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Dear Valued Client:

The end of 2010 brought some significant changes to the federal gift, estate and generation-skipping transfer (“GST”) tax laws that we would like to share with you. You might remember that we sent a summary of these tax laws last year and this letter will clarify how the laws continue to evolve.

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

On December 17, 2010, President Obama signed the Tax Relief, Unemployment Insurance, Reauthorization and Job Creation Act of 2010 (the “2010 Tax Act”), which included the following provisions:

- For 2010, the federal estate tax was reinstated with a \$5 million exemption and a 35% tax rate. The gift tax exemption remained at \$1 million with a 35% tax rate and the GST tax was reinstated with a \$5 million exemption and a tax rate of 0%. For decedents who died in 2010, an election may be made to have no estate tax apply. If this election is made, however, the income tax carry-over basis rules, rather than the “basis step-up rules” discussed below, will apply to the assets of the decedent’s estate.
- For 2011 and 2012, the newly reinstated federal estate and GST taxes have been realigned with the federal gift tax, with exemptions for each increased to \$5 million per taxpayer (indexed for inflation beginning in 2012), and a tax rate of 35%. The carryover basis rules applicable to a decedent’s assets were eliminated, and the so-called “basis step-up rules” were reinstated, pursuant to which the cost basis of a decedent’s assets are adjusted to fair market value on the decedent’s date of death for income tax purposes.
- Beginning in 2011, for the first time in history, the exemptions from gift and estate tax are “portable,” which means that a surviving spouse may use any unused portion of their predeceased spouse’s exemption, in addition to his or her own \$5 million exemption, to shelter additional transfers during life or at death. Portability does not apply to the exemption from GST tax.
- The 2010 Tax Act is scheduled to “sunset” in 2013, at which point, absent further legislation, the gift, estate and GST tax exemptions will be reduced to \$1 million, with higher tax rates and no portability of exemption between spouses.

The following chart summarizes the new exemptions and tax rates:

Year	Gift Tax	Estate Tax	GST Tax
2010 Rates and Exemptions	35% and \$1 million	35% and \$5 million*	0% and \$5 million
2011 Rates and Exemptions	35% and \$5 million	35% and \$5 million	35% and \$5 million
2012 Rates and Exemptions	35% and \$5 million, indexed for inflation	35% and \$5 million, indexed for inflation	35% and \$5 million, indexed for inflation
Scheduled 2013 Rates and Exemptions	55% and \$1 million	55% and \$1 million	55% and \$1 million

* As noted above, for decedents dying in 2010, an election may be made to have no estate tax apply.

B. Some Preliminary Observations

The portability of the federal gift and estate tax exemptions is a welcome addition to the law, providing a “life vest” for couples who did not plan for estate taxes, permitting them to take advantage of their combined federal estate tax exemptions. Portability is not automatic, however. In order to take advantage of this new opportunity, the executor of the estate of the first spouse to die must file a federal estate tax return and make an election on that return to permit portability, even if the return is not otherwise required. Thus, there will be some time delay and expense associated with securing this new opportunity. Furthermore, in light of the scheduled sunset of the 2010 Tax Act in 2013, caution should be exercised in relying on the significantly increased exemption amounts and the portability rule as the sole method of estate tax planning.

Traditional tax planning methods, which usually include the creation of trusts for the benefit of the surviving spouse and possibly others in order to make use of the federal estate tax exemption of the first spouse to die, continue to have many advantages over simply relying upon portability. Greater certainty with respect to the ultimate disposition of one’s assets and the use of one’s federal estate tax exemption, the opportunity to shelter appreciation in the value of the first spouse’s assets between the deaths of the first spouse and second spouse, better protection of the inheritance from the surviving spouse’s or family’s creditors, the opportunity to take advantage of one’s GST tax exemption in order to transfer assets to grandchildren or further lineal descendants, and minimizing any state (e.g., Massachusetts, Vermont, or Maine) imposed estate taxes (for which there is presently no portability of exemption), are a few of the advantages still associated with traditional tax planning.

Finally, the increased gift and GST exemptions present a window of opportunity to make significant lifetime gifts to children and grandchildren, despite the fact that there are some uncertainties about further estate tax exposure if the 2010 Tax Act sunsets.

If you would like to engage us to discuss how the 2010 Tax Act impacts you and your estate plan, please do not hesitate to call.

Sincerely,

Flood, Sheehan & Tobin, PLLC