

Staying prepared amid changing estate tax laws

President Obama signed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (TRA 2010) into law on Dec. 17, 2010, bringing a little certainty to federal estate tax law, but only for two years. At the end of the two-year reprieve (Dec. 31, 2012), the law — which now allows for \$5 million of a decedent's estate to be exempt from taxation with the excess taxed at a rate of 35 percent — will automatically roll back to how it was in 2001 (i.e., \$1 million per individual estate-tax exemption and a 55 percent maximum estate and gift tax rate), unless Congress takes further action between now and then to stop the rollback. With many Republicans and Democrats proclaiming themselves to be balance-the-budget hawks, Congress will have to find a way to pay for the estimated \$68 billion in lost estate tax revenues (savings to taxpayers) that will occur before the end of 2012.

tax (regardless of the value of the estate), but the assets in the estate receive a "carryover" income tax basis (i.e., the heirs inherit the decedent's income tax basis).

Executors of estates, and their professional advisers, will want to take a hard look at the pros and cons of selecting the second option or letting the first option be the automatic (default) option.



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Introduction of Spousal Portability

Executors will now be able to transfer to the surviving spouse any unused estate-tax exemption from the first spouse's death. Thus, it is "portable." Some believe this will eliminate the need for "bypass" trusts (also known as "credit shelter trusts," "exemption trusts" and "B trusts,") which prevent the unused estate-tax exemption from the first spouse's death from being "wasted." That is a misconception and may lull people into a false sense of security think-

Optional Estate Tax for 2010

TRA 2010 allows the executor of the estate for a decedent who died in 2010 to choose between two estate-tax options. The first is automatic unless the executor elects out of it. It imposes estate tax on the decedent's estate value that exceeds \$5 million, the tax rate is 35 percent, and the heirs receive a stepped-up income tax basis for assets in the estate at the time of death.

The second option is not automatic — the executor must elect it. It provides for no estate

ing they don't need bypass trust estate-tax planning. However, the portability feature rolls back to no portability at the end of 2012, and bypass trusts still provide powerful asset-management and asset-protection provisions that are important to most families — when they are aware of the provisions and how they work.

The \$5-million-per-decedent estate tax exemption and the portability provision are good for the families of those dying in 2010-12, but they can also be very dangerous if the estate tax exemption rolls back to \$1 million and the portability provision disappears on or before Dec. 31, 2012. In those situations, the estate tax exemption at the first spouse's death may very well go unused, and that may increase the estate tax imposed at the death of the second spouse. That may seem like a long time from now, but for those who understand that "time flies," it is just around the corner.

Until the end of 2012, there are still sound tax reasons to use a bypass trust. For one, funding the bypass trust on the first spouse's death allows its assets to increase in value with no corresponding estate tax at the death of the second spouse.

Gifting Opportunities

Conditions for reducing larger estates through gifting have never been better. Under TRA 2010, there is a \$5 million lifetime gift-tax exemption; before

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TRA 2010 it was \$1 million. The generation-skipping tax exemption is also pegged at \$5 million rather than \$1 million, and add to that historically low federal interest rates and relatively low asset values. Individuals worth more than \$5 million and couples worth more than \$10 million (or people who think the law will roll back to lower estate tax exemptions) should all take a look at the pros and cons of making gifts using the new \$5 million gift tax exemption. The case for making significant wealth transfer gifts between now and Dec. 31, 2012 is compelling.

Conclusion

The author is a member of the American Academy of Estate Planning Attorneys. This article was written in conjunction with

the academy, which recommends that families immediately consult with their estate-planning attorney to see how the foregoing tax-law changes will affect them now and in 2012 when the current law "sunssets" (or rolls back to what it was in 2001). Like the Boy Scouts say, "Be Prepared." That is a good motto for families to keep their estate planning fine tuned, up to date and protecting their hard-earned assets.

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