# Taxing Times

## HIGHLIGHTS

**BUSH TAX CUTS EXTENDED**
The Bush era income tax rates remain, for two years at least. For everyone, even the wealthy. More on p.2.

**ESTATE, GST AND GIFT TAXES CHANGE FOR THE BETTER**
The new law provides for a 35% top rate for estate, generation-skipping transfers and gift taxes and provides a unified exemption of $5 million for gifts and estates. Portability was also introduced for the first time—see p. 2 and 3.

**DUE DATES AND RETROACTIVITY**
Returns due for decedents dying in 2010 are extended for 9 months from date of the Act and a new election is allowed.

**IRAS DIRECT TO CHARITY ARE ALLOWED**
The popular feature of allowing IRA distributions directly to charities was reinstated, with a special rule allowing payments made in January 2011, to be pushed back into 2010.

# The Last-Minute Tax Fix of 2010

### *The "Tax Relief" Act of 2010*

On December 17, 2010, President Obama signed into law H.R. 4853, the "Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010" (the "Act"). The Act was a compromise and one that was enacted to last for only two years. Unless Congress takes action, all of the tax changes effectuated in the Act will expire December 31, 2012. Even though these rates and provisions may not last, they will provide significant planning opportunities while they are around. And because they may not last, the provisions of the Act raise significant concerns as we plan, once again, for an uncertain tax future. Below is a summary of changes to the estate, generation skipping transfer (GST) and gift tax rates:

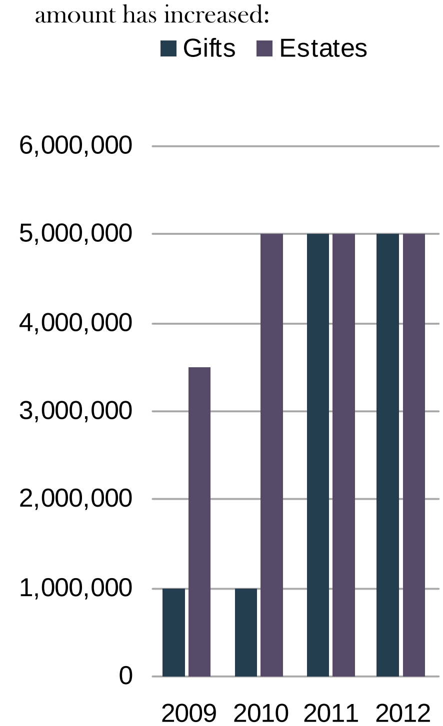
| Tax/Year | 2009 | 2010 | 2011 |
|---|---|---|---|
| Estate | 45% | 0/35% | 35% |
| GST | 45% | 0% | 35% |
| Gift | 45% | 35% | 35% |

Keep in mind that the estate tax rate for 2010 was 0%. However, estates of decedents dying in 2010 were entitled to only a limited "step-up" in the income tax basis of the decedent's assets. The new law allows an election for estates of decedents dying in 2010 to use either the new provisions or the old. If the estate elects to apply the new provisions, with its new lower rates and exemptions, the estate will also be entitled to a full basis step-up, as under the law in effect prior to 2010.

The new estate and GST tax exemptions are $5,000,000, retroactive to 1/1/2010, adjusted for inflation, starting in 2012. *However, unless Congress extends these rules or adopts new legislation, both of these exemptions will be reduced to $1,000,000 in 2013.*

One of the most surprising and unexpected provisions of the Act is the provision that re-unified the estate and gift tax exemptions. The last tax year during which these exemptions were the same was 2003. Applying the Act, the amount of taxable gifts that an individual can make during his or her lifetime without the imposition of gift tax is also capped at $5 million. The new limit is a significant increase over the old $1 million limit. However, along with the other provisions of the Act, this provision is scheduled to expire at the end of 2012. *The gift tax exemption change is not retroactive to 2010, unlike the estate and GST exemptions.*

Here is how the exemption amount has increased:



## GIFT TAX BONUS

### INCREASE TO $5 MILLION

One of the most surprising provisions of the Act is an increase in the amount of taxable gifts that individuals can make during their lifetime without imposition of gift tax. The new limit is $5 million, which is over and above the annual exclusion of $13,000 ($26,000 per married couple) that you can gift to anyone each year. This $5 million limit is a significant increase over the old $1 million limit. However, along with the rest of the Act, it is scheduled to expire at the end of 2012.

### *Estate and Gift Taxes, continued*

All this uncertainty places a premium on designing a flexible estate plan. Thus, consider reviewing your estate tax planning documents to make sure that you can take advantage of the new provisions, or that you can be comfortable with the results of the application of formulas under your existing wills and trusts.

