The Effect of the 2010 Tax Act on Estate, Gift, and Generation-Skipping Transfers

Jan 11 2011

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Practice Area: Trusts and Estates & Estate Planning & Estate and Trust Administration

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "2010 Tax Act") was signed on December 17, 2010. In most respects, this law is effective retroactive to January 1, 2010; but unless Congress makes additional changes, it will remain in effect only through 2012.

Estate Tax
Starting January 1, 2010, the estate tax lifetime applicable exclusion, frequently referred to as the exemption, is $5.0 million (reduced by amounts used during lifetime on gifts). This threshold will be indexed for inflation starting in 2012. The tax rate imposed on transfers above the exemption is a flat 35%. In addition, the "stepped up" basis rules will apply. That is, all property of the decedent will receive a new basis for income tax purposes equal to the fair market value of those assets at the date of the decedent's death.

Estates of Decedents Who Died in 2010
Estates of decedents who died during 2010 may elect to use the 2010 law that was in effect under EGTRRA. If you are administering an estate of a decedent who died in 2010, you should consult with an advisor to review the tax implications of the available choices.

Portability
The new law introduces the concept of "portability". Portability allows a surviving spouse to add to his or her own lifetime exemption the unused exemption at the death of the first of the spouses to die. For example, if a spouse dies leaving an estate of $1.0 million to a trust, the deceased spouse has $4.0 million in unused exemption. If an election is properly made at the death of the first spouse, the survivor will have his or her own $5.0 million exemption and, in addition the predeceased spouse's $4.0 million exemption to shelter transfers at the survivor's death. In this example, portability allows the survivor to leave up to $9.0 million to his or her beneficiaries without federal estate tax.

Generation-Skipping Transfer Tax
The federal generation-skipping transfer (GST) tax is a tax imposed on the transfer of property by gift or at death to grandchildren or further descendants. This tax is in addition to any gift or estate tax on the transfer. The GST lifetime exemption beginning January 1, 2010 is $5.0 million. The rate on transfers in excess of the exemption during 2011 and 2012 is 35%.

Gift Tax
Beginning January 1, 2011, the gift tax lifetime exemption is $5.0 million and the tax rate on amounts over that figure is 35%. This creates a clear planning opportunity for those individuals who are interested in making sizeable gifts: there will be no gift tax on total lifetime gifts up to $5.0 million. Use of the lifetime exemption on gifts reduces the exemption available at death.

Prospective donors should keep this substantial tax-free transfer possibility in mind in 2011 and 2012.

The annual exclusion amount that can be transferred to any donee with no gift tax consequence remains at $13,000 for 2011.

Wisconsin Estate Tax
Wisconsin's estate tax expired December 31, 2007. Other states, including Illinois, continue to have a state estate tax.

Your Estate Plan
Many estate plans provide for a division of assets using a formula based on the estate or GST tax. For example, the plan may include a Family Trust or other trust that will receive the maximum amount that can pass free of federal estate tax. If that formula went into effect when the exemption was $1.0 million, the Family Trust would receive $1.0 million and typically the spouse would receive all other property (either outright or in a Marital Trust). For a death on or after January 1, 2011, $5.0 million of the decedent's property would pass to the Family Trust under this formula, substantially reducing or perhaps eliminating the amount of property passing to the spouse.

Similarly, an estate plan might include a formula provision passing property to grandchildren in the maximum amount that can pass free of GST tax. The increase in the GST exemption to $5.0 million may dramatically affect the amount of property passing to children.

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