January 2011

SUMMARY OF THE ESTATE TAX ASPECTS OF THE 2010 TAX ACT

On December 17, 2010 President Obama signed the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (the "2010 Act").

The 2010 Act significantly changes the federal estate tax law for calendar years 2011 and 2012.

This Alert will summarize the major estate tax aspects of the 2010 Act.

Estate Tax Exemption Amount for 2011 and 2012

The 2010 Act raises the Federal Estate Tax Exemption Amount to $5 million dollars (indexed for inflation in 2012) for persons dying during calendar years 2011 or 2012.

Maximum Estate Tax Rate for 2011 and 2012

The 2010 Act sets the top estate tax bracket at 35%, which is lower than under prior law.

Step-up in Income Tax Basis

The 2010 Act reinstates step-up in income tax basis when a person passes away during calendar years 2011 or 2012. Modified carry-over basis, which was in effect for 2010 under prior law, has been eliminated. Step-up in income tax basis means that any property received by the heirs of a person who has died during 2011 or 2012, will pass to the heirs with a new cost basis equal to the property's fair market value on the date of the death.

Portability between Spouses of a Deceased Spouse's Unused Estate Tax Exemption

The 2010 Act provides for "portability" between spouses of the $5 million dollar estate tax exemption amount for estates of decedents dying in 2011 or 2012, if both spouses die before 2013. This means that surviving spouses of persons dying during calendar years 2011 or 2012 may elect to take advantage of the unused portion of the $5 million dollar estate tax exemption amount of their deceased spouse, thereby providing a surviving spouse with a larger estate tax exemption amount upon their death.

To preserve the first deceased spouse's unused estate tax exemption, the executor for such deceased spouse must file an estate tax return for such deceased spouse's estate and make an election on such return, even if the filing of an estate tax return would not otherwise be required.

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Gift Tax Lifetime Exemption Amounts for 2011 and 2012

The 2010 Act increases the applicable lifetime exemption amount to $5 million dollars (indexed for inflation in 2012) for gifts made after 2010 by a donor before any gift taxes would be owed. Note: This $5 million dollar lifetime exemption amount is reduced by any gift exemption used prior to 2011.

The annual gift tax exclusion amount for 2011 remains at $13,000 per person per calendar year (and married couples may continue to "split" their gift and make combined gifts of $26,000 per person per calendar year). In addition, exclusions continue for gift transfers made for medical or educational purposes for an individual.

Note: Any gifts made by an individual during calendar years 2011 and 2012 (which exceed the annual exclusion amount of the $13,000 per person calendar year) will reduce such person's estate tax exemption amount upon death.

Maximum Gift Tax Rate for 2011 and 2012

The 2010 Act sets the top gift tax bracket at 35%, thereby unifying it with the top estate tax rate for 2011 and 2012.

Generation-Skipping Transfer Tax Exemption Amount for 2011 and 2012

The 2010 Act raises the generation-skipping transfer tax exemption amount to $5 million dollars (indexed for inflation in 2012) beginning on January 1, 2011.

Maximum Generation-Skipping Transfer Tax Rate for 2011 and 2012

The 2010 Act sets the top generation-skipping transfer tax exemption amount at 35% for calendar years 2011 and 2012.

The 2010 Act's Effect Upon Persons Dying During Calendar Year 2010

Prior to the enactment of the 2010 Act, the federal estate tax was eliminated for persons dying during calendar year 2010 and modified carryover basis rules were in effect with respect to property passing from a decedent who died during calendar year 2010.

The 2010 Act gives estates of decedents who died during calendar year 2010 the option to apply (1) the estate tax based on the new 35% top estate tax bracket and $5 million dollar estate tax exemption amount, with stepped-up basis; or (2) no federal estate tax and modified carryover basis rules under prior law.

The 2010 Act also extends the time to file a federal estate tax return, for a decedent who died during calendar year 2010, until September 17, 2011, which is nine (9) months after the 2010 Act was enacted (rather than the usual time period of nine (9) months after the decedent's date of death.)

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Any questions concerning the matters raised in this Alert should be addressed to the members of our Tax and Trusts & Estates practice group.

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Best Wishes to You & Your Families for a Very Happy & Healthy 2011!

Comments on the 2010 Act

(i) The 2010 Act is a temporary fix which sunsets on December 31, 2012. If Congress fails to act prior to December 31, 2012, then the federal estate tax will revert to what it would have been under prior law (i.e.: a $1 million dollar estate and gift tax exemption amount and a top estate and gift tax bracket of 55%).

(ii) The 2010 Act increases the gift tax lifetime exemption amount to $5 million dollars per person (or $10 million dollars per married couple). This change provides an extraordinary opportunity to move substantial assets out of the estates of individuals and down to the next generation.

(iii) The increased $5 million dollar estate tax exemption amount provided under the 2010 Act does not apply to non-United States Citizens who are not residents of the United States. As a result, non-US Citizens who are not US residents must pay particular attention to pre-2010 estate tax law.

(iv) Many estate plans contain tax driven formula clauses which pass assets upon death based upon the then amounts of the estate tax exemption amount. As a result of the significant increase in the estate tax exemption amount for 2011 and 2012, the dynamics of your estate plan (and the flow of assets under your existing estate plan) may have radically changed. Please be sure to review your estate plan in light of the newly enacted provisions of the 2010 Act.

(v) The 2010 Act may impact the amount of state estate tax exposure which will exist upon death. This issue should be reviewed accordingly.

(vi) The 2010 Act may impact your current estate planning documents, while, at the same time, provide significant estate planning opportunities. We recommend that you review your estate planning documents in light of the passage of the 2010 Act.

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