The Act also introduced a new concept – called "portability"—that affects the use of estate tax exemptions available to a decedent and the decedent's spouse. Portability allows a surviving spouse to use the deceased spouse's unused estate tax exemption for himself/herself simply by making an election on the decedent's estate tax return. Under prior law, in order to fully utilize each spouse's estate tax exemption, each spouse needed to own assets separately at death that could be used to fund a so-called "by-pass trust" under his or her testamentary instrument. Often, if the spouses held assets as joint tenants, the opportunity to take advantage of the exemption of the first spouse to die was limited or not available.

### *For 2010 Estates*

The 2010 Tax Relief Act allows the estates of those who died during 2010 a choice—either apply the new estate tax rules (with the $5 million exemption, the 35% rate and a full step-up in the basis of all estate assets), or the 2010 law, where there is no estate tax and a limited basis step-up. To allow executors time to make an informed decision, the due date for estate tax returns of decedents who died in 2010 is automatically extended until nine months from the date of enactment, or 9/17/11. *However, these extensions do not apply at the state level. And, assuming that the estate elects to apply the 2010 law provisions, the date for making basis elections has not been extended.* It remains to be seen whether the states and the IRS will make allowances for these anomalies. It is important not to overlook the fact that, if the estate will be exempt from federal estate tax due to the $5 million exemption, electing to apply the new rules also allows a full step-up in the basis of all of the estate's assets. Thus, executors of 2010 estates will need to analyze many factors and numbers to properly compare these options.

### *Income Tax Changes*

After extensive debate over the direction to take when addressing income taxes, Congress and President Obama fashioned a compromise under the Act that allowed the Bush tax rates to stay in effect for two more years. The Act kept the 2009 income tax rates until the end of 2012. This means that the top tax rate on ordinary income will stay at 35% and the top tax rate for most long-term capital gains and qualifying dividends will remain at 15%.

The Alternative Minimum Tax ("AMT") rate was "fixed" in order to provide relief to millions of Americans who would otherwise have faced large tax increases due to the applicability of the AMT. This relief will last through the 2011 only. The AMT exemption amount for a married couple is now increased to $72,450. It is estimated that this fix will allow 21 million households to escape AMT.

In addition, the ability to deduct state sales tax as an itemized deduction was retained through 2011.

# Estate Planning

## What Can You--What Should You--Do Now?

***Review your estate plan. It is always a good idea to review your estate plan any time there is a change in the law, a change in your family or financial circumstances, or simply the passage of time. The provisions of the Act are such a change.***

If your will creates a "credit shelter trust" or "by-pass trust," which allows use of the applicable estate tax exemption (referred to in the tax code as the "applicable exclusion amount"), you may wish to confirm that the increase in the exemption will not cause a greater proportion of your estate to pass under this clause than you had planned. For example, many wills provide that the maximum amount possible, tied to the then effective applicable exemption amount, passes to such a trust, with the rest to pass to your spouse. However, with the new $5 million exemption, that may result in much more going to the trust than you planned. If the beneficiaries of this trust are not the persons that should benefit from this larger share of your estate, then changes in that will provision will be required.

***If ever there was a time to consider making additional gifts, it is now. The law increased the gift tax (and generation skipping transfer tax) exemptions to $5 million.***

Consider making substantial lifetime gifts. If you have been contemplating making gifts of property in excess of a million dollars, doing so during 2011 through 2012 is probably the right time. With the five million dollar gift tax exemption, there is tremendous flexibility for significant gift giving. If you are considering accelerating the transfer of assets to your children and/or your grandchildren, a current gift in lieu of a bequest may have several benefits, such as reducing your estate for state estate tax purposes and saving federal estate tax on future appreciation in the value of the gifted assets. Note, however, that there may be potential adverse federal estate tax consequences connected to large gifts if the new law is allowed to lapse and the credit is reduced to an amount less than $5 million. Accordingly, large gifts should not be made without the advice of counsel.

***Many spouses do not own sufficient assets solely in their separate names, resulting in lost tax saving opportunities on the death of the first spouse. Don't ignore this problem simply because the Act allows the surviving spouse to use the unused exemption from the deceased spouse.***

Keep separate assets separate. It is convenient, for probate and other purposes, for spouses to own assets as joint tenants with rights of survivorship. However, don't plan to change the ownership of your separate assets or assets held as tenants in common with your spouse to jointly held ownership simply because the Act provides for portability of the estate tax exemption. Although it is possible that Congress will enact a new law retaining this portability concept, do not overlook the fact that, for now, portability is only available if both spouses die before January 1, 2013. This means that a married person dying after December 31, 2012 may not be able to pass along his or her unused exemption to a surviving spouse, and a widow or widower dying after that date may not be able to take advantage of his or her spouse's unused exemption, even if the appropriate election was made on the earlier estate tax return. Plus, maximizing use of the exemption on the death of the first spouse removes assets from a couple's combined estates sooner, often at a lower value, resulting in further federal estate tax savings. Finally, you will need to have separately held assets in order to maximize potential state estate tax saving opportunities.

