



The Estate Tax Is Back

Take a fresh look at your estate plan

New laws have significantly changed the estate tax, which is back after a one-year repeal in 2010. Under the new law, the first \$5 million of an estate is tax-exempt, and amounts in excess of that limit are subject to a maximum 35% tax. The laws, which are scheduled to expire at the end of 2012, also changed the rules governing gift and generation-skipping transfer taxes.

We spoke with attorney **Carol Harrington**, a partner in McDermott Will & Emery LLP in Chicago and an expert on transfer-tax law, to find out what the new laws may mean for giving and estate plans.

Q How does the new legislation affect estates that were processed during 2010, when there was no estate tax?

A. Executors of estates processed last year can elect either the 2010 law or the new law. The 2010 law has no estate tax, but makes heirs subject to “carryover basis”: Heirs must pay capital gains tax on any appreciation in excess of \$1.3 million that occurred under the former owner. Under the new legislation, heirs are not subject to carryover basis. However, they will pay up to 35% estate tax on amounts inherited beyond \$5 million.

People inheriting estates worth less than \$5 million generally should choose the 2011 law. But higher-value estates might be better served by the 2010 rules, because the tax on appreciation might be lower than the estate tax.

Q Under the new law, a surviving spouse inherits any unused portion of the deceased partner’s \$5 million exemption, making up to \$10 million of the couple’s estate tax-exempt. How might this new provision, known as portability, affect couples’ estate plans?

A. A couple with a large estate previously had to create a trust to take full advantage of each member’s exemption. The portability provision eliminates the need for trusts for many couples — the surviving spouse can simply add the unused portion of the deceased’s exemption to his or her own, provided the legislation is still valid at the time of the surviving partner’s death. Like the rest of the legislation package, this provision is set to expire at the end of 2012, so it remains to be seen whether the portability clause will become permanent.

Q How does the new law change gift and generation-skipping taxes?

A. There are three components to the transfer-tax system: a gift tax for transfers during life; an estate tax for transfers after death; and a generation-skipping transfer tax for gifts to grandchildren or great-nieces/nephews. In previous years, tax rates varied for the three components, which made gift planning complex. Under the new legislation, all three components have a tax-exemption limit of \$5 million, with a 35% maximum tax rate for transfers in excess of that amount.

Q How might people proceed with their estate planning in light of these changes?

A. It’s impossible to predict whether the legislation will expire in 2013 as scheduled or be made permanent. I generally encourage clients to review their estate plans every three to five years, but with the laws constantly changing, people need to pay even closer attention, and update wills and other estate documents any time there is a change in legislation. ■

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