Congress Passes 2010 Tax Relief Act – Estate Tax Changes (12/17/2010)

Congress has approved and the President quickly signed a multibillion dollar tax cut package, the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 ("2010 Tax Relief Act") (H.R. 4853). The new law follows through on the framework agreed to on December 6th by President Obama and GOP leaders in Congress. Major changes from this legislation include an extension of the Bush-era individual and capital gains/dividend tax cuts for all taxpayers for two years, a one-year payroll tax cut of two percentage points, 100% bonus depreciation for business owners through December 31, 2011, and a top federal estate tax rate of 35% with a $5 million exclusion.

Overview of Estate Tax Relief

Under the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"), there was no estate tax applied to decedents dying in 2010, but estate and other transfer taxes were scheduled to rise substantially for post-2010 transfers (i.e., starting January 1, 2011). The 2010 Tax Relief Act provides temporary relief. Among other changes, it reduces estate, gift, and generation-skipping transfer ("GST") taxes for 2011 and 2012, and continues other estate and gift tax relief provisions that were set to expire after December 31, 2010. It preserves estate tax repeal for 2010 in a roundabout fashion, in that, estates wanting a zero estate tax for 2010 must elect such option, along with the modified carryover basis

The Closely Held Business Team attorneys at Harrang Long Gary Rudnick are committed to serving the needs of business owners in a responsive and proactive manner. They understand the challenges and the opportunities provided by the law in today's business climate, and are focused on the advancement of each client's success in business.

Randall L. Duncan, Chair
C. Robert Steringer
Arden J. Olson
Mark P. Amberg
John A. Riherd
Joshua P. Stump
Jonathan D. Mishkin, LL.M.
Marjorie A. Elken
John T. Witherspoon
Kate G. Watkinson

rules that were set to apply for 2010. Otherwise, *by default*, the estate tax is revived for 2010, with a $5 million exemption, a top tax rate of 35%, and a step-up in basis to fair market value. Also, for estates of decedents dying after December 31, 2010, a deceased spouse's unused exemption may be shifted to the surviving spouse. However, these generous rules, which explained below, are temporary – much harsher rules are slated to return after 2012.

Background - EGTRRA Transfer Tax Changes

The passage of EGTRRA substantially increased the estate tax exemption in stages. For individuals dying in 2006-2008, the exemption was raised to $2 million. It increased to $3.5 million for individuals dying in 2009. Additionally, EGTRRA changed the gift tax system so that the gift tax exemption remained frozen at $1 million, even as the estate tax rose. However, on January 1, 2011, under the "sunset rule," the estate exemption was scheduled to return to $1 million so as to reunify with the gift tax exemption.

Under EGTRRA, the top estate and gift tax rate was reduced in stages. It was 45% for transfers made in 2007 through 2009. In 2010, there was to be no estate tax, and the top gift tax rate was reduced to 35%. The top estate and gift tax rate was scheduled to revert to 55% in 2011.

For 2010, the basis rules for inherited property were to be similar to the gift tax rules, but with many opportunities for heirs to obtain increases in basis. For example, these so-called modified carryover basis rules would have allowed the basis of assets received from an individual dying in 2010 to be increased by $1.3 million and by an additional $3 million for assets going to a surviving spouse. Under the "sunset rule," the pre-EGTRRA step-up in basis rules were to return in 2011.

Application to Oregon Inheritance Tax

Unfortunately, the changes made in the 2010 Tax Relief Act were not adopted by the Oregon Legislature. Therefore, the inheritance tax exemption remains at $1 million per person.

Estate Tax Relief

In summary, enactment of the 2010 Tax Relief Act accomplishes the following:

1. Increased Exemption and Reduced Top Rate – The 2010 Tax Relief Act lowers estate and GST taxes for 2011 and 2012 by increasing the exemption amount from $1 million to $5 million, and reducing the top rate from 55% to 35%. Please note that the $5 million exemption is *per person*. Thus, with proper planning, there is a $10 million exemption for a married couple. Plus, as explained below, there is a new portability feature available for married couples.

