Farrell Fritz Estate and Gift Tax Alert: Breaking News

December 17, 2010

As you may know, the United States Congress passed the *Middle Class Tax Relief Act of 2010* last night. It is anticipated that President Barack Obama will sign this extremely important piece of legislation into law this afternoon.

In addition to providing an extension to unemployment benefits during this difficult economic time, and extending various income tax cuts implemented by President George W. Bush, this bill delivers tremendous, sweeping changes to the federal gift and estate tax. Unfortunately, this legislation is only a two-year "band-aid"; and it appears that we will find ourselves and our government embroiled in the gift and estate tax debate at least until 2013.

In order to keep our colleagues, friends and clients prepared and informed, we have prepared this brief summary of the anticipated impact of this new and revolutionary legislation.

Estate Taxes

Old Law - Prior to the enactment of the new law, no federal estate taxes would apply to the estate of an individual dying in 2010. There is, however, potential for some negative income tax consequences, as there would be a limited ability to "step-up" the basis in inherited property to date of death values for capital gains tax purposes. Most importantly, 2011 would have brought about a revival of the federal estate tax, with a shockingly low exemption amount of $1,000,000 per person and estate tax rates of up to 55%.

New Law - Once the new law is enacted, representatives of the estates of individuals dying in 2010 will have two options which will need to be carefully considered: (1) a $5,000,000 estate tax exemption, with the excess taxed at a rate which will not exceed 35%, along with the unlimited ability to "step-up" the beneficiary's cost basis in inherited property to date of death value for capital gains tax purposes; OR (2) absolutely no federal estate taxes, but a limited ability to "step-up" the estate beneficiary's cost basis in inherited property to date of death values for capital gains tax purposes.

Estates of those dying in 2011 or 2012 will be subject to a generous $5,000,000 estate tax exemption (with a 35% maximum rate on the excess) and an unlimited ability to "step-up" cost basis in inherited property to the value at the time of the decedent's date of death. Additionally, under certain circumstances, a surviving spouse may utilize the unused estate tax exemption of a pre-deceased spouse. Unfortunately, New York State only provides for a $1,000,000 estate tax exemption and no "portability" of unused estate tax exemption between spouses. This disparity will necessitate careful analysis of existing estate plans.

Gift Tax

For 2010, each individual is limited to making lifetime gifts not to exceed $1,000,000 which are not subject to gift tax. Gifts in excess of this amount will be subject to a 35% federal gift tax. Upon enactment of the new law,

in 2011 the federal gift tax exemption will be "reunified" with the federal estate tax exemption. This means that starting in 2011, each individual will have a lifetime exemption of $5,000,000. This dramatically increased exemption provides tremendous opportunities for estate planning, especially in the current economic environment, where asset values, and the required interest rates used in connection with estate planning, are historically low. It is important to note that any gifts made during an individual's lifetime utilizing gift tax exemption will also erode the individual's estate tax exemption. Accordingly, it is important that any significant gifts made be considered strategically, with the individual's overall estate planning in mind.

Generation-Skipping Transfer Tax

Presently, the Generation-Skipping Transfer Tax (GST) has been repealed for 2010, thus removing an additional layer of taxation that would otherwise be present when property is gifted or inherited by beneficiaries who are two generations younger than the grantor. This repeal was only temporary, however; and the GST was due to be reinstated in 2011.

Under the new law, 2011 will bring a generous $5,000,000 GST exemption amount, enabling tremendous opportunities for inter-generational wealth transfers with very limited transfer tax consequences.

Summary

In conclusion, it appears that the federal government has temporarily averted a potential gift and estate tax crisis by passing the *Middle Class Tax Relief Act of 2010*. The new law provides for very generous exemptions and unprecedented opportunities for multi-generational estate planning. On the negative side, this law is only a temporary repair, as we have no guidance as to the future of gift and estate taxes for 2013 and beyond. Accordingly, the window of opportunity to take advantage of the estate planning options which the new law provides is limited. If Congress does not act again before December 31, 2012, we will be in the same uncertain and challenging tax scenario that we were facing only a few days ago.

If you have any questions about the new law, or how it may impact your estate planning, please do not hesitate to contact us. Thank you.

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