

The “2010 Tax Relief Act” and What it Means For Your Estate Planning

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On December 17, 2010, President Obama signed into law the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the “2010 Tax Relief Act”). The 2010 Tax Relief Act extends many income tax measures created during the Bush administration. In addition to merely extending income tax measures, however, it dramatically changed the law relating to estate tax, gift tax, and generation-skipping transfer tax, albeit only temporarily. This Client Alert summarizes these important changes. If you have any questions relating to these changes, please do not hesitate to contact any attorney in the Trusts and Estates Group at Procopio.

New Estate Tax Rate and Exemption Amount for 2011 and 2012.

For 2011 and 2012, the “Exemption Amount” for estates of U.S. persons is US\$5 million, and estates valued higher than this amount will be subject to estate tax at a 35% rate. Foreign citizens and domiciles continue to receive a mere US\$60,000 exemption. The Exemption Amount and highest Tax Rate for 2013 (unless Congress passes another law) will go back to US\$1 million - US\$60,000 for foreign citizens/domiciles - and 55%.

Estate Tax Exemption Portability.

“Portability” is a new concept introduced under the 2010 Tax Relief Act. Generally, portability

will allow a surviving spouse to claim the unused portion of a deceased spouse's US\$5 million Exemption Amount, so that the surviving spouse may have as much as US\$10 million in his or her estate before an estate tax is incurred. This benefit is only available if the surviving spouse dies in 2011 or 2012 and there are other issues which make planning using the portability concept problematic. Use of a Bypass Trust at the first death to take advantage of the Exemption Amount will still be advantageous in many cases. However, if portability becomes a concept that lasts beyond 2012, then some clients may prefer not to use a Bypass Trust at the first death. This portability concept does not apply to foreign citizens/domiciles.

Higher Gift Tax Exemption for 2011 and 2012.

Beginning in 2011, the lifetime Exemption Amount for gifts made by U.S. persons increases from US\$1 million to US\$5 million, and the gift tax rate will be 35%. However, the annual exclusion of only US\$13,000 will continue to apply to foreign citizens/domiciles who do not receive the US5 million Exemption Amount. This increased Exemption Amount for U.S. persons will present new wealth transfer opportunities over the next two years, especially for clients who may have already used their US\$1 million exemption in prior years. As before, any use of the Exemption Amount for gifts during life reduces the amount that will be available at death to avoid estate tax.

Retroactivity of Estate Tax for 2010.

A question that has been weighing heavy on the minds of estate planning attorneys and their clients is whether Congress would reenact the estate tax retroactively so that it applies to estates of decedents who die in 2010. That question has been answered by the 2010 Tax Relief Act. Estates of U.S. decedents who die in 2010 may elect to be subject to the estate tax or not. If the U.S. citizen or domicile estate elects to be subject to the estate tax, then they will enjoy a US\$5 million estate tax exemption, a 35% rate, and a full step-up in tax basis of all assets included in the gross estate. If they elect not to be subject to the estate tax, the prior law will apply so that they will suffer no estate tax but receive only the limited step-up in tax basis.

Extension of Certain Deadlines for 2010 Decedents.

For estates of decedents who die before the date of enactment of the 2010 Tax Relief Act, the following deadlines are extended until 9 months after the date of enactment:

- filing an estate tax return;
- filing a large estate return (regarding basis allocation);
- paying the estate tax, and
- making qualified disclaimers.

Generation-Skipping Transfer Tax Considerations.

Prior law was unclear on whether a generation-skipping transfer tax exemption existed in 2010. The 2010 Tax Relief Act makes it clear that generation-skipping transfer tax exemption for 2010, 2011, and 2012 is US\$5,000,000 per person (again applicable for U.S. citizens

or domiciles only). It also makes it clear that the generation-skipping transfer tax rate for 2010 is 0%. This rate increases to 35% in 2011 and 2012.

The 0% rate for 2010 transfers created a significant planning opportunity for those wishing to transfer wealth to grandchildren or more remote generations. Such transfers must have been made before January 1, 2011, and must have been made in a form that constitutes a generation-skipping transfer. These types of transfers would include direct transfers to grandchildren or to a trust in which all beneficiaries are grandchildren of the transferor. It would not include a transfer to a trust in which a child or other non-skip person is a beneficiary. Since each person receives an increase in the generation-skipping transfer tax exemption for 2010, in order to take advantage of this 0% tax rate, a transferor would have to file a 2010 gift tax return in which he or she opts out of the automatic allocation of generation-skipping transfer tax exemption to the transferred property.

Continued Availability of Entity Planning.

Past proposed legislation related to the estate tax included provisions

severely limiting the availability of valuation discounts for certain assets such as interests in closely-held businesses. Valuation discounts allow for the reduction in value of an interest in an entity such as family limited partnerships and limited liability companies due to restrictions on transferability, management, and distributions. The new law does not include provisions limiting valuation discounts. However, taxpayers should be mindful that these discounts could be limited, or unavailable altogether, in the future and may want to take advantage of valuation discounts while they are available under the current law.

Continued Availability of Short Term GRATS.

Certain past proposed legislation related to the estate tax also included provisions that severely limited the use of Grantor Retained Annuity Trusts ("GRATs") by prohibiting the use of short-terms. By transferring an asset to a GRAT and retaining an annuity for a term of years, the taxpayer is able to transfer the future appreciation of the asset to beneficiaries free of gift tax. Luckily, the new law does not prohibit the use of short-term GRATs. Therefore, short-term

GRATs are still available as a valuable tax planning tool given the low-interest rate environment we find ourselves in these days.

Foreign Persons (Non-U.S. citizens) Who are Not Domiciled in the United States.

Finally, it is worth noting that while the business, financial and tax press has focused on many of the above new estate tax provisions in the 2010 Tax Relief Act (and how they apply to U.S. persons), little discussion has been had regarding non-U.S. citizens with U.S. assets. In short, the 2010 Tax Relief Act did not increase the exemption amounts of U.S. situs assets free from estate tax. The US\$60,000 exemption applicable to foreign estates continues to the be law, which means that foreign investors should be as diligent as ever regarding how they invest in the United States to minimize the U.S. estate and gift tax exposure. See **[FOREIGN INDIVIDUALS AND THE U.S. ESTATE TAX \(SIMILAR TO AN INHERITANCE TAX\).](#)**

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