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The 2010 Tax Act: How Will The Tax Act Impact Your Existing Estate Plan?

Mark Twain wrote, "Suppose you were an idiot. And suppose you were a member of Congress. But I repeat myself." After being totally irresponsible and failing to act prior to 2010 to address the expiring estate tax provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA")(please see our article entitled "Economic Growth & Tax Relief Reconciliation Act of 2001 Revisited" on our website), Congress has finally passed, and President Obama immediately signed, legislation increasing the unified credit and reinstating the "stepped-up basis" rules for decedents dying in 2010 and thereafter. However, the new legislation is only effective for two (2) years. Congress will have another opportunity to prove Mark Twain wrong at that time.

First The Good News

On Friday, December 17, 2010, President Obama signed the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (the 2010 Tax Act). This Act extends, for the next two (2) years, many of the individual and capital gain/dividend tax cuts enacted during the Bush presidency. The 2010 Tax Act reduces payroll taxes, increases bonus depreciation, provides for alternative minimum tax relief and reinstates the estate tax. A summary of the estate tax provisions are discussed below.

Under EGTRRA, the estate tax had been suspended for decedents dying in 2010. It was scheduled to be revived in 2011, utilizing the one million dollar ($1,000,000.00) unified credit and maximum tax rate of 55% that was in effect in 2001, before EGTRRA was enacted.

The 2010 Tax Act decreases the maximum estate tax rate to 35% and establishes the unified credit against estate taxes at $5 million, $10 million for a married couple. The exclusion amount is to be adjusted for inflation. It reinstates the traditional "stepped-up basis" rule for all assets included in a gross estate. Prior to its passage, under EGTRRA, the stepped-up rules were replaced with modified carry over basis, see our article entitled "Capital Tax Time Bomb" on our website and the Spring 2009 edition of our newsletter "A Step Ahead."

For decedents who died during 2010, the 2010 Tax Act allows the representative to elect between (a) an estate tax based on a $5 million exemption, a

35% tax rate and an unlimited step-up in basis or (b) no federal estate tax and a modified carry over basis. The time within which to file estate tax returns and make payments has been extended, for estates of decedents dying after December 31, 2009 and up to the date of enactment of the Act, for nine months.

The 2010 Tax Act allows a surviving spouse of a decedent who passed away after 2010 to elect to use the unused portion of the estate tax exclusion of a deceased spouse, which provides the surviving spouse with a larger exclusion.

The 2010 Tax Act has also made some significant modifications to gift and generation skipping transfer taxes. Under the Act, the gift tax is retained. However, the highest gift tax rate is reduced to 35% and the lifetime exclusion is increased to $5 million. Under EGTRRA, the Generation Skipping Tax (GST) did not apply for the year 2010. The 2010 Tax Act revives the GST with a 35% rate and $5 million exclusion. It also reunifies the Gift and Estate taxes for gifts made after December 31, 2010. Each tax type had a separate exclusion amount prior to the enactment of the Act.

And Now The Bad News

By enacting the 2010 Tax Act, Congress has applied a temporary band-aid approach to the estate and gift tax issues rather than a more permanent fix. This will lead to a great deal of confusion and ultimately be detrimental to the many people who mistakenly believe Congress has appropriately addressed these issues.

We have spoken with many people who now believe, erroneously, that they do not have to do estate tax planning. We have been told that the portability provisions make estate tax planning unnecessary, because any unused unified credit of a deceased spouse can be used by the survivor. This belief ignores significant limitations contained in the new legislation. For example, it does not take into account the New York State estate tax. By failing to incorporate estate tax planning now, couples who own property worth more than $1,000,000 will pay more in state estate taxes than they would otherwise pay.

The perceived ability to utilize the unused unified credit of the first spouse to die will fail if the second spouse dies after December 31, 2012, when the law reverts back to the 2001 levels and portability did not exist. Also, if the surviving spouse remarries, the unused portion of the deceased spouse's unified credit is no longer available, again resulting in a greater tax.

When all of the deceased spouse's assets are left to the surviving spouse, that spouse is free to name new beneficiaries. Surviving spouses may remarry or become estranged from children who had a close relationship with the deceased spouse. Either of these events could result in the surviving spouse choosing to redirect his or her assets, after the death of the first spouse, including the assets received from the first spouse, to someone other than the beneficiaries selected by the deceased spouse.

Another factor to consider is that Medicaid planning, and other asset-protection planning, can be incorporated into the plan of the first spouse to die. Certain trusts created for a surviving spouse can protect those assets from being considered in

determining the Medicaid eligibility of the surviving spouse. A properly drafted trust created under the Will of the first spouse to die can allow the trust assets to be used for the benefit of the survivor to enhance his or her quality of life and to supplement, but not replace, governmental benefits. This planning technique is lost when the assets are left to the surviving spouse outright.

Clearly, the 2010 Tax Act can significantly impact estate plans regardless of when the plans were created. Having your plans reviewed on a regular basis by a qualified attorney allows your particular situation to be evaluated so that an appropriate plan can be devised which is tailored to your needs. If you have questions related to how this Act might affect your existing estate plan, please contact Berwitz & DiTata LLP to arrange for a consultation. Those whose estate plans were prepared by our firm will not be charged for this consultation. As a courtesy to readers who have not had their estate plan prepared by Berwitz & DiTata LLP, we will charge a nominal fee of $350.00 for the consultation.