January 15, 2011

Estate Planning Update - January 2011

Changes to the Estate and Gift Laws Enacted

For most of 2010, we expected action from Congress on the fate of the estate tax. As most of you know, Congress agreed on a temporary estate tax measure at the end of the year, which clarifies the tax laws for now. On December 17, 2010, President Obama signed into law the Tax Relief, Unemployment Insurance Authorization and Job Creation Act of 2010, which includes changes to the federal estate, gift and generation-skipping transfer ("GST") tax laws for 2011 and 2012.

While the new law provides short-term clarity for estate, gift and GST taxes, the statute is ?temporary? and sunsets on December 31, 2012. Therefore, we can expect further changes to the laws in this area sometime within the next two years. A brief summary of the key items from the new law and some planning items to consider follow.

What does the new law say?

- For 2011, the federal estate tax exemption, the federal gift tax exemption and the federal GST exemption are all increased to $5,000,000, and the tax rate for all three taxes is now 35%.
- For 2012, the federal estate, gift and GST exemptions are indexed for inflation, still with a 35% tax rate.
- Beginning this year, a surviving spouse may, in many cases, be able to make use of any federal estate tax exemption unused in the estate of the predeceased spouse. The surviving spouse can use this additional exemption either for lifetime gifts or at the surviving spouse's death. This is commonly referred to as "portability."
- All of these changes are scheduled to end in 2013, when the estate and gift taxes revert to a $1,000,000 exemption with a top rate of 55%, the GST tax reverts to an exemption of about $1,400,000 with a flat rate of 55%, and portability expires.

What should you do about your estate plan?

Generally, the changes to the law should not require significant changes to many current estate plans. However, estate plans vary widely and the new law's effect on them should be evaluated individually. While there will be exceptions, the following observations are likely to apply in many cases:

- Making lifetime gifts can still be good planning. Those with wealth substantially in excess of their present and future needs should continue to use strategies that can shift future appreciation in property to younger generations without causing a gift tax. The increase in the lifetime gift tax exemption to $5,000,000 makes those strategies more accessible and potentially more meaningful. In particular, those who had made gifts up to the previous $1,000,000 limit may want to consider opportunities for additional gifts to children or grandchildren.
- Most estate plans now in effect were designed around the previous federal estate tax exemption (which after several scheduled increases reached $3,500,000 in 2009), and many also take into account the now widespread "decoupling" of

state estate taxes. Those plans, which automatically take into account the increased exemption amounts, are not significantly affected by the new law.

    - Estate plans for married residents of "decoupled" states (those that impose an estate tax independent from the federal estate tax, including Connecticut, Massachusetts, New Jersey and New York) should include provisions to ensure that they account for the now significant difference between the applicable state and federal estate tax exemptions. Please let us know if you would like to confirm that your plan is up to date.

- The new "portability" of the federal estate tax exemption means that married couples may be able to utilize their combined $10,000,000 federal estate tax exemption regardless of the ownership of the assets between them at the time of the first death and the type of estate plan. However, portability should not be considered a substitute for prudent estate planning. It does not apply to state estate tax exemptions or to the GST exemption. In addition, the surviving spouse can only take advantage of the amount of the decedent's spouse's unused exemption, whereas any growth in property set apart in a sheltered "Family Trust" at the first death represents an additional amount passing free of tax to heirs. Apart from these limitations, portability is currently scheduled to expire after 2012 so it is not advisable to rely on it as a primary estate planning tool.
- Estate plans of unmarried clients will probably not be significantly affected. However, any bequests tied to the estate tax or GST tax exemption amounts will increase significantly and may need to be revisited.
- No matter how the tax law changes, you still need an estate plan. All the non-tax reasons for having one remain, including seeing that your property passes as you wish after death, naming executors and trustees in whom you have confidence to manage property, naming guardians for minor children, and providing for the management of your financial and medical affairs if you are unable to take care of them yourself.

These are some general points about the new law. Please contact us if you would like to discuss how these changes may affect you. If you have not updated your documents in the last few years, this is an appropriate time for a more comprehensive review of your estate plan to ensure that it still meets your estate planning needs and objectives.