

## **2010 TAX RELIEF ACT**

You are probably aware by now that at the end of 2010, President Obama signed last minute legislation entitled the new “Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010,” (“TRUICTA”, or “2010 Tax Relief Act”). The new Act extended the Bush tax cuts *and* it reinstated the Federal estate tax. The Act was part of the Republican/Obama tax compromise, which changed the Federal estate tax and generation skipping tax provisions in dramatic ways, including the following:

- For years 2011 to 2012, the threshold for Federal tax liability is \$5 million (indexed for inflation after 2011). For 2010, estates may elect a no tax regime in exchange for accepting the carry-over basis rules.
- The marginal Federal gift and estate tax rate is 35%; Maryland will maintain its own estate tax which can be as high as 16% tax on estates in the upper range. Maryland does not have a gift tax.
- The gift and estate taxes are reunited in 2011 and 2012 so that allowable gifts of \$5 million result in a reduced estate at death.
- There is also a \$5 million dollar generation skipping transfer tax exemption for 2011 and 2012.
- The new Act has a “portability,” feature, allowing the unused exclusion of one spouse to be tacked onto the surviving spouse’s exclusion amount.

## **BACKGROUND**

Ten years ago, in 2001, Congress enacted the Economic Growth and Tax Relief Reconciliation Act of 2001 (“EGTRRA”), the first of two large legislative packages, now commonly referred to as the “Bush tax cuts.” EGTRRA gradually lowered the maximum estate tax rate and substantially raised the estate exemption amount until the year 2010, when the Federal estate tax was completely eliminated.

If EGTRRA had continued in the year 2011, estates over \$1 million dollars would have been subject to Federal estate tax rates as high as 55%. Income tax levels and estate tax levels would have increased significantly had Congress not enacted the new Tax Relief Act.

The President and his political party were forced last year to extend the Bush tax cuts to those in the highest tax brackets to avoid facing political backlash from modest income earners forced to pay dramatically increased income tax in 2011. Now, having reached successful compromise, each political party believes it has the winning formula to succeed in the 2012 elections.

## **ESTATE PLANNING IMPLICATIONS OF THE 2010 TAX RELIEF ACT**

One of the obvious challenges of the new Act is its temporal nature; it is set to expire in 2 years. It is impossible to know what the exclusion amount will be for 2013 but it will undoubtedly be hotly debated in Congress. Estate planning documents need to be sufficiently flexible to handle a variety of potential outcomes.

The current \$5 million dollar Federal exemption amount through 2012 exempts many estates from Federal estate tax. However, Maryland estates will continue to pay tax on amounts above the \$1 million dollar threshold. The new Act doesn't reinstate the estate death tax credit, so a Maryland couple failing to plan could be forced to pay as much as a \$100,000 death tax penalty.

Couples with estates up to \$10 million dollars will have no Federal Estate tax liability so long as a credit shelter trust is in place after the first spouse to die. The portability feature of the new law is designed to simplify planning for couples with less than \$10 million in assets but there are potential tax pitfalls for the unwary. For instance, in order to exercise the portability option, an election must be made in the estate of the first spouse to die so that the unused credit amount carries over to the estate of the surviving spouse. It would be very easy for the surviving spouse to overlook or miss this opportunity. Inflation could also trigger a tax caused by reliance on the portability feature alone without proper credit shelter trust planning.

Other risks include failing to update estate planning documents directing that the surviving spouse receive a distribution amount above any Federal estate tax exemption. This type of outdated formula language could mean that the entire estate of the first spouse to die goes to the residuary estate, which may not name the surviving spouse as a beneficiary. So, clients who have not updated their documents since the 2001 EGGTRA legislation should make updating their estate planning documents a top priority.

We recommend that your estate plan be as flexible as possible to carry out your estate plan design during the life of the Tax relief Act and beyond. Even without the ever changing tax map, families change, needs and interests change. We can help ensure your plan accurately reflect those changes.

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