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2010 Tax Relief Act: Is it Time to Give?

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The enactment of the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (the "2010 Tax Relief Act") on December 17, 2010, created the opportunity to make larger non-taxable gifts than ever before under the modern federal estate and gift tax systems. But it also created many questions and uncertainties. While practitioners and clients applauded the increased "lifetime" exemption to $5,000,000, care and thought must be taken before making a substantial gift.

Due to the reunification of the estate, gift and generation-skipping transfer tax system, a $5,000,000 exemption is now applicable to estate, gift and generation-skipping taxes. This allows a substantial amount of wealth to be transferred without incurring what was previously an onerous tax. Indeed, in addition to the significant increase from the previous $1,000,000 exemption on lifetime gifts, the 2010 Tax Relief Act also capped the highest gift tax rate at 35%, which is a significant savings from the previous gift tax rate of 45%. Left unaffected is the annual gift exclusion of $13,000 per year per recipient, which is subject to future adjustment for inflation.

Taking advantage of the increased lifetime exemption may require fairly swift action. The 2010 Tax Relief Act is effective only through December 31, 2012. Unless Congress passes new legislation, the 2001 Internal Revenue Code provisions will be reinstated beginning January 1, 2013. For gifting purposes, that means the exemption will drop back to a $1,000,000 lifetime exemption and the top gift tax rate will jump to 55% from 35%.

Although Congress could extend the provisions of the 2010 Tax Relief Act, or even increase its threshold limits, we are currently in a two-year "window of opportunity" to make significant lifetime gifts. Making significant lifetime gifts can

remove future appreciation of assets that would otherwise be subject to estate taxation when the donor dies. Lifetime gifts may reduce the taxable estate of the donor beneath the threshold for federal and/or state estate taxation, resulting in important tax savings.

There is one caveat. Capital gains issues must be considered before making a lifetime gift. The recipient of the lifetime gift takes the "carry over" basis of the donor for income tax purposes. Had the recipient inherited the same asset, there most likely would be a step-up in basis. The step-up in basis would eliminate or reduce any capital gain on the subsequent sale of the gifted asset. Careful tax analysis must be undertaken before making significant gifts or transfers of appreciated capital assets.

Caution is advisable when planning lifetime gifts or transfers in light of the "sunset" provision of the 2010 Tax Relief Act. It is possible that beginning in January, 2013, if Congress passes no further legislation, the estate tax exemption will drop from $5,000,000 to $1,000,000. This creates an interesting dilemma. If a post-2012 decedent made gifts in excess of $1,000,000 but within the $5,000,000 limitation before 2013 (or an amount in excess of the ultimate estate tax exemption amount after January 1, 2013), there is debate as to the tax consequences of such gifts or transfers in excess of the post-2012 applicable estate tax exemption. There is no clear guidance on this issue from the Internal Revenue Service.

As with any complex planning, it is best to solicit the advice and input of your trusted advisors who will help you determine how to maximize your tax savings and benefits within the context of your planning goals.

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The Probate, Trust and Personal Planning Group at Partridge Snow & Hahn LLP is edicated 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.

Deborah DiNardo
Melissa E. Darigan
Lawrence D. Hunt
Michael A. Kehoe
Kristin N. Matsko
David C. Morganelli
John J. Partridge
Kathleen A. Ryan
Marvin S. Silver
Steven E. Snow