

- The new tax laws
- Portability

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President Obama Signs Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010

On December 17, 2010 the President signed into law the much debated and endlessly evolving Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the Act).

The Act contains many extended as well as many new provisions that will significantly impact the tax liabilities of our individual and businesses clients. More specifically, the Act:

- Extends for two years individual tax rates that were set to expire on December 31, 2010.
- Continues to “patch” the Alternative Minimum Tax (AMT) – which lessens AMT’s impact.
- Provides new incentives for business investment in machinery and equipment.
- Grants a two percentage point reduction in the employee share of payroll taxes for 2011 (including similar reductions in the self-employment taxes paid by individuals who operate their businesses individually or as single member LLCs).
- Provides much needed (albeit temporary) certainty to the estate and gift tax.

In this newsletter we will focus our discussion on the estate and gift tax provisions of the Act, while future editions will analyze the personal and business provisions with an eye toward implementing tax planning strategies that will maximize opportunities contained in the Act.

Background: Before we discuss the specific estate and gift tax provisions of the Act, some background on the estate and gift tax rules they replace will be helpful.

With the passage of the Economic Growth and Tax Relief Act in 2001, a series of long-term changes to the estate, gift and generation skipping transfer taxes was set in motion, changes which:

- Partially separated the previously unified estate and gift tax.
- Scheduled increases in the estate and gift tax exemptions and decreases in the tax rates.
- Culminating in a repeal of the estate tax altogether in 2010.

For 2011, however, the estate and gift taxes were scheduled to revert back to their status as they generally applied in years prior to 2002.

During the transitional years between 2002 and 2009 the estate tax exemption increased from \$675,000 to \$3.5 million per taxpayer and the gift tax exemption increased from \$675,000 to \$1 million per taxpayer. (Note that any exemption that remained unused at death was forever lost.) The top estate tax rate decreased from 55% to 0% (2010) and the top gift tax rate decreased from 55% to 35%.

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More About Portability

One of the more significant changes to come out of the Act is the concept of portability of unused tax exemptions between spouses. This represents a fundamental change in estate planning techniques.

Under the Act, any unused estate tax exemption of a deceased spouse is available for use by the surviving spouse – in addition to his or her own \$5 million exemption. The combined exemption amounts may then be used by the surviving spouse to offset gift taxes on lifetime transfers or to offset taxes on his or her estate. These provisions ensure that a married couple will be able to avail themselves of the entire combined \$10 million estate and gift tax exemption.

It should be noted that if there is more than one predeceased spouse, the surviving spouse can only use the unused exemption of the last deceased spouse.

Keep in mind that although these changes are good news for all of us, they are temporary. Your tax and financial experts at DHL&S can help you navigate what used to be the murky waters of estate and gift planning and keep you up to date as tax policy evolves over the next couple of years.

For more information on how we at DHL&S can help with these and other tax planning opportunities, please contact us at 203-929-3535, or visit our website at www.dhls.com.



(continued from front – President Obama)

Also, during these transitional years, the law provided that when property was received as a gift, the tax basis (i.e., the cost) of the property in the hands of the gift recipient was the same as its cost in the hands of the person who made the gift (the so-called Carryover Basis rule). As a result, a recipient would pay income tax on the subsequent sale of appreciated property received as a gift.

On the other hand, *inherited* property received a tax basis equal to its fair market value on the date of death of the decedent. Because of this “step up” in basis, no income tax would be due on a subsequent sale of the inherited property for that portion of the value that appreciated while it was held by the decedent.

Modified Carryover Basis rules for inherited property were implemented for 2010 to reflect the repeal of the estate tax. For 2010, the cost of a decedent’s property could be increased by up to \$1.3 million for property left to non-spousal beneficiaries and an additional \$3 million for property left to a spouse.

The New Rules: The Act provides many very favorable estate and gift tax planning opportunities, some of which have never been available before and some of which are present by their absence. But more on that later!

The Act preserves the repeal of the estate tax for 2010 only. Beginning in 2011, the Act provides an estate tax exemption for estates valued up to \$5 million per taxpayer, a top tax bracket of 35% and a step up to fair market value in the basis of a decedent’s asset.

Under the Act, a deceased spouse’s unused estate tax exemption becomes portable; that is, the unused balance of the \$5 million per taxpayer exemption may be used by the surviving spouse against his or her own estate tax as opposed to previous law that said what was unused was lost (*see sidebar on page 1*).

Is there a dreaded “but” lurking somewhere amidst all of this good news you ask? Of course there is.

The dreaded “but” is that these provisions are only temporary and will expire at the end of 2012, only to be replaced by much harsher rules thereafter, unless of course, we have déjà vu all over again and Congress comes up with another last minute solution.

Let’s look at some of the details:

For 2011 and 2012 the estate, gift and generation skipping transfer tax exemption is set at \$5 million per individual. For a married couple this means that combined estates of up to \$10 million will be exempt from estate tax. The exemption is available for transfers of property during one’s lifetime as well as assets transferred at death. The top tax rate for estate, gift and generation skipping transfer tax purposes is 35%. Assets transferred during one’s lifetime will have a carryover basis to the recipient, and the decedent’s assets will receive a “step up” in basis equal to the date of death fair market value of the property.

Although the estate tax is repealed for 2010, an election can be made to apply the 2011/2012 provisions to the estate of a decedent dying in 2010. That is, an executor may choose between (1) no estate tax and applying the Modified Carryover Basis rules or (2) applying the estate tax (based on the \$5 million exemption and 35% top tax rate) and stepping up the basis of the decedent’s assets to their fair market value.

This is a very taxpayer friendly option, and deciding whether the election is appropriate in your particular circumstances depends on many factors, including the basis of the decedent’s assets, the nature and liquidity of those assets and the intentions of the heirs with respect to use of the inherited property.

Included by omission: We’ll now conclude by pointedly noting what was not in the Act. And that is any provisions to

DHL&S Family News and Events

- The Principals of DHL&S would like to take this opportunity to commend our staff for their generosity this holiday season. Their charitable donations and fund-raising efforts for the Spooner House Shelter Services, Give 2 the Troops, Inc., Birmingham Group Health Services Annual Thanksgiving Food Drive, Holiday Gift Giving Program and the CT Basket Brigade helped many families this holiday season.

restrict the rather generous “minority interest” and “lack of marketability” discounts that have been taken by taxpayers (and blessed by the courts) when valuing asset transfers for estate and gift tax purposes. While there has been much discussion and several proposals to limit taxpayers’ options in this regard, none of these found their way into the Act. While we cannot take this legislative inaction as an invitation to be unreasonable, the fact that Congress has not challenged the discount guidelines established by the courts in recent years provide ample opportunity to minimize estate and gift taxes in the valuation context.

Lastly, the rescheduled December 31, 2012 sunset of the very favorable provisions contained in the Act should not be overlooked. After nearly a decade of estate planning uncertainty, the Act is a breath of fresh air. Given the tepid economy, depressed real estate values and historically low interest rates, 2011 and 2012 provide a window of opportunity to maximize the transfer of estate value to future generations at minimal cost.

The tax professionals at DHL&S will help you review your situation and make all appropriate elections and comply with the attendant filing requirements. Check out our website at www.dhls.com or call us at 203-929-3535.