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A Guide to the New Estate Tax Law, and How it Affects Estate Planning in 2011

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The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 ("TRA 2010") was passed by Congress and signed into law by President Obama on Dec. 17, 2010. This sweeping tax overhaul made some major changes to the federal estate tax, which is applied to the value of your assets that you leave behind at death. In addition to extending the Bush-era income tax cuts for two years, the Act raised the exemption from federal estate tax (the maximum amount that can pass free of estate tax) to \$5 million a person, reduced the tax rate to 35%, and includes a helpful new provision for widows and widowers. Although the new law provides welcome relief, it is important to note that these provisions only apply until the end of 2012 when the law expires. What Congress may do at that point is unknown.

Without this extension, the estate tax exemption amount would have reverted to only \$1 million per person with a maximum tax rate of 55% effective January 1, 2011. Although \$1 million may sound like a large amount, when you consider that a person's taxable estate generally includes life insurance proceeds, home equity, retirement accounts and most other assets, it's easily attainable.

Although many more families will now be sheltered from estate tax, it is important to realize how the new provisions work, and to recognize that there is much more to estate planning than just tax considerations. Here are the key provisions of the new law:

1. Estate Tax Exemption – \$5 million per person for 2011 and 2012.
2. Exemption Portability – This is a new feature in the law. Although the term "portability" does not actually appear in the bill, it is a provision that allows a spouse to transfer any unused portion of his or her individual exemption to the surviving spouse. This means that a couple can together pass on \$10 million without any estate tax being imposed. Portability is not automatic, but requires the executor of the deceased spouse's estate to file an estate tax return upon the first spouse's death, even if no tax is due.
3. Estate Tax Rate – maximum of 35%, down from 55%.
4. Annual Gift Tax Exclusion – remains at \$13,000 for 2011. While you are alive, you can give up to \$13,000 to as many individuals as you want to without triggering gift tax or utilizing your lifetime gift tax exemption.
5. Unified Estate and Gift Tax Exemption of \$5 million – under the new law, the lifetime gift tax exemption and the estate tax exemption are expressed as a total amount, and it is possible to use this "unified credit" to transfer assets either during lifetime or at death or a combination of the two. (From 2004 to 2010, the two amounts were different; the gift tax exemption remained at \$1 million, while the estate tax exemption increased.)

If you have already worked with an estate planning attorney to minimize your potential estate taxes, you should review your Will or Trust in light of these changes in the new law. Many documents use formulas that refer to the estate tax exemption amount. Since the exemption amount has increased so dramatically (from \$675,000 in 2001 to \$5 million in 2011-2012), these "formula" plans could lead to unintended results. For example, your Will may direct that an amount equal to the estate tax exemption amount be placed into "bypass trust" for the benefit of your children. The surviving spouse has access to the trust's income and, if necessary, the principal, but what is in the trust "bypasses" the survivor's estate. The problem is, since the exemption amount now is \$5 million, the surviving spouse could be left with nothing outside of the trust. Additionally, IRA's, primary residences and other assets that shouldn't be in the trust for income tax reasons could be automatically included.

Regardless of your age, marital status or net worth, taxes are only one consideration when planning your estate. The real purpose of an estate plan is to make things as easy as possible for your heirs to carry on and to ensure that your assets go where you want them to. Don't think that just because your assets are less than \$5 million, estate planning is unnecessary. Nothing could be farther from the truth, and everyone should have a plan of some type. Generally, every plan should include the following:

1. A Will or Revocable Living Trust, directing the distribution of your assets upon your death. A Will can also be used to identify a guardian for any minor children.
2. A Durable Power of Attorney, which authorizes someone to make financial and legal decisions on your behalf if you become disabled or incapacitated.
3. A Medical Power of Attorney, which gives someone the authority to make medical decisions on your behalf.
4. A Living Will or Advance Directive, which expresses your wishes about efforts to extend your life.

David M. Butterbaugh is an attorney with our firm who specializes in estate planning, probate, and guardianship law. Mr. Butterbaugh is Board Certified in Estate Planning and Probate Law by the Texas Board of Legal Specialization. Contact him today to make an appointment to review your existing estate plan, or if you don't have one in place, to prepare a plan that is best suited to you and your family's situation.