The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010

Signed into law on December 17, 2010, by President Obama. The following is a recap of some of these changes. Many of these changes have several options for the next 2-years. On January 1, 2013, if Congress does not act again, the gift, estate and GST exemptions will be back to the $1 million (adjusted for inflation) and the top tax rate will be 55%. We strongly recommend your clients work with a qualified elder law/estate planning attorney to decide which option works for their individual situation. It's important to remember that these changes are effective only for the next two years.

Tax on long-term capital gains and qualified dividends remains at 15% for two more years. If no action had been taken, capital gains would have been taxed at 20% and dividends would have been taxed as ordinary income.

The deduction for **direct** charitable donations from an IRA for those 70 1/2 or older was extended for two more years and such contributions made before January 31, 2011, can be attributed to 2010.

Estate, Gift and Generation-Skipping Transfer (GST) Tax Exemptions and Rates

For the next two years, 2011 and 2012, the gift, estate and GST tax exemptions are unified again, with the exemption set at $5 million and the tax rate at 35%. The $5 million exclusion is indexed for inflation beginning in 2012.

For those who died in 2010, they can elect the rules that were in effect at that time, no estate tax with a modified carryover basis (unlimited step-down for loss assets and a limited step-up of $1.3 million plus $3 million for assets passing to a spouse) or the $5 exemption and 35% tax rate and full basis adjustment to date of death value. Executors have an additional nine months after the enactment date to decide. **The main consideration is the amount of estate tax payable now vs. income tax that would be due on the gain when assets are sold in the future**.

Note: MN estate tax exemption is still at $1million. WI has no estate tax (It expired in 2008).

Gifts and Generation-Skipping Transfers

Gifts and Generation-Skipping Transfers for 2010, the gift tax exemption remained at $1 million with a 35% tax rate, but the GST exemption was reinstated at $5 million with a 0% tax rate for 2010 only. For 2011 and 2012, the gift and GST exemption is $5 million with a top rate of 35%.

Estates that could be taxable in 2013, should consider using their $5 million gift and GST tax exemptions in 2011 and 2012. If congress fails to act, January 1, 2013, the estate and gift exemptions will return to $1 million and the GST exemption will decrease to $1 million (adjusted for inflation), all with a top tax rate of 55%.

Being able to make transfers of up to $5 million ($10 million per couple) without having to pay gift taxes allows for planning opportunities that, combined with leveraging strategies, can transfer huge amounts of wealth.

This can also be utilized to fund Irrevocable Life Insurance Trust. **A very large amount of life insurance coverage can be purchased with gift exemptions of $5 million and $10 million. If structured properly, the insurance proceeds can pass free of probate, income and estate taxes to younger generations.**

Note: MN and WI do not have a gift tax at this time. MN Clients can gift $10 million with no gift tax; if they pass it on at death $9 million would be taxable under estate tax rules. Consideration – the gift does not include a step up for land value. Depending on capital gains rates it may still make sense.

Portability

The unlimited spousal transfer remains the same. This rule applies only to deaths after Dec. 31, 2010. Starting in 2011, they can add the unused estate tax exemption of the spouse who died most recently to their own. This dramatic change enables spouses together to transfer up to $10 million tax-free. This can be passed as a gift or through the estate. Portability is not automatic. The executor handling the estate of the spouse who died will need to transfer the unused exemption to the survivor, who can then use it to make lifetime gifts or pass assets through his or her estate. This would mean filing an estate tax return when the first spouse dies, even if no tax is due. This return is due nine months after death with a six-month extension allowed. If the executor doesn't file the return or misses the deadline, the spouse loses the right to portability. Spouses should file it even if they're not wealthy today as circumstances could change on the future.

There is no inflation adjustment for the unused exemption. The surviving spouse can only use the exemption amount of the spouse who died most recently so remarriage could affect the benefit. **Fifteen states and the District of Columbia still have their own estate taxes, and most have exemptions of $1 million or less.** None, as of now, have any portability provisions. That means residents of those states, **including MN and WI,** more than ever need to meet with an attorney even if they have already drafted an estate plan to make sure they have addressed all of these new provisions.

Please consult a tax advisor for tax advice.