

Estate Taxes—New Developments Affecting Estate Planning

INTRODUCTION

In December 2010, President Obama signed into law the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the 2010 Tax Relief Act), which temporarily modifies the estate, gift and generation-skipping transfer (GST) taxes for 2011 and 2012. The following provides information regarding the prior law and the key provisions of the 2010 Tax Relief Act. The Prudential Insurance Company of America and its financial professionals do not provide tax or legal advice. You should discuss how the new legislation may affect you personally with your tax and legal advisors.

PRIOR LAW 2001-2010

Under the Economic Growth and Tax Relief Reconciliation Act of 2001 (the 2001 Act), estate and gift tax rates were gradually reduced from 55% to 45%, which was the tax rate in 2009. In 2010, estate taxes were repealed and the gift tax rate was set at 35%, equal to the highest income tax rate. The estate tax applicable exclusion amount gradually increased to \$3.5 million in 2009 while the gift tax applicable exclusion amount remained at \$1 million for all years. During the 1-year estate tax repeal, instead of beneficiaries receiving an increase in basis for certain types of inherited assets, there was instead a “modified carryover basis” for inherited assets. The GST tax provisions were aligned with the estate tax provisions.

THE 2010 TAX RELIEF ACT

Estate, Gift and GST Applicable Exclusions, Tax Rate and Basis—Estate, gift and GST tax applicable exclusions have all been re-unified at \$5 million per person, \$10 million per married couple in 2011. In 2012, these amounts are all indexed for inflation and rounded to the nearest \$10,000. The tax rate for all has been reduced to 35% and there is a full step-up in basis for capital assets, excluding income

Estate, gift and GST tax applicable exclusions have all been re-unified at \$5 million per person, \$10 million per married couple in 2011. In 2012, these amounts are all indexed for inflation and rounded to the nearest \$10,000.

in respect of a decedent (IRD), such as retirement assets, gains on deferred annuities, and other sources of income. The re-unification of the gift tax in 2011 and 2012 is very significant, allowing a married couple to gift \$10 million gift tax-free.

Without further legislation, these changes are effective only for the next two years. On January 1, 2013, the estate and gift tax

applicable exclusion amounts will drop back to \$1 million and the tax rate will increase to a maximum of 55%.

Inflation adjustments—The applicable exclusion, as noted above, is indexed beginning in 2012, but for only one year. Beginning in 2013, the estate and gift tax applicable exclusion amounts will drop back to \$1 million without any inflation adjustment, but the GST applicable exclusion amount will be indexed, and will approximate \$1.4 million.

“Portability” of any Unused Exclusion—A new provision allows an executor to transfer the unused applicable exclusion (estate or gift) to a decedent’s surviving spouse with the timely filing of an estate tax return, assuming both spouses die before 2013. There are limitations for multiple deceased spouses. The GST applicable exclusion amount is not portable. For smaller estates, this may temporarily relieve the estate planning need of ensuring that sufficient assets are titled in each spouse’s name. See additional planning issues.



Prudential

Deaths in 2010 - Election permitted—For estates of individuals dying in 2010, executors can “optionally” elect to apply these new provisions to the decedent’s estate, or elect no estate tax with a modified carryover basis (unlimited step-down for loss assets and a limited step-up of \$1.3 million plus \$3 million for assets passing to a surviving spouse). For smaller estates, opting to pay federal estate tax and eliminating potential capital gain taxes may be preferable. For 2010 tax returns, executors also have an additional nine months after the enactment date (December 17, 2010) to decide, file an estate tax return, pay taxes and make disclaimers.

Sunset—All provisions of the 2010 Tax Relief Act sunset again on December 31, 2012.

SUMMARY OF THE 2010 TAX RELIEF ACT

- ▶ The estate, gift and GST applicable exclusions have been re-unified and increased to \$5 million per person, \$10 million per married couple.
- ▶ The applicable estate, gift and GST tax rates have been reduced to 35% through 2012.
- ▶ Carryover basis has been repealed and there is a full step-up in basis of capital assets.
- ▶ The estate, gift and GST applicable exclusions are indexed for cost of living in 2012.
- ▶ Portability of the deceased spouse’s applicable exclusion amount (estate and gift) is available to the surviving spouse, if the estate tax return is filed timely. Limitations exist for subsequent marriages. The GST applicable exclusion amount is not portable.
- ▶ There are optional estate tax and GST provisions for 2010 decedents.
- ▶ All provisions, except repeal of the carryover basis, sunset on December 31, 2012.

