

Change in Estate and Gift Rates

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As we have been reporting for some time, unless Congress takes some action before the close of the 2012 calendar year, the generous estate and gift tax provisions of the 2010 Tax Act will expire, to be replaced with a unified estate and gift tax exclusion that for a married couple would protect \$2 million. Likewise, the tax rate for estates and gifts would increase from its current level of 35% to 55%. These are considerable increases. On Valentine's Day the President released his budget proposal to Congress and we got another look at what the Administration is hoping to accomplish.

The Administration has taken a somewhat middle of the road approach to the estate and gift tax rates, proposing to return to the very spot we were in during 2009. If enacted, the estate exemption would be reduced from its current \$5 million per individual to \$3.5 million. The gift exemption, which is presently linked to the estate exemption (so that use of the gift exemption reduces on a dollar for dollar basis the amount you could pass on death without incidence of the estate tax) would be reduced to \$1.0 million. The linkage would remain in place, so that if you used the gift exemption you could only pass \$2.5 million on death tax free. The tax rate would increase from its current 35% level to 45%, both as to the estate and gift taxes. The generation skipping transfer tax would generally follow the changes made to the estate tax exemption and rate of tax. The one thing introduced by the 2010 Tax Act which will not change is the notion of portability. That will become permanent.

Prior to the 2010 Tax Act there was a premium placed on getting your financial house in order before you died. A married couple either needed to be sure that each of their estates contained enough in value to take advantage of the exemptions or include provisions in their Wills to allow the survivor to make some adjustments in ownership through the use of disclaimers. The 2010 Tax Act allowed a surviving spouse a third, simpler bite at the apple. One provision allowed spouses to elect to carry the unused portion of the exemption from the estate of the first spouse to die to the survivor. That election has to be made on the Estate Tax Return (Form 706) of the first spouse to die. A simple example will demonstrate the power of portability. Let's assume that at the time of the death of the first spouse the exemption is \$3.5 million, the estate of the first spouse is at \$2.5 million and the estate of the survivor is \$4.5 million. Since the estate of the first spouse is less than the amount of the exemption, when the first spouse dies there is no estate tax due. However, there is \$1.0 million in unused exemption (\$3.5 million exemption less \$2.5 million estate yields \$1.0 million unused exemption). The survivor can elect to move or "port" the \$1.0 million unused exemption from the estate of the deceased spouse, to his or her estate, increasing their exemption from \$3.5 million to \$4.5 million. Since the survivor's estate is \$4.5 million, by porting the unused exemption from one estate to the other, this married couple can take advantage of the full \$7.0 million which would otherwise be available to them, regardless of how property is owned. Retaining portability is clearly a welcomed sight.

Not as welcomed, however, is the reduction in the gift exemption. This, however, should be viewed as an opportunity. The Administration has staked out this ground since last Summer, making it clear that it did not intend to make the \$10 million combined exemption a permanent part of the tax law. We know that on January 1, 2013 a married couple can pass only \$2.0 million free of the gift tax. The message we should take away from this proposal is that the time to make lifetime gifts is now, before the end of the calendar year, before rates go up and the exemption goes down. With interest rates at historic lows, the opportunities for taxpayers to make gifts of assets worth many times the current \$10 million joint exemption are significant. We are prepared to assist our clients and friends in identifying these opportunities, devising plans to exploit these opportunities and effectuating those techniques which make the most sense.

If you would like to discuss how any of these changes may affect your business or personal income tax situation, or have any other tax or estate planning questions, please contact, Scott Borsack (215.864.7048), Bill Hussey (215.864.6257), Kevin Koscil (215.864.6827) or Suzanne Prybella (215.864.7188).

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