

Tax Relief Act of 2010

Tax, Trusts & Estate Department

Greenbaum, Rowe, Smith & Davis LLP Client Alert

February 2011

On December 17, 2010, President Obama signed into law the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "Act"). As you may know, this Act extended for two years the current income tax rates and other income tax provisions first enacted during President Bush's administration. In addition to these income tax extensions, the Act also made major changes to the Federal estate and gift tax laws, some of which are as follows:

- The Act reinstates the Federal estate tax retroactive to January 1, 2010. Additionally, inherited assets will once again receive a "stepped up" basis.
- The Act increases the estate, gift and generation-skipping transfer ("GST") tax exemptions to \$5 million per person and provides for future cost of living increases. The GST tax is a tax on transfers to grandchildren or more remote descendants which is imposed on top of the estate or gift tax. In contrast, in 2009, the estate and GST exemptions were \$3.5 million and the gift tax exemption was \$1 million. The increase in the exemption for estate and GST purposes was effective January 1, 2010, while the increase in the exemption for gift tax purposes was not effective until January 1, 2011.
- For the first time, the Act will make it possible for a surviving spouse to use part of his or her deceased spouse's estate and gift tax exemptions. As a result, instead of having a \$5 million estate and gift tax exemption, a widow or widower could potentially have as much as \$10 million of exemption. "Portability" of the exemption only applies to spouses dying after December 31, 2010, and only if the estate of the first spouse to die makes an affirmative election on a timely filed estate tax return. Thus, someone who is already a widow or widower on December 31, 2010 cannot take advantage of portability. Note that, while the estate and gift tax exemptions are portable, the GST exemption is not, and there is a risk that a predeceased spouse's unused estate and gift tax exemptions could be lost if the survivor remarries.
- The estate of a person dying in 2010 may elect to apply the "no estate tax law" which was in effect for 2010 prior to the passage of the Act. Making this election would result in no estate tax, but would limit the step-up in basis which the inherited assets would otherwise receive. This could result in higher capital gains tax when the inherited assets are sold.
- Under the Act, estate, gift and GST tax rates will be 35%.
- These new estate and gift tax laws are temporary and are set to expire on December 31, 2012. Thus, the uncertainty we experienced both before and after the recent midterm elections is likely to be repeated during the next presidential election. If Congress does nothing, the estate and gift tax laws will revert back to a \$1 million exemption and a top rate of 55%.

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The estate taxes imposed by New Jersey, New York or any other states are unaffected by the changes made to the Federal law. Thus, for example, the New Jersey estate tax exemption remains at \$675,000, while the New York estate tax exemption remains at \$1 million. In addition, there is no portability of exemptions for state estate tax purposes. As such, state estate taxes can still result in a significant expense to a decedent's estate.

For purposes of illustration, the New Jersey and New York estate taxes for various size taxable estates are as follows:

Taxable Estate	New Jersey Tax	New York Tax
\$1,000,000	\$33,200	0
\$2,000,000	\$99,600	\$99,600
\$3,000,000	\$182,000	\$182,000
\$5,000,000	\$391,600	\$391,600
\$10,000,000	\$1,067,600	\$1,067,600
\$20,000,000	\$2,666,800	\$2,666,800

In light of the changes to the Federal estate tax law, it may be advisable that your estate plan be reviewed to see if changes are warranted. In particular, the formulas used in existing Wills to determine how much passes to which persons and trusts may no longer produce the intended results and could result in unexpected dispositions, or result in state death taxes which clients may wish to avoid.

In addition to having your estate plan reviewed for tax reasons, you may also want to review the persons named as your primary and secondary beneficiaries, terms of any trusts for family members, and the individuals named as your executors, trustees, and guardians.

Finally, since there is the possibility of the increased exemptions and lower rates expiring in 2012, clients may wish to take advantage of the planning opportunities that are available while the current tax law is still in effect. For example, the higher gift tax exemption will allow clients to make additional gifts without paying Federal gift tax. Since the Act did not address either grantor retained annuity trusts (GRATs) or valuation discounts, many estate planning techniques can be accomplished more effectively utilizing the additional gift tax exemption and the current low interest rate environment.