

Estate Tax Laws in Place for 2011-2012

By Wesley E. Wright and Molly Dear Abshire, as published in the Houston Chronicle Senior Living Section on February 22, 2011.

With the deaths of several high profile billionaires in 2010, such as Dan Duncan and George Steinbrenner, it has been widely publicized that the estates of individuals dying in 2010 would not be subject to an estate tax.

However, without Congressional intervention, the estate tax was set to return in 2011 with an individual exemption of \$1 million and an effective tax rate of 55 percent. However, in late 2010, the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act, ended the year of uncertainty surrounding the future of the estate tax. Several key provisions of this legislation are outlined in this article.

In 2011, the individual exemption amount has increased to \$5 million and the effective tax rate has been reduced to 35 percent. This reduces the number of estates that would be subject to an estate tax. The \$5 million exemption is indexed for inflation, meaning this amount will eventually increase. It is important to note these estate tax provisions are applicable only for 2011 and 2012 meaning that unless Congress establishes a permanent estate tax regime, the same uncertainty that surrounded 2010 will occur in 2013 (with the tax exemption reduced to \$1 million and the rate increased to 55 percent).

Another important aspect of the new legislation is the return of the "step-up" in basis rules.

The step-up rules provide for an increase basis in the hands of the estate's beneficiaries for property owned by a decedent. The basis is used in the calculation of capital gains tax owed on the sale of property received by a decedent.

In 2010, carry-over basis rules applied with beneficiaries of some estates having to pay an increased amount of capital gains tax. Therefore, beginning in 2011 the beneficiaries of estates will have a basis equal to the fair market value of the asset at the time of death.

However, what about the estates of decedents dying in 2010 who are unable to use the step-up in basis rules and whose beneficiaries may be forced to pay capital gains upon the sale of property? Congress, as part of the new legislation, has provided for the executors of the estate of decedents dying in 2010, to elect whether or not they want the estate taxed pursuant to the rules in 2010 (i.e. carry-over basis) or pursuant to the new rules.

Considering most estates are below the \$5 million exemption amount, it makes sense most executors will choose the 2011 option.

Another feature of the estate tax beginning in 2011, is that an individual's exemption is portable to the surviving spouse. This means that any unused exemption amount can be passed on to the decedent's surviving spouse. For example, husband dies in 2011 with a \$4 million estate leaving \$1 million of

unused exemption. If his surviving spouse dies in 2012 with a \$6 million estate, she may add on his unused exemption amount to her exemption and avoid paying any estate tax.

In addition to the estate tax, the gift tax and the generation-skipping transfer ("GST") tax are addressed under the new legislation. For the first time, the estate tax, gift tax and GST tax have one unified exemption amount. This means that if an individual makes a \$2 million gift during his lifetime, he still has \$3 million of his exemption remaining or if the taxpayer creates a GST trust for his grandchild with \$4 million, he still has \$1 million of exemption.

It is important to realize gifts made during an individual's lifetime still effect the amount of the exemption remaining at the time of death. Additionally, an individual may still make tax-free gifts of up to \$13,000 per person in 2011.

The changes to the estate tax in 2011 will provide certainty for the next couple of years. However, until the rules become permanent, it is still necessary to monitor the current status of the estate tax and how it affects your estate plan.