

ONCE MORE INTO THE BREACH

1. Introduction to New Law:

On December 17, 2010, Congress once again stepped into the breach ó at just about the last minute ó and passed The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010. This was long overdue, and, as a matter of fact, it was something I expected would have been passed in the beginning of 2010 and made retroactive to all estates of those dying after January 1, 2010 - the date the federal estate tax was to disappear in its entirety for one calendar year (1/1/2010 ó 12/31/2010). The law which would have become effective January 1, 2011 and all years thereafter is now postponed until January 1, 2013. At that time (1/1/13), a \$1,000,000 applicable exclusion and 55% max estate tax rate become the law (see attached Schedule setting forth the history of the Applicable Exclusion amount since 2001).

2. Effect on Deaths Occurring in 2010:

- a. Rather than extend the law which was in effect in 2009 and would have afforded a \$3,500,000 applicable exclusion and a 45% maximum effective tax rate (the simplest methodology to my way of thinking), Congress in its infinite wisdom, gave us a two (2) year band-aid , which afforded us two (2) choices as follows:

- (1) No estate tax for 2010 (the prior law) with the basis of decedent's assets being a modified carryover basis (the value of the assets in decedent's hands prior to his demise) with a \$3,000,000 basis increase available for those assets passing to a surviving spouse and \$1,300,000 allowance for assets passing to any other person, or
- (2) a \$5,000,000 applicable exclusion, 35% tax rate with a date of death basis (stepped-up basis) for those assets in the estate.

b. The unlimited marital deduction would continue as before in the (2) scenario). This means that husband and wife could pass to their children \$10,000,000 federal estate tax free ó PROVIDED both die before 1/1/2013.

c. The Act also extends the time for filing estate tax returns for decedents dying in 2010, as well as the filing of carryover basis form 8939, to nine (9) months after the date of enactment of this Act, i.e. September 15, 2011.

3. January 1, 2011 through December 31, 2011:

a. The \$5,000,000 exclusion amount applies fully for these two (2) years as does the stepped up (date of death) basis. Once again, \$10,000,000 is available to pass to the heirs of husband and wife during this window. This credit amount of \$5,000,000 is equivalent to \$1,730,800 of tax dollars ó not inconsequential by any means.

- b. Stepped up basis is once again fully reinstated.

c. Portability of the extent a spouse does not need to fully utilize his or her \$5,000,000 exclusion, then the unused portion may be added to the spouse's \$5,000,000 of but only for 2011/2012!! This requires filing a federal estate tax return for the first spouse to show what the unused portion of this exclusion may be available for use when the second spouse dies.

d. Inflation of the \$5,000,000 credit amount is indexed for inflation for 2012 ONLY.

e. The max tax rate is also reduced from 45% in 2009 to 35% for 2010 through 12/31/2012.

4. 2013 and Thereafter:

a. As of this minute, the applicable exclusion amount, or credit, for 1/1/2013 and thereafter is the old 2002 amount - \$1,000,000.

I don't believe that when 2013 arrives, this \$1,000,000 applicable exclusion will be allowed to remain at that level of especially not after two (2) years of \$5,000,000 per. Congress will probably wait until the last minute to act as they did this time.

b. The maximum estate tax rate is up to 55% - surprisingly higher than the 50% max rate which applied in 2002 when the applicable exclusion was \$1,000,000.

5. Gifts:

a. Prior to 2011, the lifetime gift tax exemption was \$1,000,000 of this is the figure utilized once to absorb any gift tax when you exceed the \$13,000 annual gift tax exclusion (per donee) as well as the unlimited medical or tuition amounts.

b. For 2011 and 2012, this lifetime exemption is now \$5,000,000 (plus the ubiquitous one year of in essence of inflation rider) of meaning parents can jointly gift to their children \$10,000,000 (plus, of course, the \$13,000 annual exemption).

c. For 2013 and thereafter (so far), the \$1,000,000 lifetime exemption will apply.

PLANNING DURING THE UNCERTAINTY

1. Gifts:

One thing which certainly comes to the forefront is the amount of property that can be gifted outright in addition to the usual \$13,000 annual exclusion amount, i.e. husband and wife can jointly gift each of their children (or anyone else for that matter) \$26,000 each calendar year with no filing requirements. If their estates are large enough then they can avail themselves of

all or part of the current lifetime exclusion of \$5,000,000 per donor, then by all means have them do so keeping in mind that the donee's basis remains that of the donor.

2. Wills:

Based on the uncertainties that seem to now exist (see above and below), is it necessary to plan for estate tax consequences? The answer is, of course, a resounding YES! Unless Congress does away with the estate tax entirely ó which some feel is a distinct possibility replacing same with a straight capital gains tax on the value of the assets owned by a decedent versus his basis in said assets reported on a final income tax return ó there will be some sort of estate tax, to say nothing of the State Death Taxes ó both Inheritance and Estate Taxes in New Jersey ó which can be addressed on a properly planned Will. In addition, how do we address those special scenarios many families find themselves in from time to time, i.e., divorces, family members with drug or alcohol problems, special children, etc? With the potential existing for a \$1,000,000 credit in 2013, as well as a New Jersey estate tax imposition on assets above \$675,000 passing to other than a spouse, Wills are still essential and still form the basis of any estate plans.

3. Trusts:

a. Revocable Living Trusts (and Pour/Over Wills) are not the end all and be all that many attorneys and financial planners make them out to be. All my New York clients have them due to the rather large probate fees New York imposes based on the assets passing through the Will (probate assets). New Jersey probate fees are modest in comparison and are not asset based. I utilize Living Trusts for my Jersey clientele when the clients own real property in states other than New Jersey where that property passes according to the laws of that State; this requires separate probates for that state or states, as the case may be. Revocable Living Trusts convert the real property interests to Trust interests treating them as any other personal property interest when the Grantor of the Trust dies.

b. Irrevocable Life Insurance Trusts to insure that the proceeds of life insurance policies are kept out of the estates of both husband and wife passing untaxed to the children or grandchildren are still an estate planning basic to my mind..

c. Qualified Personal Residence Trusts utilized to pass a main residence and vacation home to the children thereby eliminating capital appreciation in the property over the term of the trust ó especially useful now when property values and interest rates are so low.

d. GST Trusts (see below), are just some of the Trusts, which can still be utilized with great effectiveness still.

4. GST Trusts:

The Generation Skipping Tax has been around for years and can be a veritable tax trap for those who wish to benefit their grandchildren since their children may not need what their parents may leave them. In so doing, however, the grandparents may incur a tax at the maximum

federal estate tax rate then in effect because the property is passing to a skip person meaning not the next generation (children), but rather a generation beyond the grandchildren. The IRS does not allow a GST exemption which for 2011-2012 is \$5,000,000 per; in 2013 and thereafter this exemption drops to \$1,000,000 and the tax rate increases to 55%. In 2010, what you could have left if skip persons was unlimited for there was no estate or gift or GST tax.

Suggested Course of Action - Life Insurance purchased by and through an Irrevocable Life Insurance Trust which has provisions for both the children and grandchildren or even further down the line or as the insured Grantor may desire.