

ALERT:

Impact of the 2010 Tax Act on your estate, gift and GST tax issues

The “Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010” (the “Act”) is complex, and this Alert only highlights features that are important to Estate, Gift and Generation-Skipping Transfer Tax (“GST Tax”) planning.

The Act expires in two years, and there is no way of knowing what Congress will do in the future. The next two years offer opportunities, that may be gone on January 1, 2013, to anyone with a significant estate or who might otherwise want to make substantial gifts to children, grandchildren or others. We strongly recommend looking at how these opportunities might work for you in the near-term.

1. **Estate Tax Free Amount Increased:** The Act increases the amount a person can leave at death without being taxed (the “Estate Tax Free Amount”) to \$5 million dollars per person (\$10 million per married couple) for 2011 and 2012 (indexed for 2012), but this expires as of January 1, 2013 unless yet another tax act is passed in time.
2. **Gift Tax Free Amount Re-Unified with Estate Tax:** The Act re-unifies the Gift Tax Free Amount and the Estate Tax Free amount at \$5 million per person but only for 2011 and 2012 (indexed for 2012). ***This makes 2011 and 2012 excellent times to make significant gifts.***
3. **Estate Tax Free Amounts are “transferrable” to spouses upon death:** Estate Tax Free Amounts are “portable” for married persons where one spouse dies before January 1, 2013. If a person dies leaving \$3 million in assets (without reaching the full \$5 million Estate Tax Free Amount), the \$2 million balance will carry over to the surviving spouse. However, if the surviving spouse remarries, his or her Estate Tax Free Amount could change again in certain circumstances.

Appreciation on the deceased spouse’s unused Estate Tax Free Amount is not counted. The purpose of a “by-pass” or “shelter” trust is to keep future growth from being subject to *estate* taxes. Accordingly, if a deceased spouse left \$3 million in an estate tax sheltered trust for the lifetime of the surviving spouse and the value grew to \$4 million by the time the surviving spouse died, the \$1 million in growth would also be sheltered from **estate** taxes. However, the carryover Estate Tax Free Amount from the deceased spouse would stay fixed, regardless of growth in asset values. Also, the Estate Tax Free Amount carried over by a surviving spouse is not indexed for inflation.

The portability features of the Act are available **only** if a deceased spouse’s estate files an election for portability on a timely filed U.S. Estate Tax Return, even if the return would not otherwise be required. Also, while a U.S. Estate Tax Return typically cannot be audited once it has been filed for three years (except for fraud and the like), there is no Statute of Limitations on when a U.S. Estate Tax Return can be audited solely for purposes of determining the value of the deceased spouse’s unused Estate Tax Free Amount carried over by the surviving spouse.

4. **New Maximum Tax Brackets:** The new maximum tax bracket for estate, gift and GST taxes is 35%, but the maximum brackets will revert to 55% on January 1, 2013 unless a new tax act is in place by then.

5. **Capital Gains Adjustment Reinstated:** The Act reinstates the old adjustment rules that allow estates to receive a full basis adjustment (the so-called “step-up” in basis) for capital gains tax purposes on many of a decedent’s assets. This is very beneficial where a decedent dies owning low basis, high value assets, but can be detrimental where the assets have declined substantially in value, as has happened to many in recent years, since there can also be a “step-down” in basis.
6. **Primary State Estate Tax Issues:** The Act does not generally affect Michigan decedents but will affect decedents in fourteen (14) other states that require an estate tax return to be filed even if no federal return is required. In those states the form and filing requirements may be modified because of the Act. Professional guidance should be sought to ensure all filings are completed and are correct in form and substance.
7. **What to Do with Your Existing Documents:** So, what changes need to be made on your existing documents? For single persons, perhaps no changes are needed, unless the GST Tax is involved. For married couples, much will depend upon whether the parties want any restrictions on the surviving spouse after the first death. If restrictions are involved, then few changes may be needed. However, if the couple wants the surviving spouse to have as much outright ownership and control as possible, then extensive changes may be needed.

There may also be issues whether Irrevocable Trusts continue to be necessary to shelter life insurance proceeds from estate taxation, which may involve issues as to who receives the assets of terminated Irrevocable Trusts. However, since the Act expires in two years, terminating Irrevocable Trusts until we know what the future law will be may be very unwise.

The Act also opens broad opportunities for shifting future growth out of the estate tax system by any number of gifting mechanisms. This is particularly important for persons contemplating substantial gifts and would not be adversely affected if no new tax law is enacted by December 31, 2012.

Finally, do **not** make the mistake of thinking that no planning is needed if you don’t have estate tax exposure. Some of the most important reasons for planning include avoiding probate and what kind of legacy you will leave: who is to make medical and financial decisions if you are unable and financial decisions when you are gone; who is to inherit what and when and under what conditions; and who is to care for young children or special needs family members.

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