



Dear Friends,

One of the final acts of Congress in 2010 was to enact the 2010 Tax Relief Act. Before the new law, there was no estate tax for 2010, but possible higher taxes because there were less favorable income tax basis rules. Also, under the prior law, estate and other transfer taxes were scheduled to rise substantially in 2011.

Overview of the new law. The 2010 Tax Relief Act provides temporary relief. Among other changes, it reduces estate, gift and generation-skipping transfer (GST) taxes for 2011 and 2012. For persons dying in 2010, their representatives can choose to apply the old law or the new law.

Lower rate and higher exemption for 2011 and 2012. For estates of individuals dying in 2009, the top estate tax rate was 45% and there was a \$3.5 million exemption. For 2011 and 2012, the 2010 Tax Relief Act reduces the top rate to 35%. It also increases the exemption to \$5 million for 2011 with a further increase for inflation in 2012. Because of the temporary nature of these relief provisions, planning continues to be difficult unless you are certain of death occurring before 2012! After 2012, the top rate will be 55%, and the exemption will be \$1 million (the pre-Bush tax cut levels).

Gift tax changes. Years ago, the gift tax and the estate tax were unified—they shared a single exemption and were subject to the same tax rates. This was not the case in recent years. For example, in 2010, the top gift tax rate was 35% and the exemption was \$1 million (even though there was no estate tax). For gifts made after December 31, 2010, the gift tax and estate tax are reunified and an overall \$5 million exemption applies.

GST tax changes. The GST tax is an additional tax on gifts and bequests to grandchildren. The 2010 Tax Relief Act lowers GST taxes for 2011 and 2012 by increasing the exemption amount from \$1 million to \$5 million (as indexed after 2011) and reducing the rate from 55% to 35%.

New portability feature. Under the 2010 Tax Relief Act, any exemption that remains unused as of the death of a spouse who dies after December 31, 2010 and before January 1, 2013 is generally available for use by the surviving spouse in addition to his or her own \$5 million exemption for taxable transfers made during life or at death. Under prior law, the exemption of the first spouse to die would be lost to the extent not used. This could happen where the spouse with resources below the exemption amount died before the richer spouse. One way to address that was to set up a "credit shelter" trust for the poorer spouse. Now, the portability rule may make setting up a trust unnecessary in some cases. But there still may be other reasons to employ credit shelter trusts. For example, a credit shelter trust may protect appreciation occurring between the death of the first spouse and the death of the second spouse from being subject to estate tax. Such a trust also can protect against creditors. Plus, the transferred exemption may be lost if the surviving spouse remarries and is again widowed. Finally, it is unknown whether this portability feature will continue to be available if the second spouse dies after 2012.

Conclusion. The estate tax relief in the new law is substantial, but it is temporary. While death and taxes are certainties, predicting future actions of Congress is not. Nevertheless, estate planning to reduce taxes remains an important consideration. Even if taxes are not a concern because an estate is below the (current) exemption level, it is important to have a proper estate plan to ensure that the needs of intended beneficiaries are met.

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