

Opportunities and consequences of recent changes in gift, estate, and generation-skipping taxes

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the Act) passed late last year, which not only extended Bush-era tax rate cuts for at least two more years, but also created opportunities with its significant changes to gift, estate, and generation-skipping taxes.

We recently hosted a webinar explaining the potential possibilities and unintended consequences the changes could have, as well as why the Act's new deadlines, tax rates, and exemption levels underscore the necessity of estate planning in current conditions. Below is a summary of key points from the webinar.

Estate and generation-skipping tax changes

The Act increased the estate tax exclusion to \$5 million per person for 2010 through 2012. The top marginal tax rate was lowered to 35 percent from 45 percent in 2009. Since the generation-skipping transfer (GST) tax exemption is tied to the \$5 million estate tax exclusion, it also increased. The GST tax rate is 35 percent for 2011 and 2012. Both the estate and GST exemption amounts will be indexed for inflation in 2012. At the end of 2012, the law will sunset, returning to 2001 rates unless Congress acts.

Portability. Starting in 2011, a new provision applies, allowing the unused estate tax exclusion of a deceased spouse, who died in 2011 or later, to be transferred to the surviving spouse. This unused exclusion can then be used by the surviving spouse during his or her lifetime (see gift tax changes below) or at death to shelter asset transfers from tax. Note that the surviving spouse may only use the unused exemption of his or her most recently deceased spouse. Also, there are limitations in portability as any unused GST exemption or any unused state estate exemption is not portable to a surviving spouse.

Gift tax changes

Beginning in 2011, the Act reunifies gift and estate exclusions, which means the lifetime gift tax exclusion is also \$5 million. This is a significant increase over the \$1 million from prior years. The top marginal gift tax rate is 35 percent. As noted above, a surviving spouse will have his or her own \$5 million exclusion and possibly any unused exclusion from his or her last deceased spouse to transfer during his or her lifetime.

Planning opportunities

Under the Act, these new provisions are effective for 2011 and 2012 only, and will revert to exclusion levels and rates from 2001 unless Congress acts. However, this should not deter you from taking advantage of the Act's significant changes:

- > Consider whether the increased estate exclusion to \$5 million per person (\$10 million per married couple) means you should rework your will or revocable trust's division and distribution provisions. Can the first deceased spouse simply leave his or her estate to the surviving spouse rather than funding a family trust, considering the increased exemption and the portability of the unused exclusion to the surviving spouse? There will, however, be many situations where funding the family trust at the first death will still make sense. In order to take full advantage of your increased generation-skipping exemption, additional planning and language may need to be added to your documents. Also, take into account the implications of state estate tax as most of the states that assess a separate tax have lower exemption amounts where careful planning may be necessary.
- > Because the gift tax exclusion had been fixed at \$1 million since 2002, even while the estate tax exclusion climbed to \$3.5 million in 2009, individuals were forced to limit wealth transfers or enter into more complicated transfer-planning techniques. The Act's additional \$4 million exclusion allows additional straight gift transfers during an individual's lifetime rather than waiting until death. This has the added benefit of shifting post-transfer appreciation to heirs. It may make sense to revisit prior transfers involving gifts and sales of assets or look for additional opportunities to transfer wealth to heirs during your lifetime. It is an opportune time to consider wealth

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transfers: interest rates are still near all-time lows, asset values may also be lower, which means the potential for appreciation is much higher, and tax rates are lower now than in the recent past. Also, it is more tax efficient to make taxable gift transfers today rather than waiting to make those same transfers at death.

- > Finally, even if the new exclusion limits result in your estate being nontaxable, make sure the ownership of assets between spouses is optimal to take advantage of each spouse's exclusion and that beneficiary designations coordinate properly with your will or trust dispositive provisions. In addition, this may be a good time to evaluate your documents for nontax reasons to ensure your estate is disposed of the way you intend it to be.

For your consideration

As noted above, you have more reasons than ever to revisit your estate plan, review your documents, and evaluate opportunities to make larger lifetime gift transfers. Interest and tax rates are low and asset values may still be a bit depressed. Seize this moment.

For more information or any questions you might have on this topic, we encourage you to contact your Baker Tilly tax advisor or send an e-mail to tax@bakertilly.com.