2013 AND THEREAFTER— UNLESS CONGRESS ACTS AGAIN

- ▶ The estate, gift, and GST applicable exclusions drop back to \$1 million per person, \$2 million per married couple.
- ▶ The estate and gift applicable exclusions will not be indexed for inflation, though the GST

applicable exclusion, which had been previously indexed for inflation, will continue and approximate \$1.4 million in 2013.

- ▶ The applicable estate, gift and GST tax rates will increase to a maximum of 55%.
- ▶ The full step-up in basis for capital assets will continue, excluding income in respect of a decedent (IRD).
- ▶ Portability of the “latest” deceased spouse’s applicable exclusion amount expires.

PLANNING ISSUES

More than ever, proper planning with your attorney and other advisors is critical to ensure that your estate is settled according to your wishes and without a loss of a significant portion of those assets. Only with proper planning will your estate pass to the heirs you select at the time and in the manner you desire.

Do you still need a Credit Shelter Trust (CST) with the new portability rules? Despite the apparent simplicity of leaving everything to your surviving spouse and relying on portability, if you are married, there are strong reasons to continue to use Credit Shelter Trust planning. These include:

- ▶ Portability of the applicable exclusion amount sunsets on December 31, 2012.
- ▶ Funding a CST can minimize growth in the surviving spouse’s estate.
- ▶ The deceased spouse’s unused exclusion may be limited if the surviving spouse remarries and survives his/her next spouse.
- ▶ Asset protection can be provided with a CST for the surviving spouse.
- ▶ The unused GST applicable exclusion amount is not portable.
- ▶ The credit shelter trust allows the deceased spouse to make sure that the assets in that trust are managed and distributed according to his/her wishes and not those of the surviving spouse.
- ▶ Transferring all assets and porting the applicable exclusion amount provides maximum flexibility and control to the surviving spouse for smaller estates.

PLANNING OPPORTUNITIES IN 2011 AND 2012

Transferring up to \$5 million (\$10 million per married couple) without having to pay gift taxes allows for significant planning opportunities that, combined with leveraging strategies, can transfer huge amounts of wealth. In essence, Congress has provided a 2-year “Gift Tax Holiday.”

Some transfer techniques include:

▶ **Simple Gifts of Cash or Other Assets—**

Significant “simple” gifts up to \$5 million (\$10 million per married couple) can now be made in cash or other assets without sophisticated planning. If the law sunsets and the applicable exclusion returns to 1 million in 2013, these gifts may be added back to the taxable estate for estate tax purposes, though all growth on the gifts will be excluded.

▶ **Life Insurance—**Large amounts of life insurance can either be transferred out of the taxable estate or purchased with the availability of significant lifetime gifts. If structured properly, the insurance proceeds can pass free of probate, income and estate taxes to younger generations, potentially “skipping” generations.

▶ **Advanced Transfers—**Gifts and/or selling income-producing property to a family limited partnership, limited liability company, or a defective grantor trust (where the taxable trust income is attributed to the donor) can provide a substantial transfer of wealth. These transfers can be further leveraged through the use of discounting techniques, which have not been reduced or impacted by the Act.

Since the new estate tax legislation sunsets on December 31, 2012, permanent planning cannot be done. You may be interested in the effect of these estate tax changes on your individual situation. Your financial professional can provide you with insurance and investment products and services that will complement the estate planning that you do with your attorney and other advisors.

Life insurance is issued by The Prudential Insurance Company of America and its affiliates. All are Prudential Financial companies located in Newark, NJ, and each is solely responsible for its own financial condition and contractual obligations. Life insurance policies contain exclusions, limitations, reductions of benefits and terms for keeping them in force. Your financial professional can provide you with costs and complete details. The availability of other products and services varies by carrier and state.

This material is designed to provide general information in regard to the subject matter covered. It should be used with the understanding that it does not constitute legal, accounting or tax advice. Such services should be provided by the client’s own legal, accounting and tax advisors. Accordingly, information in this document cannot be used for purposes of avoiding penalties under the Internal Revenue Code.

**Securities and Insurance Products:
Not Insured by FDIC or Any Federal Government Agency.
May Lose Value.
Not a Deposit of or Guaranteed by Any Bank or Bank Affiliate.**

Prudential, the Prudential logo, and the Rock symbol are service marks of Prudential Financial, Inc. and its related entities.