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Dear Client:

RE: Estate Tax Relief in the Tax Relief Act of 2010

On December 17, 2010, President Obama signed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. Although the primary feature of this legislation is a two-year extension of the Bush-era income tax cuts, the Act also addresses the repeal of the Estate Tax for 2010 and its reinstatement in 2011. The legislation reenacts the Estate Tax for 2010 (but grants an option to elect back into the repeal) and provides generous estate and gift tax exemptions and rates for 2011 and 2012. Unfortunately, the Act is only a temporary measure — in 2013, the pre-2001 estate and gift tax provisions will return, with the potential to impose a much greater tax burden on estates and gifts.

Following is a summary of the provisions of the new Act, with a discussion of the opportunities and pitfalls that it presents for your personal estate planning.

## **Estate and Gift Taxes in 2011 and 2012**

For decedents dying in 2011 and 2012, the Act greatly reduces the reach of the estate tax by granting estates a \$5.0 million exemption for property subject to the tax. In addition, the Act introduces the concept of exemption “portability” between spouses — if one spouse does not use all of his or her \$5.0 million exemption, it may be used by the estate of the surviving spouse, effectively creating a \$10.0 million exemption for married couples. The few estates that exceed this \$5.0/\$10.0 million threshold will be subject to a new 35% tax rate, considerably lower than the 45% rate that prevailed before 2010.

Gift taxes are also lighter. Since 2001, taxpayers have had only a \$1.0 million lifetime exemption for Gift Tax purposes. That exemption is increased to \$5.0 million for gifts made in 2011 and 2012, and the tax rate on 2011 and 2012 gifts in excess of that amount is 35%.

## **Estates of Decedents Dying in 2010**

The estates of those who died in 2010 faced considerable uncertainty prior to the passage of this legislation. A 2001 law repealed the estate tax for persons dying in 2010, but also imposed a carryover basis regime that required that heirs use the decedent's tax basis for inherited property. Before 2010, that property had received a basis step-up at death. For some heirs, this 2010 requirement was a greater tax burden than would have been imposed by the estate tax. In addition, there was a risk that the estate tax would be retroactively reinstated for 2010, so many executors did not know what to do.

Congress has now eliminated that uncertainty for 2010 estates. It has repealed carryover basis and reinstated the estate tax for 2010, but with the \$5.0 million exemption and 35% tax rate that are also available in 2011 and 2012. The new law also provides that estates of persons dying in 2010 can elect out of the estate tax, provided that they accept the carryover basis regime.

The estate tax return is normally due nine months after the date of death. In light of the special circumstances in 2010, the Act extends that filing date (as well as the payment date for the tax) for 2010 decedents to September 17, 2011.

### **Generation-Skipping Transfer Tax**

The Act makes a number of changes to the Generation-Skipping Transfer (GST) Tax, which, to simplify things a bit, is an additional tax imposed on gifts and bequests to grandchildren and great-grandchildren. The 2001 legislation repealed the GST tax for 2010 only, but there was a lack of clarity as to the effect of that repeal. The recent Act should eliminate that uncertainty, because it provides that the GST tax was in effect in 2010, but with a 0% tax rate. This means that any generation-skipping transfers that occurred in 2010 were tax-free, but that taxpayers could still take advantage of the various GST tax exemptions that could reduce or eliminate the tax in future years.

Going forward, the Act aligns the GST tax with the reformed estate and gift taxes. In 2011 and 2012, the GST exemption is increased to \$5.0 million and the tax rate is 35%. In 2013, the GST tax, like the estate and gift taxes, will revert to a \$1.0 million exemption and a 55% tax rate.

### **Planning Opportunities**

There are material estate planning opportunities over the next two years. One opportunity has a short lifespan. There is a very narrow window, until December 31, 2010, in which to make generation-skipping gifts in Trust or directly to grandchildren or great grandchildren that are free of the GST tax. If you are interested in doing so and can act quickly, please contact us immediately so that we can explore your options.

Estates of decedents who died in 2010 now have certainty as to the tax law, but still must decide whether to accept the new default regime (\$5.0 million exemption, 35% tax rate) or to elect into the prior 2010 law (no estate tax, but with carryover basis). If the estate is less than \$5.0 million, in most cases it will be best to accept the application of the estate tax and thereby acquire a basis step-up in the assets. But an analysis should still be done to determine whether the heirs are better off with a stepped-up basis or the carryover regime. It is worth noting that, if the estate of a married decedent accepts the application of the estate tax in 2010, the portability provisions do not apply to the unused portion of the \$5.0 million exemption. Portability applies only to decedents dying in 2011 and 2012.

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If your existing Will/Trust provides for a "Credit Shelter Trust" for the first of you or your spouse to die, consideration should be made to revising that plan for greater flexibility of the survivor. For the great majority of our clients, who intend to live well beyond 2012, the temporary nature of the estate and gift tax changes means that they cannot be relied upon for planning purposes beyond 2012. Congress will revisit the estate, gift and GST taxes in late 2012, and we cannot predict what action it will take at that time. Nevertheless, many clients have been reluctant to do any estate planning in light of the legislative uncertainty and the possibility of estate tax repeal. Now that we know that the estate tax will be with us for at least another two years, the time is ripe to do estate planning. Many clients should consider revised estate plans that take advantage of the 2011 – 2012 rules but protect against possible increased estate tax in 2013 and beyond.

Please contact us if you have questions or wish to meet concerning your estate plan.

**Circular 230 Notice:** In accordance with Treasury Regulations which became applicable to all tax practitioners as of June 20, 2005, please note that any tax advice given herein (and in any attachments) is not intended or written to be used, and cannot be used, by any taxpayer for the purposes of avoiding tax penalties.

Very truly yours,



CROWN & COMPANY, CPA's

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