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TO: Clients and Friends
FROM: The Attorneys at Bove & Langa, P.C.
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THE BOVE & LANGA REPORT
SPECIAL EDITION: NEW FEDERAL ESTATE TAX LAW

Throughout this year, we contemplated the ominous possibility that Congress would pass a law retroactively reinstating the federal estate tax and generation skipping transfer tax ("GST tax") for deaths occurring in 2010. Low and behold, at the very last minute, they did -- sort of. Read on.

On December 17, 2010, after receiving the approval of the House and Senate, the *Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010* (the "2010 Tax Relief Act") was signed by President Obama. The 2010 Tax Relief Act extends certain provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") through the end of 2012, as well as enacts various provisions relating to the estate, GST, and gift taxes effective in 2010.

The 2010 Tax Relief Act is not limited to estate, GST, and gift tax matters. There are various income, employment, and other tax provisions included in the law as well. Despite the broad reach of the new law, the following brief summary of the 2010 Tax Relief Act focuses only on the estate, GST, and gift tax provisions of the Act, and gives you our initial thoughts on how you will be impacted.

2010 TAX YEAR

Federal Estate Tax: The new law imposes an estate tax in 2010, but an estate can elect out of the tax. Here is how it works: The estate tax will be imposed on estates over $5 million (assuming no taxable lifetime gifts which reduce the exemption amount). With some traditional exceptions, an estate asset receives a step-up (or step down) in the income tax basis of the asset equal to the fair market value at death. Instead of the imposition of this new 2010 federal estate tax, the executor

has the option to elect "repeal" -- no federal estate tax and no step-up in basis and instead elect to apply the modified carryover basis regime under previous 2010 law. (See our January 2010 Special Report on Repeal for a discussion of modified carryover basis.) As a rule of thumb, where there is no surviving spouse, a 2010 estate under $5 million will take advantage of the new 2010 estate tax, and estates over $5 million will elect to have no federal estate tax. But, each estate must be analyzed individually.

Extension of Time to Perform Certain Acts in Relation to the Federal Estate Tax: For 2010 decedents dying between January 1st and December 17th, certain deadlines have been extended to September 17, 2011: (i) filing a federal estate tax return, (ii) filing a basis allocation return, (iii) paying federal estate tax, and (iv) making disclaimers (note that with disclaimers, there is often state law to comply with as well, which may not have a corresponding deadline to this federal law).

Gift Tax: The gift tax exclusion amount remains at $1 million.

GST Tax: The GST tax is back, with a $5 million GST tax exemption to shelter generation skipping transfers in 2010. This can be quite helpful. Prior to the 2010 Tax Relief Act, a 2010 trust funded with the "the maximum GST tax exemption amount" would receive nothing. Now, that trust would receive $5 million.

Significantly, the GST tax rate (the “applicable rate”) is zero for 2010. This means that transfers in 2010 into a trust for the benefit of grandchildren (not children and grandchildren) will be subject to the GST tax, but no tax will be due because of the zero applicable tax rate. As a result, subsequent distributions out of such a trust in future years will not be subject to the GST tax because the trust property was already subject to the GST tax in 2010. Although any amount can be transferred in 2010 to grandchildren directly or into a trust for the benefit of grandchildren without incurring a GST tax, the amount of such a transfer will be subject to the gift tax to the extent the amount transferred exceeds the transferor’s available 2010 gift tax exclusion amount. For many clients who wish to transfer wealth to a grandchild, depending on the amount to be transferred and the gift tax exemption amount available, it may be more beneficial to wait until 2011 to make such a transfer when the gift tax exemption climbs to $5 million.

It is only the case where a client wishes to transfer over $5 million to grandchildren and has the liquidity to pay the resulting gift tax that a 2010 transfer in trust to grandchildren may be advantageous.

For generation skipping transfers made prior to December 17th, the deadline for filing a return reporting the transfer is also extended to September 17th of next year. In addition, even if the decedent’s estate elects the estate tax "repeal" option, the decedent will still be treated as the

transferor for GST tax purposes in 2010.

Transfer Tax Rate: The maximum estate and gift tax rate is 35%. As stated above, the GST tax rate is zero.

2011 & 2012 TAX YEARS

Federal Estate Tax: The $5 million exemption extends into 2011 and is indexed for inflation in 2012. All estates will be eligible for the step-up in basis treatment.

Gift Tax: Here is the really exciting news for clients with large estates: Starting in 2011, the gift tax is reunified with the estate tax, meaning that there will be a $5 million gift tax exclusion. This exclusion amount will also be indexed for inflation in 2012. A married couple who has fully utilized each of their $1 million lifetime gift tax exemptions will now be able to gift together an additional $8 million to the younger generations, as long as action is taken within the two year timeframe. Of course, as bears repeating, use of the gift tax exclusion reduces the available federal estate tax exclusion at death.

GST Tax: The $5 million exemption amount extends to 2011 and is indexed for inflation in 2012.

Portability of Federal Exemption Amount: A surviving spouse may add the deceased spouse's unused estate tax exemption amount (as reduced by lifetime taxable gifts) to the surviving spouse's own federal estate tax exemption amount, so long as the first deceased spouse's executor made the appropriate election on a timely filed federal estate tax return. This additional federal estate tax exemption amount is not indexed for inflation and will disappear in the event of the surviving spouse's remarriage. (Another bargaining chip in the prenuptial negotiations?)

Interestingly, a literal reading of the law suggests that portability will apply to 2011 estates and all estates going forward, and does not expire at the end of 2012, but this remains to be confirmed. Also of note is that the election by the executor of the first deceased spouse serves to keep the statute of limitations on that return open until the limitations period ends for the estate of the second deceased spouse -- but just for purposes of determining the amount of the portable exemption. (The dreaded valuation issue .....)

Transfer Tax Rate: The maximum estate, gift, and GST tax rate is 35%.

2013 & BEYOND

On January 1, 2013 the federal tax laws revert to the 2000 levels as if EGTRRA and the 2010 Tax Relief Act never happened. Exclusions of $1 million for gift and estate taxes, with the maximum tax rates for most estates at about 55%; and an exclusion of $1 million, indexed for inflation, for the GST tax.

There is, of course, the chance that Congress will once again act before 2013 to change these federal tax laws. Probably on December 17, 2012. In the meanwhile, stay tuned to the Bove & Langa Report, the next one is due out in January, for updates and changes to the law, as well as for various estate planning opportunities created by the 2010 Tax Relief Act.

Finally, please remember that the changes discussed in this Special Edition apply only to the federal law. Various states, including Massachusetts, enforce their own separate estate tax laws that were not affected by the 2010 Tax Relief Act.