Money Talk

By Thomas A. Mecham and Brent A. Andrewsen

Window of Opportunity

Estate Planning and Estate Taxes for 2011 and 2012

What is the condition of your current estate plan? Is it rock solid? Anyone who endeavors to "complete" his or her estate plan soon learns estate planning is more of a process than a single event. This is because the estate planning process is governed by a complex set of laws that seem to be ever changing. The most recent example is the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 signed into law by President Barack Obama on December 17, 2010.

A Brief History

In 2001, Congress enacted the "Bush Tax Cuts," which included favorable changes for taxpayers to the gift tax laws (governing transfers during life) and estate tax laws (governing transfers at death). From 2001 through 2009, the amount taxpayers could pass at death, free of estate taxes, increased from $1 million to $3.5 million. In 2010, the federal estate tax or "death tax" was entirely eliminated, but only for 2010. Meanwhile, the amount which taxpayers could transfer by gift to beneficiaries during their lifetime held constant at $1 million from 2001 to 2010. The impact of the "repeal of the death tax" reached popular consciousness when George Steinbrenner, owner of the New York Yankees, died in 2010 leaving an estimated $600 million to his heirs free from federal estate tax.

Cowering under the glare of taxpayers angry at the expiration of the "Bush Tax Cuts" and the return to a $1 million federal estate tax exemption, Congress finally blinked. The 2010 Act includes generous increases to the estate and the gift tax exemptions, as well as many income and employment tax goodies. Ever willing to tantalize taxpayers, however, Congress made such changes effective only for the 2011 and 2012 calendar years. Special transitional rules for the estate and gift tax also were included for 2010.

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Current Law

The key changes in the 2010 Act likely to affect your estate plan are: (1) an increased exemption amount of $5 million for transfers at death, (2) the "portability" of this exemption amount between spouses—a concept previously unknown but long sought after with respect to the federal estate tax, and (3) an increased exemption amount of $5 million for transfers during life, a 400 percent increase over the prior exemption of $1 million.

Each of these changes presents planning opportunities. With proper estate planning, married couples can now transfer up to $10 million free of estate tax. Assets transferred in excess of $5 million for individuals and $10 million for married couples are taxed at a flat rate of 35 percent (as opposed to a top rate of 45 percent under prior law). Often overlooked is the fact that the face value of life insurance policies is included in the total value of your estate. So, if you have just under $10 million in assets and a $5 million life insurance policy, you have an estate tax problem.

An intriguing new feature of the 2010 Act is the ability of a surviving spouse to use the unutilized portion of his or her deceased spouse's $5 million exemption, essentially making the exemption of the first spouse to die transferrable or "portable" to the surviving spouse. Portability allows a surviving, wealthier spouse to pass additional wealth to his or her heirs, which could be particularly helpful in second marriages where spouses have different intended beneficiaries. The benefits of portability can be obtained, however, only by filing an estate tax return for the estate of the first spouse to die. For those who have employed traditional "A/B Trust" or marital deduction planning, it is probably still too early to toss out your existing trusts just yet, as the portability provisions of the 2010 Act are set to expire at the end of 2012.

Limited Time Offer

By far the most significant change in the 2010 Act is the increase in the gift tax exemption to $5 million. Already, those who felt constrained by the prior $1 million exemption have taken advantage of the increased $5 million exemption, and this despite the possibility of a so-called "clawback" in the event Congress does not make permanent the new exemption amounts. Even though lifetime gifts are subject to the same tax rate imposed upon bequests at death, the prospect of future appreciation of the gifted asset and the time value of money make lifetime gifts superior to those at death. If Congress does not make the new exemptions permanent, taxpayers' current ability to transfer up to $5 million free from gift tax truly will have been a once-in-a-lifetime opportunity.

Although exemption amounts and tax rates after 2012 are uncertain, the estate and gift taxes appear likely to stay, and certainly should not be ignored for larger estates. Therefore, consider updating your estate plan and making sufficient gifts during your lifetime so your estate will not exceed the exemption amount in effect at your death. UB

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