2. Modified Carryover Basis Rules - Estates of decedents dying during 2010 may choose between: (1) an estate tax regime premised on a $5 million exemption and 35%

top rate with a step-up in basis for inherited assets; or (2) no estate tax and modified carryover basis. In technical terms, the 2010 Tax Relief Act makes the estate tax and basis changes effective retroactively for estates of decedents dying after 2009, while allowing the opt-out choice for estates of decedents dying during the 2010 tax year.

3. Gift Tax Changes – Under the 2010 Tax Relief Act, for gifts made in 2010, the exemption is $1 million and the gift tax rate is 35%. For gifts made after December 31, 2010, the gift tax is reunified with the estate tax, with an applicable exclusion amount of $5 million and a top estate and gift tax rate of 35%.

4. Generation-Skipping Transfer Tax Changes - Under the 2010 Tax Relief Act, the GST exemption for decedents dying or gifts made after December 31, 2009 and before January 1, 2011, is equal to $5 million. Therefore, up to $5 million in GST tax exemption may be allocated to a trust created or funded during 2010. Although the GST tax is applicable in 2010, the GST tax rate for transfers made during 2010 is 0%.

5. Extension of Filing Deadlines - For a decedent dying after December 31, 2009, and before December 17, 2010, the due date for filing an estate tax return, making any payment of estate tax, and disclaiming an interest in property passing by reason of death is not to be earlier than September 17, 2011 (the date that is nine months after the enactment date of December 17th).

6. Portability of Unused Exemption between Spouses – Under the 2010 Tax Relief Act, any exemption that remains unused upon the death of a spouse who dies after December 31, 2010 (the “deceased spousal unused exclusion amount”), is generally available for use by the surviving spouse, as an addition to the surviving spouse’s exemption. A surviving spouse may utilize the predeceased spousal carryover amount in addition to his/her own $5 million exclusion for taxable transfers made during life or at death. Note that if a surviving spouse is predeceased by more than one spouse, the amount of unused exclusion that is available for use by such surviving spouse is limited to the lesser of $5 million or the unused exclusion of the last deceased spouse.

7. New EGTRRA Sunset - Under the 2010 Tax Relief Act, the sunset of the EGTRRA estate, gift, and GST tax provisions, which was scheduled to apply to the estates of decedents dying, gifts made, or generation-skipping transfers made after December 31, 2010, is extended to December 31, 2012. Therefore, these changes should be viewed as a “two-year” patch.

Our attorneys have significant estate planning experience to navigate these changes in the estate tax law. If you have questions about how these changes affect your current planning documents, please do not hesitate to contact our estate planning attorney Jonathan D. Mishkin, LL.M., or the chair of our Business Department, Randall L. Duncan, and we would be pleased to provide guidance and assistance.

Required Tax Disclaimer and Additional Tax and Professional Advice

Internal Revenue Code Circular 230 requires us to disclose that this is not a reliance opinion. This is not intended or written by us to be used, and it cannot be used by you, for the purpose of avoiding penalties that may be imposed on you or another taxpayer, and you should consult directly with your tax professional.

Randall L. Duncan
Shareholder

Portland Office: (503) 242-0000
Direct Line: (503) 417-6010
randall.duncan@harrang.com

Jonathan D. Mishkin, LL.M

Portland Office: (503) 242-0000
Direct Line: (503) 417-6007
jonathan.mishkin@harrang.com

Nothing in this communication creates or is intended to create an attorney-client relationship with you, constitutes the provision of legal advice, or creates any legal duty to you. If you are seeking legal advice, you should first contact a member of the Closely Held Business Team with the understanding that any attorney-client relationship would be subsequently established by a specific written agreement with Harrang Long Gary Rudnick P.C. To maintain confidentiality, you should not forward any unsolicited information you deem to be confidential until after an attorney-client relationship has been established.

LOCATIONS:

Portland
1001 SW Fifth Avenue
16th Floor
Portland, OR 97204-1116
Phone: (503) 242-0000
(800) 315-4172
Fax: (503) 241-1458

Eugene
360 E 10th Avenue
Suite 300
Eugene, OR 97401-3273
Phone: (541) 485-0220
(800) 315-4172
Fax: (541) 686-6564

Salem
333 High Street, NE
Suite 200
Salem, OR 97301-3632
Phone: (503) 371-3330
(800) 315-4172
Fax: (503) 371-5336
www.harrang.com