

ESTATE PLANNING OPPORTUNITIES IN 2011 AND BEYOND

On December 17, 2010, President Obama signed into law the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the “2010 Tax Relief Act”). The Tax Relief Act extended the tax cuts passed in 2001 and 2003, **but only for a period of two years (i.e., 2011 and 2012)**. While most of the press coverage dealt with the extension of the cuts to the income tax rates and the decreased withholding of Social Security taxes from wages and self-employment income, significant changes were made to the federal estate, gift, and generation-skipping transfer tax system.

The past ten years had seen a significant increase in the amount that can be transferred without being subject to a federal estate tax, from \$675,000 in 2001 to \$3.5 million in 2009 (the “exemption amount”), as well as a reduction in the top marginal estate tax rate from 55 percent to 45 percent, culminating in the elimination of the federal estate tax in 2010.

In addition, the potential impact of the federal gift tax, while not repealed, had also been reduced, with the exemption being increased to \$1 million and a top marginal rate of 35 percent in 2010. However, without legislation both the estate and gift tax exemption would have been \$1 million in 2011, with a top marginal rate of 55 percent applicable to both.

The 2010 Tax Relief Act provides for the following changes:

- **INCREASED ESTATE EXEMPTION:** the federal exemption amount has been increased to \$5 million, indexed for inflation beginning in 2012.
- **PORTABILITY OF UNUSED EXEMPTION:** for decedents dying in 2011 and 2012, the exemption is “portable” between spouses—if the estate of one spouse does not use all of his or her \$5 million exemption it may be used by the estate of the surviving spouse.
- **INCREASED GIFT TAX EXEMPTION:** the gift tax exemption has been increased from \$1 million to \$5 million, resulting in a “unified” gift and estate tax.
- **TOP MARGINAL TAX RATE:** the top marginal tax rate is 35 percent for both the federal estate tax and the federal gift tax.
- **DECEDENTS DYING IN 2010:** the Tax Relief Act applies to estates of decedents dying in 2010, with a \$5 million exemption, a top marginal tax rate of 35 percent, and a “stepped-up” basis for inherited assets for income tax purposes. However, the Executors of decedents who died in 2010 may elect to have no federal estate tax apply along with a modified “carryover” basis for inherited assets. For estates over \$5 million the Executor will need to carefully analyze the estate assets to determine whether making the election will result in a more favorable tax result.
- **GENERATION-SKIPPING TAX:** the generation-skipping tax (“GST”) is an additional tax that may be imposed on transfers that skip generations (i.e. transfers to grandchildren). In 2011 and 2012 the GST exemption has also been increased to \$5 million with a top marginal rate of 35 percent.

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While the Tax Relief Act substantially increases both the gift and estate tax exemption and reduces the top marginal tax rate, the law is only applicable for 2011 and 2012. Unless Congress passes additional legislation, the pre-2001 laws will apply and both the estate and gift tax exemption will be reduced to \$1 million in 2013, with a top marginal rate of 55 percent.

WHAT IS THE OPPORTUNITY?

If you have a substantial estate, you should consider making lifetime gifts. Annual exclusion gifts of \$13,000 per person per year can be made, as well gifts for payment of tuition and medical expenses if made directly to the institution.

If the situation warrants, you should seriously consider making larger gifts in 2011 and 2012 to take advantage of the \$5 million lifetime gift exclusion. If properly made, these large lifetime gifts could remove the appreciation on the assets gifted from your estate and potentially reduce your estate tax liability significantly.

WHAT ABOUT MASSACHUSETTS?

Massachusetts “decoupled” its estate tax laws from the federal law effective January 1, 2003. For deaths occurring on or after January 1, 2006, if a decedent’s Massachusetts gross estate exceeds \$1 million (the “Massachusetts Filing Threshold”), a Massachusetts estate tax return must be filed within nine months of the date of death and any tax due must be paid at that time. The 2010 Tax Relief Act that raised the federal exemption from estate taxes to \$5 million does not change Massachusetts law, and planning for the potential impact of the Massachusetts estate tax is still necessary for many individuals.

- **Assume a Massachusetts decedent has a taxable estate of \$1,500,000 in 2011. There would be no federal estate tax but the Massachusetts estate tax would be \$64,400. Alternatively, if a Massachusetts decedent had a taxable estate of \$5 million in 2011 there would still be no federal estate tax under the new law, but the Massachusetts estate tax would be \$391,600.**

Unlike the federal estate and gift tax system, Massachusetts has no gift tax. However, any lifetime gifts in excess of the federal annual exclusion from gifts must be subtracted from the \$1 million Filing Threshold requirement. The benefits of lifetime gifting can also be significant for Massachusetts taxpayers, even if they have no exposure to the federal estate tax, and large lifetime gifts can be made with no current gift tax cost.

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WHY IS IT A GOOD TIME TO REVIEW YOUR ESTATE PLAN?

The recent developments to the estate and gift tax laws present an opportune time to review your estate plan. For those of you who have existing estate planning documents that were drafted to take advantage of the prior federal estate tax laws, you need to consider whether those documents still make sense for you. For those of you who are considering the benefits of lifetime gifting, you should not make substantial gifts until consulting with an attorney who specializes in estate planning and perhaps your accountant, so that the impact of making the gifts are understood and the appropriate gifting strategies are used.

Remember that even though you may not be subject to the federal estate tax law, you may still need to plan for the Massachusetts estate tax. In addition, there are many non-tax reasons for estate planning. For example: your estate planning documents should reflect your current circumstances and be updated to reflect changes in your personal and financial situation; potential physical or mental incapacity should be addressed; the role of life insurance in your estate plan should be understood; and the advantages and disadvantages of trusts should be considered.

The purpose of estate planning is to help ensure that your estate will be transferred to your intended heirs in an orderly and cost effective manner. While no estate plan should be motivated solely for tax avoidance, the potential impact of federal and state estate taxes must be taken into consideration in formulating your plan. Our goal is to help you better understand your options and to assist you in developing your overall strategy.

Please do not hesitate to contact us with any questions you may have.

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