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## Estate, Gift and GST Tax Relief - Temporary Reprieve?

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Late last year, Congress passed and President Obama signed into law the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "Act"). Most of the media focus was on the extension of the "Bush tax cuts" for income taxes for all taxpayers, but the Act also provided some much needed relief from the estate, gift, and generation skipping transfer ("GST") taxes. Before December 17, 2010, it was unclear whether there would be any estate or GST tax imposed at all on estates of decedents dying in 2010 and transfers made in 2010, but great concern existed about the anticipated reversion to much lower exemptions and much higher transfer tax rates beginning at the start of 2011. The Act removes this concern, at least for now, and clarifies how the estate, gift and GST taxes will apply in 2010 and for the next two years. Absent additional legislation, however, the transfer tax provisions will now revert in 2013 to what they were before 2001. This will mean an estate and gift tax exemption of only \$1 million, a GST exemption of an indexed amount that would have been \$1.34 million in 2010, and a maximum transfer tax rate of 55%. The reprieve from high transfer taxes may thus be short-lived.

The Act reinstated the estate tax for estates of persons dying in 2010, but with an increased estate tax exemption of \$5 million and a lowered estate tax rate of 35%. It also reinstated the GST tax to estates of persons dying in 2010; however, for 2010 only the GST tax rate is zero. The GST exemption will also be \$5 million. The gift tax exemption remains at \$1 million for gifts made in 2010, and the tax rate remains at 35%. Beginning in 2011, the federal estate, gift, and GST tax exemptions will all be the same, \$5 million, and the tax rates will also be the same, 35%. The exemptions will be indexed beginning in 2012.

Although the estate tax is reinstated for 2010, the estate of a person who died in 2010 may still elect to have no estate taxes at all apply to the estate, but to have "carryover basis" apply instead. Under carryover basis, assets passing from the decedent will have a basis for income tax purposes equal to the lesser of the decedent's basis or the fair market value of the asset. Thus, the estate and its beneficiaries make a trade off between no estate taxes on the one hand but potentially higher income taxes from capital gains on the other. There is a general basis increase or "step-up" of \$1.3 million that applies to all assets passing from the decedent, and an additional spousal basis step-up of \$3 million for assets passing to a spouse or a trust for the spouse's benefit. There are certain other basis increases that may apply. Although the decision whether to elect out of the estate tax will mainly affect those estates that exceed the \$5 million estate tax exemption, there are a number of factors that must be considered.

The Act also permits a surviving spouse to use the unused exemption of his or her last predeceased spouse, thus making the exemption "portable." For example, if Husband dies leaving his entire estate to Wife in a manner that would qualify for the marital deduction, his estate would not use any of his \$5 million exemption. Wife's exemption would thus be increased to \$10 million for purposes of making gifts while she is alive and to reduce or eliminate her taxable estate when she dies. While this portability provision may appear to eliminate the need for a so-called "bypass" trust, there are many good reasons for using a bypass trust to hold the assets covered by the estate tax exemption of the first spouse to die. For example, the bypass trust will exclude any

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growth in the value of the assets from the estate tax when the surviving spouse dies, and may provide the assets with some protection from the creditors of the surviving spouse. For most individuals, using the bypass trust when the first spouse dies will continue to be preferable.

Finally, the Act extends the due date for filing estate tax and certain other related tax returns and making certain tax elections until September 19, 2011 for decedents who died before December 17, 2010. The Act also extends to September 19, 2011 the date by which an individual must make a qualified "disclaimer" of a transfer made in 2010 before December 17. A qualified disclaimer is giving up the right to receive a gift or bequest in a manner that does not cause the person giving up the right to be treated as also making a taxable gift to the person who receive the gift or bequest as a result of the disclaimer. A disclaimer may be very beneficial for taking advantage of the provisions in the new Act that were not anticipated before December 17, 2010, such as the zero GST tax rate and the \$5 million gift tax exemption that will apply to gifts in 2011 and 2012.

As a result of the changes made by the Act, many families will need to review their estate plans, particularly because of the increase in the gift tax exemption from \$1 million to \$5 million. Also, anyone who is handling an estate of someone who died in 2010 will need to determine whether to make the election out of the estate tax and anyone who received a gift or bequest in 2010 will need to decide whether to disclaim the gift or bequest. Unfortunately, as is the usual case with new tax legislation, planning may be complex in some cases and dealing with the uncertainty as to what will eventually happen to the transfer taxes in 2013 will be challenging.