhorn Harris today.

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Gary Botwinick chairs the firm's Taxation/Trusts & Estates Department. He joined the firm in 1998, becoming Partner in 2001. His career began in the IRS Manhattan District Counsel Office, where he tried civil cases before the U.S. Tax Court. Subscribe to and read Gary's Blog, "Estate Planning for You" www.estateplanningnj.blogspot.com/



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