Fox Rothschild LLP
ATTORNEYS AT LAW

DECEMBER 2010

TAX & ESTATES DEPARTMENT

ALERT

Significant Modifications Made to the Federal Estate & Gift Tax

President Obama Signs the Tax Relief Act of 2010: Wide Impact on Estate Planning Strategies

On Friday, December 17, 2010, President Obama signed into law the Tax Relief Unemployment Insurance Reauthorization and Job Creation Act of 2010 (Tax Relief Act), which reinstates the federal estate and generation skipping transfer taxes effective for decedents dying and transfers made after December 31, 2009. The exclusion from estate tax is increased to $5 million and is further indexed for inflation for decedents dying after 2011. The maximum federal estate tax rate as well as the generation skipping transfer tax rate are each set at 35 percent. The gift tax continues to remain in effect with the applicable exclusion remaining at $1 million per individual for taxable gifts made during 2010 and subject to a 35 percent rate. For gifts made after 2010, the lifetime gift tax exemption is increased to the estate tax exclusion of $5 million and the gift tax rate is set at 35 percent rate. The familiar annual exclusions for gift tax purposes remain in effect.

The generation skipping transfer tax exemption for decedents dying or gifts made after 2009 is increased to $5 million effective January 1, 2010. For 2010, the generation skipping transfer tax rate is zero percent, although taxable transfers are otherwise applied against each individual's lifetime exemption amount. Accordingly, up to $5 million in generation skipping transfer tax exemption can be allocated to a trust created or funded during 2010, subject to any amount of the exemption that was previously allocated. The generation skipping transfer tax rate for transfers made in 2011 and 2012 is set at 35 percent.

Repeal of the Modified Carryover Basis Rules

The Tax Relief Act generally repeals the "modified carryover basis rules" for determining the income tax basis for property owned by and acquired from a decedent. Under these complex rules, which were effective for decedents dying in 2010, a beneficiary of property received from the decedent at death was required to continue to carry the decedent's historical tax basis for income tax purposes. Special exceptions were provided permitting an increase to basis of $1.3 million per estate, $3 million for property passing to a surviving spouse and adjustments for any unused tax attributes held by the decedent such as net operating loss carryovers or property that had depreciated below cost. Under the Act, a recipient of property acquired from a decedent after 2009 will again be able to step up the basis of inherited property to fair market value as under prior law. However, for a decedent who dies during 2010, the Tax Relief Act generally permits the executor of the estate to elect to apply the Internal Revenue Code as if the new estate tax and basis step-up rules had not been enacted. If such an election is made, the estate will not be subject to estate tax, and application of the modified carryover basis rules will be required. Restoring the fair market value

approach is far simpler and less cumbersome than having to apply the modified carryover basis rules. The Act also permits a deduction for death taxes paid to any state or the District of Columbia for decedents dying after 2009.

Portability of Unused Estate Tax Exclusion Between Spouses

The Tax Relief Act provides that any exclusion amount that remains unused as of the death of a spouse dying after 2010 generally can be used by the surviving spouse as an additional exclusion. This means, for example, if the first spouse to pass dies in 2011 with a taxable estate of $2.5 million, then the surviving spouse's lifetime estate exclusion ($5 million) can be increased by the deceased spouse's unused portion (i.e., $2.5 million), for an aggregate exclusion of $7.5 million. The new rule does not allow a surviving spouse to use any unused generation skipping transfer tax exemption of a predeceased spouse. Special rules are provided where an individual has survived the death of more than one spouse. This rule may take away, in certain cases, the need to equalize estates of married couples while living and the need to utilize so-called "credit shelter" trusts.

Sunset Provisions

As many of you are aware, we have had to all live through the "phase-out" of the federal estate and generation skipping tax over a 10-year period that began in 2001 and resulted in no federal estate or generation skipping transfer tax in 2010. Unfortunately, the compromise arrived at by Congress only stays in place for two years, i.e., for estates of decedents dying, gifts made or generation skipping transfers made prior to 2013. At that time, the estate and gift tax rules in effect prior to 2001, which feature a $1 million lifetime exclusion for estate, gift and generation skipping transfer taxes and the highest maximum rate of tax of 55 percent, will go back into effect unless Congress acts.

Impact on Estate Plans

The reinstatement of the federal gift estate and generation skipping transfer taxes, which patch features the portability of the lifetime estate tax exemption among spouses, higher exemption amounts to $5 million and the 2013 sunset rule, requires estate plans be re-evaluated in light of the change in the law. This is particularly true with respect to certain wills and trusts that set by formula, based on the then-applicable exemption in the federal estate or generation skipping transfer tax, the amount each family member will receive under the will or other dispositive instrument such as a lifetime trust.

Further Guidance

Additional guidance will be forthcoming from the IRS with respect to the provisions of the Tax Relief Act. In the coming weeks, we will provide you with this guidance when available together with our more in-depth analysis of the specific provisions of the Tax Relief Act.

Please Call Us With Your Questions

We encourage you to contact your relationship lawyer at Fox Rothschild or a member of the firm's Tax and Estates Department in the state in which you maintain your permanent residence to discuss the potential impact of the Tax Relief Act of 2010 on your current estate plan and evaluate whether appropriate changes should be made.

Fox Rothschild LLP
ATTORNEYS AT LAW

Attorney Advertisement

© 2010 Fox Rothschild LLP. All rights reserved. All content of this publication is the property and copyright of Fox Rothschild LLP and may not be reproduced in any format without prior express permission. Contact marketing@foxrothschild.com for more information or to seek permission to reproduce content. This publication is intended for general information purposes only. It does not constitute legal advice. The reader should consult with knowledgeable legal counsel to determine how applicable laws apply to specific facts and situations. This publication is based on the most current information at the time it was written. Since it is possible that the laws or other circumstances may have changed since publication, please call us to discuss any action you may be considering as a result of reading this publication.