

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010

As you may have heard, until last week the income and estate tax laws were in a state of flux. After much debate, proposal, and counter-proposal, President Barack Obama signed into law The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 on December 17th (the “Act”). The Act contains many significant tax provisions that may affect you and your family. Some of the more pertinent provisions are summarized below.

{ Income Tax Provisions }

EXTENSION OF THE BUSH TAX CUTS

The Act extends the “Bush Tax Cuts” originally enacted by the Economic Growth Tax Relief and Reconciliation Act (“EGTRRA”) which were set to expire at the end of 2010. This extension will apply to all taxpayers, including individuals with incomes above \$200,000 (\$250,000 for married couples). Under the Act, the extension encompasses the following:

- Keeping the current tax rates across all income levels;
- Repealing the *phase-outs* of personal exemptions and itemized deductions;
- Keeping the top capital gain and dividend rate at 15%;
- Maintaining the marriage penalty relief; and
- Continuing the \$1,000 child tax credit.

ALTERNATIVE MINIMUM TAX (“AMT”) PATCH

The Act includes a two-year AMT patch, which prevents the AMT exemption from being lowered in 2010. Without this provision, the AMT would apply to many taxpayers who would otherwise be exempt.

PAYROLL TAX HOLIDAY

The Act reduces the employee share of FICA (Social Security) taxes from 6.2% to 4.2% for 2011. It does not affect the employer share of FICA taxes. This provision is meant to replace the Making Work Pay Credit that was in effect for 2009 and 2010. However, unlike the Making Work Pay Credit, there is no phase-out for high income taxpayers. Thus, to a taxpayer with wages at or above the \$106,800 cap, this reduction results in a tax savings of \$2,136. A similar reduction in self-employment (“SECA”) taxes is provided for self-employed individuals to provide for equal treatment.

EXPENSING OF BUSINESS INVESTMENTS

The Act provides for full expensing of investments that currently qualify for bonus depreciation and are placed in service through the end of 2011. This allows businesses to expense the full cost of equipment and other qualifying property placed in service in 2011. Additionally, bonus depreciation at the current

level (i.e., 50% expensing followed by regular depreciation) is available for such investments in 2012.

{ Estate Tax Provisions }

In addition to addressing the income tax provisions described above, the Act significantly changes the gift, estate, and generation-skipping transfer (“GST”) tax laws beginning in 2010, which will certainly affect year end and future planning.

NEW SUNSET DATE IN 2012

- EGTTTRA’s estate tax provisions, which were scheduled to expire at the end of 2010, will now expire at the end of 2012.
- Absent further legislation, the new estate tax provisions as changed under the Act will apply for tax years 2010, 2011, and 2012.

REPEAL OF THE “REPEAL OF THE ESTATE AND GST TAX IN 2010”

- The one-year repeal of the estate and GST tax in 2010 has been repealed by the Act. In other words, the Act applies the estate and GST taxes retroactively for 2010, which is the default rule.
- Reinstatement of the estate tax for 2010 also means a reinstatement of the step-up in basis rule for estate assets.
- However, executors of the estates of decedents who die in 2010 can elect to opt-in to the “no estate tax” regime under EGTRRA.
- Those electing to opt-in to the no estate tax regime will continue to be subject to the carryover basis rules (with the \$1.3 million and \$3 million basis adjustments).¹

MODIFICATIONS TO ESTATE, GIFT, AND GST TAXES – \$5 MILLION EXEMPTIONS AND 35% RATE

- The “applicable exclusion amount” — or the exemption amount for estate tax purposes — is \$5 million per individual (\$10 million per couple).
- This \$5 million exemption amount applies to transfers and bequests made in 2010, but the lifetime exemption for 2010 gifts remains at \$1 million.
- The maximum rate on taxable estates is 35%.
- Beginning in 2011, the exemption is indexed for inflation to the nearest \$10,000.

¹ However, even if the executor elects back in to the no-estate-tax regime, the decedent will still be considered the transferor for GST tax purposes (as if the estate has been subject to estate taxes).

- Beginning in 2011, the estate and gift taxes will be “unified” with the same \$5 million indexed exemption — meaning all \$5 million of an individual’s exemption can be made during life without incurring any gift taxes.

