



Estate Tax Changes in New Tax Bill

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On Friday, President Obama signed into law the “Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010”, extending for two years the Bush era income tax rates and containing several other measures relating to unemployment insurance and incentives for business.

The Act restores the estate tax which had expired as of January 1, 2010, applying a flat estate tax rate of 35% and an “exemption equivalent” of \$5 million to deaths occurring in 2011 and 2012. The new estate tax laws apply retroactively to 2010 as well, though estates can “opt out” by electing to apply the prior 2010 law (which featured no estate tax but only allowed a limited basis step-up for income tax purposes).

Executive Summary

Exemptions and Rates	2010*	2011	2012	2013
Estate tax exemption	\$5 million	\$5 million	\$5 million	\$1 million
Gift tax exemption	\$1 million	\$5 million	\$5 million	\$1 million
GST exemption	\$5 million	\$5 million	\$5 million	\$1 million
Gift and estate tax rate	35%	35%	35%	55%
GST tax rate	0%	35%	35%	55%

Basis Step-Up

The basis step-up is restored for all deaths occurring in 2010*, 2011 & 2012.

***2010 Optional Election**

For deaths occurring in 2010, estates can choose between the new law (with an estate tax rate of 35%, a \$5 million exemption, and stepped-up basis) and the existing law (with no estate tax and modified carryover basis).

Portable Estate Tax Exemption

For deaths occurring after December 31, 2010, an estate can transfer any unused portion of a decedent’s estate tax exemption to a surviving spouse.

One of the most surprising changes is an increased \$5 million exemption for gifts made in 2011 and 2012, reunifying the federal estate and gift tax exemptions. The estate and gift tax exemptions were last “unified” in 2003, with a single graduated tax rate and exemption amount that applied to cumulative transfers made by a taxpayer whether during lifetime or at death.

Since 2004, however, the exemption applicable to estates has exceeded the exemption for lifetime gift transactions, most recently with a \$3.5 million estate exemption and a \$1 million gift exemption in 2009.

Also significant is a new portability feature that will allow a surviving spouse to use the unused portion of a predeceased spouse's estate tax exemption. In some cases this may eliminate the need for married couples to use credit shelter or "Family Trust" structures in their estate plan to ensure that both spouses obtain full benefit for their exemption amount. It also means that some married couples will not need to be as vigilant about maintaining equal asset ownership between them.

The basis step-up rules are restored for 2010, 2011 and 2012 (subject to the "opt out" option for 2010). In most cases the income tax basis in property inherited from a decedent's estate will be equal to the fair market value of the property as of the decedent's date of death. This replaces the modified carryover basis rules previously in place for 2010, which generally said that recipients of property from a decedent's estate received an income tax basis equal to the decedent's basis.

The Act extends a federal estate tax deduction for death taxes paid to any state, preventing the return of the state death tax credit that had prevailed up until 2005. This extension all but ensures continued disparity in whether various states will impose a state-level estate tax. Minnesota residents will likely continue to have a \$1 million estate tax exemption for Minnesota estate tax purposes. It will be interesting to see how the new federal estate tax portability feature is reconciled with Minnesota's estate tax law.

The generation-skipping tax ("GST") also returns, with an exemption for decedents dying or gifts made after December 31, 2009 equal to the applicable exclusion amount for estate tax purposes (e.g. \$5 million for 2010). As a result of this change, a donor's GST exemption can now be allocated to trusts created or funded in 2010, sidestepping some of the uncertainty about how the one-year repeal of the GST tax would affect future distributions. Although the Act restores the GST for 2010, the applicable tax rate for transfers made in 2010 is zero percent. The GST tax rate for transfers in 2011 and 2012 is 35%.

Like the prior estate tax law, this Act contains a sunset provision which causes it to expire after 2012. All of the estate tax changes will need to be revisited before then to avoid a reversion back to pre-2002 laws (which carried a \$1 million federal estate tax exemption and a maximum tax rate of 55%).



The most immediate consequence of the Act is that most married couples with traditional tax shelter planning in their estate documents should have their estate plans reviewed. The increased gift tax exemption available in 2011 and 2012 also presents a significant opportunity for wealth-transfer planning.

To learn more on how this legislation affects your personal situation, contact a Boulay Advisor at 952.893.9320 or learnmore@bhz.com.