***Tax free gifting plans serve to benefit your children and grandchildren now and reduce your estate taxes in the future, without using up any of your exemption.***

Maintain any programs of tax-free gifting. Annual exclusion gifts ($13,000 per person or $26,000 if there is a spouse who agrees to treat the gift as having been made half by each spouse), direct payments of medical expenses and tuition, establishing and funding Grantor Retained Annuity Trusts (GRATs) and forming and funding family limited partnerships all continue to make good sense.

***Don't forget New Jersey! (or New York or other states!)***

You may be tempted to assume state taxes cannot be much, but that is not the case in many states. New Jersey and New York, as well as many other states, impose significant estate taxes. The state estate tax exemptions in general are considerably lower than the federal exemption--$675,000 in New Jersey and $1 million in New York, for example.

# business

## Corporate Incentives and Tax Relief

***The new tax act added important incentives for business, particularly for small businesses. The depreciation rules were changed, yet again. Now the bonus depreciation is 100% for certain assets, up from the prior 50% for acquisitions after September 8, 2010 and before January 1, 2012. These assets must be placed in service before January 1, 2012.***

For other property placed in service January 1-December 31, 2012, the bonus depreciation will be 50%. After December 31, 2012, there will be no bonus depreciation. The assets this applies to are NEW tangible property with asset lives of 20 years or less, such as furniture and equipment, computers, software, certain water utility property and certain leasehold improvements. There are later deadlines for certain long lived assets and transportation property.

***"Section 179 Expensing" is improved, thanks to a provision in the Act that increased the amount that can be deducted. Prior to the Act, the deduction amount was scheduled to be reduced to $25,000 in 2012, with a further reduction for every dollar of deductible expenses in excess of $200,000. Now this limit is $125,000 with the phase-out threshold fixed at $500,000 (indexed for inflation).***

This provision of the Act benefits small businesses, which have the ability to use the thresholds. Of course, the business still needs to report income, since this expense can only offset net income, and cannot reduce income to below zero. The immediate deduction is allowed for qualifying asset purchases. Yet, this is still a significant drop from the higher limits of $500,000 and threshold of $2 million for 2010 and 2011, under the provisions of prior law. And it may still be easier to just deduct "bonus depreciation," since that deduction is subject to fewer restrictions on types of assets that will work.

***The reports of the demise of the Research and Development Tax Credit were (again) premature, as it has risen from the grave yet again. The credit expired at the end of 2009, but now has been extended to 2010 and 2011.***

Just because you do not have a laboratory attached to your business does not mean you cannot claim research credits. R&D credits are available for process improvements as well, but the rules are complex and based on incremental increases in research. Still, the savings can be substantial and should be investigated.

***The Work Opportunity Credit was also extended. It is a credit of generally 40% of the first $6,000 of wages paid to qualifying new hires (food stamp recipients, disabled or unemployed vets, disconnected youths and ex-cons). It was to expire on August 31, 2011, but was extended to December 31, 2011.***

The credit is allowed on the first $12,000 of wages for qualified veterans. The Act added new groups who can benefit, including unemployed vets and disconnected youths who began work in 2009 or 2010, however, the rules do not extend beyond 2010 for these two groups. In addition, the Act permits employees to exclude from income and employment taxes up to $5,250 in employer provided education assistance each year, through 2012.

***Enhanced inventory charitable deductions for certain kinds of products (inventory) were allowed through the end of 2011.***

These deductions are for donations of food inventory, book inventory to public schools and computer inventory for educational purposes.

***Payroll taxes were changed FOR EMPLOYEES only. That is, the employee portion of Social Security Taxes was reduced from 6.2% to 4.2% for 2011.***

Self-employed individuals pay both the employee and employer portion of Social Security taxes and the Act reduces their rate by 2 percentage points as well, from 12.6% to 10.6%.

## *Final Thoughts*

**The Act did not change many of the techniques that taxpayers have traditionally used to minimize their estate taxes. Legislative proposals that were offered during 2010, which would have modified or eliminated the beneficial use of certain estate and gift tax planning techniques, were excluded from the Act. Thus, Grantor Retained Annuity Trusts (GRATs), Qualified Personal Residence Trusts (QPRTs), Charitable Lead Annuity Trusts (CLATs), insurance trusts and Family Limited Partnerships and LLCs all remain viable transfer tax savings techniques. In addition, the current low interest rate environment makes several of these tools particularly appealing right now.**

## *Note:*

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## CONTACT US

If you have any questions or concerns regarding the Act or if you would like to explore any of our recommendations, please contact us.

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