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The New Estate Tax Bill and What it Means for You and Your Family

On December 17, 2010, President Obama signed into law the much anticipated new federal estate tax bill. The new law brings some resolution to the uncertainty of the past year, while creating yet more uncertainty in the years ahead. Following is a brief review of some of the highlights of the new law.

The estate tax exemption, which was scheduled to return to \$1 million with a top tax rate of 55%, will now be \$5 million per person with a top tax rate of 35% on estates over the exemption amount. This new exemption amount and tax rate has been made retroactive to January 1, 2010! That's right, the estate tax has been imposed *retroactively* to January 1, 2010. What does this mean for individuals who died in 2010? If a decedent's gross estate for federal estate tax purposes is valued less than \$5 million, their personal representatives and/or successor trustees will not need to do anything to take advantage of the increased estate tax exemption and full step-up in basis on their assets. The default rule for estates in 2010 will be estate tax treatment.

What does the retroactive implementation mean for individuals who died in 2010 with gross estates valued in excess of \$5 million? Those estates will have the option of choosing either estate tax treatment with the \$5 million exemption and full step-up in basis of assets or they can elect to "opt out" of the estate tax and have the assets subject to the carryover basis rules (with a \$1.3 million basis adjustment plus an additional \$3 million for assets passing to the surviving spouse). The decision to subject the estate to the estate tax system or opt out for carryover basis requires a detailed mathematical analysis of the specific assets in the estate as well as projected growth and future tax rates.

A new twist to the estate tax system beginning January 1, 2011 is the creation of the "portable" estate tax exemption for surviving spouses. Under the old law an individual's estate tax exemption was subject to "use it or lose it" treatment. This meant if the first spouse to die didn't create a special trust to take advantage of his estate tax exemption, the surviving spouse would lose the ability to utilize the unused exemption at her death. Under the new portability rules, if the first spouse to die does not use all of his or her exemption, the exemption may be transferred to the surviving spouse by the deceased spouse's personal representative on a timely filed estate tax return (9 months after the death of the 1st spouse). Therefore, in order to take advantage of the portability, the estate will be required to file an estate tax return even if the deceased spouse's estate is less than the \$5 million exemption amount. This portability provision is only in effect for 2 years. Although the estate tax exemption is portable, it is important to remember that the failure to create a trust for the surviving spouse can lead to unintended consequences included loss of assets to creditors, remarriage, or future estate taxes if the current law is not continued after the 2-year extension.

In addition to the increase in the estate tax exemption, the generation skipping transfer tax ("GST") exemption will also increase to \$5 million. For generation skipping transfers completed in 2010, the GST tax rate will be 0%, thus there will be no GST tax on transfers in 2010. In 2011 the tax rate on generation skipping transfers exceeding the exemption amount will be 35%. Unlike a surviving spouse's ability to utilize a predeceased spouse's unused estate tax exemption, the new law does not allow a surviving spouse to use the unused GST tax exemption.

January 1, 2011 will also bring reunification of the gift and estate tax exemptions. The gift tax annual exclusion (the amount one person can gift to any other person each calendar year) will remain at \$13,000 for 2010 and 2011. However, the gift tax lifetime exemption will increase from \$1 million per person to \$5 million per person on January 1, 2011. The top tax rate for lifetime gifts in excess of \$5 million will be 35%. On January 1, 2013, the gift tax lifetime exemption is set to return to \$1 million, so this change

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offers significant opportunities for making lifetime gifts, taking advantage of the increased exemption and removing the gifted assets from your estate permanently.

Finally, it is important to note, this new law is only scheduled to be in effect through December 31, 2012. Starting on January 1, 2013 we will again be facing a potential drop back to a \$1 million gift and estate tax exemption with a 55% top tax rate. This can only mean one thing—Congress will be at it again in two short years. So, we return to the only certainty in life—change!

The uncertainty in the law over the past months highlights the importance of creating and maintaining an effective estate plan. One of the best ways to do this is through a formal periodic updating and continuing education program. Your plan needs to be current and relevant when you need it, not just when you created it! We offer the Estate Security Plan (ESP) for exactly this reason. The ESP program is an education, updating and maintenance program designed to keep your estate plan relevant as changes occur in your life, the law, your lawyer's experience, and your legacy. For current Estate Security Plan (ESP) members, the new estate tax bill will be addressed at our Annual Client Meeting in February 2011. For those who are not yet ESP members and would like to learn more about the program, please feel free to contact our office for further information.