GST TAX RATE IS 0% FOR 2010 TRANSFERS

In general, the GST tax is imposed on gifts or bequests to grandchildren and more remote descendants. Transfers to these beneficiaries are known as “GST transfers.” Under the Act, the GST tax laws are as follows:

- For 2010, GST transfers are not exempt and are subject to GST tax.
- For 2010 only, the applicable GST tax rate for gifts to grandchildren is 0%. Therefore, no GST taxes will be due on a transfer made directly to a grandchild outright or in trust solely for the benefit of grandchildren if made in 2010.²
- All other GST rules apply as normal, so every individual will have a \$5 million GST exemption in 2010.³
- The GST tax rate beginning in 2011 will be 35%.

FILING DEADLINES FOR 2010 DECEDENTS

For decedents who die in 2010 prior to the date of enactment, the following deadlines are extended for nine months after the date of enactment:

- Filing an estate tax return;
- Filing a large estate (basis allocation) return;
- Paying estate taxes;
- Making disclaimers⁴; and
- Reporting GST transfers made in 2010 (but only for those transfers made prior to the date of enactment – i.e., prior to December 17, 2010).

² No GST tax will be imposed either when later distributions are made to grandchildren (although distributions to the grandchild’s descendants will be subject to GST tax because the Act does not provide that a GST transfer in trust in 2010 would create an inclusion ratio of zero).

³ In addition, GST exemption will be deemed to be allocated to any GST transfers made in 2010 (unless the transferor affirmatively elects out of the automatic allocation rules).

⁴ Note that a qualified disclaimer must also satisfy state law. Therefore, state disclaimer statutes may also need to be modified to accommodate an extended deadline.

PORTABILITY OF DECEASED SPOUSE'S UNUSED EXEMPTION AMOUNT

- Beginning in 2011, a surviving spouse will be able to use the deceased spouse's unused exemption, but only for a deceased spouse who dies after 2010.
- For example, assume Husband dies in 2011 without having used any of his exemption during life, leaving \$5 million of unused exemption. At Wife's subsequent death, her estate can use both her exemption *plus* the deceased Husband's unused exemption. Assume Wife's unused exemption amount at her death was \$4 million. Wife's estate will have \$9 million of total exemption available at that time. This is known as "portability."
- Portability must be elected by the executor of the first to die spouse's estate.
- Portability is effective for post-2010 decedents — so no portability for any unused exemption amount of a 2010 decedent.
- Portability is limited to the last deceased spouse (of a survivor) to preclude accumulation of unused exemptions over several marriages.
- Portability does not apply to any unused GST exemption amount of a deceased spouse.

{ Taking Advantage Of The New Act For Estate Planning }

With the new changes in the estate tax law resulting from the Act, taxpayers should consider lifetime planning beginning in 2011 to take advantage of the higher exemption amounts and lower rates for all transfer taxes as well as the reunification of the gift and estate tax exemption amounts beginning in 2011. Because the Act's provisions will sunset at the end of 2012, taking advantage of the new estate provisions within the next two years can potentially have a meaningful impact on the amount of wealth that can be transferred tax-free during life, which could benefit younger generations.

Please contact your advisor to learn more about the available estate planning strategies that can be implemented today to take advantage of the new estate tax laws enacted by the Act.

Disclosure: Past Performance Is No Guarantee Of Future Performance. Any opinions expressed by Convergent employees are current only as of the time made and are subject to change without notice. This article may include estimates, projections, or other forward looking statements. However, due to numerous factors, actual events may differ substantially from those presented. While we believe this information to be reliable, Convergent Wealth Advisors bears no responsibility for the advice or information provided in this article whatsoever or for any errors or omissions. Moreover, the information provided is not intended to be, and should not be construed as, investment, legal, or tax advice. Nothing contained herein should be construed as a recommendation or advice to purchase or sell any security, investment, or portfolio allocation. This article is not meant as a general guide to investing, or as a source of any specific investment recommendations, and makes no implied or express recommendations concerning the manner in which any client's accounts should or would be handled, as appropriate investment decisions depend upon the client's specific investment objectives.

Pursuant to the Circular 230 Regulations Governing Practice Before the Internal Revenue Service, any tax discussions contained herein is not intended or written to be used and cannot be used by a taxpayer for the purpose of avoiding tax penalties that may be imposed on the taxpayer.

Not FDIC insured - No Bank Guarantee - May Lose Value