Tax, Trusts & Estates Update

February 13, 2011

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

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "Act") was signed into law by President Obama on December 17, 2010. The Act significantly changed the estate, gift and generation skipping transfer ("GST") taxes and also modified income and payroll tax laws.

Highlights of the Act's Estate, Gift & GST Tax Provisions

Highlights of the Act's estate, gift and GST provisions are below. These provisions are described more fully in the section "Summary of Certain Estate and Gift Tax Provisions."

- Federal estate and gift tax rates are 35%, 2011 and 2012
- The Generation Skipping Tax (GST) tax rate is 35% in 2011 and 2012 (In 2010, there was no GST tax, and prior to 2010, the GST tax rate was 45%.
- Federal estate and gift tax exemptions are "reunified" in 2011 and 2012 to permit aggregate transfers of $5 million per person (Prior to 2011, the gift tax exemption was $1 million. Prior to 2010, the estate tax exemption was $3.5 million.)
- The GST tax exemption in 2011 and 2012 is increased to $5 million per person (Prior to 2010, the GST exemption was $3.5 million. In 2010, there was no GST tax.)
- A surviving spouse may use, both for gift and estate tax purposes, a deceased spouse's unused Federal estate (but not GST) tax exemption in 2011 and 2012.
- The above provisions of the Act expire on December 31, 2012 absent new legislation and are described more fully below.

The following is a summary of the Act's key provisions. As only a partial summary is provided, we encourage you to discuss your specific situation in detail and not to take planning actions without seeking the advice of your tax and legal advisers. While existing tax planning strategies and estate plans may still be appropriate, we recommend that they be reviewed in light of the applicable provisions of the Act.

Summary of Certain Provisions Pertaining to Individuals

The following is a summary of key provisions of the Act that pertain to individuals:

Reinstatement of Estate Tax

The Act reinstated the federal estate tax for decedents dying after December 31, 2009 with a lower 35% maximum tax rate and with a higher $5 million federal estate tax exemption. For

individuals who died in 2010 and who do not "opt out" of the estate tax, the estate tax is applied retroactively; and estate tax returns are due by September 17, 2011. The Act also repealed the modified carryover basis rules for 2010 (except for estates that opt out of the federal estate tax) and implemented the familiar "step-up" in basis regime that existed prior to 2010.

Opt-Out Provisions for 2010 Decedents

Personal representatives of the estates of persons who died in 2010 may "opt out" of the imposition of federal estate tax. If the opt out is elected, the basis of the decedent's assets will be determined under the modified carryover basis rules in effect for 2010, with a basis step-up of approximately $1.3 million for transfers to a non-spouse and a basis step-up of $3 million for certain spousal transfers.

Before electing to opt out of the federal estate tax in 2010, however, the personal representative of a 2010 decedent's estate may wish to consider the changes in the basis rules and how they might affect the basis of assets transferred to beneficiaries. Consultation with a tax professional is suggested in order to weigh the benefits of obtaining a full basis step-up under the federal estate tax regime or having a zero federal estate tax under the opt-out regime.

Portability of Estate Tax Exemption

The Act introduced the concept of portability to the estate tax exemption, giving the surviving spouse's estate the ability to use any unused estate tax exemption remaining at the death of the first spouse. Under the Act, a surviving spouse will benefit from the portability provision only after 2010. Nevertheless, while the portability provision is designed to protect the use of each spouse's exemption, there may be tax benefits to continuing to plan specifically for this, as was the case in the past. We recommend that individuals consult with their tax advisers before deciding whether or not to rely on the new portability provision.

Gift Tax Exemption

The Act gives donors a $5 million gift tax exemption, adjusted for inflation, for 2011 and 2012. The gift tax exemption remains at $1 million in 2010. The maximum gift tax rate will be 35%. Any gift tax exemption used during an individual's lifetime will decrease the $5 million federal estate tax exemption available under the Act.

GST Tax

The Act reinstated the GST tax (which was 0% in 2010) and increased the GST tax exemption to $5 million, beginning in 2010. It appears that the $5 million exemption will be available for all 2010 decedents' estates, regardless of whether an estate has opted out of the federal estate tax. The GST tax rate is 35% in 2011 and 2012.

Noteworthy Items that the Act did not Address

Valuation discounts are often used with various estate planning techniques (such as family limited partnerships). While there had been discussion that the new tax law would limit the ability to discount the value of assets in estate planning transactions, the Act does not include

such limits. As a result, valuation discount planning continues to be an effective estate planning tool, and individuals may want to take advantage of such techniques, in case use of them is limited in the future.

Pursuant to proposals that were discussed prior to the Act, a minimum ten-year term for an estate planning technique known as a "Grantor Retained Annuity Trust" ("GRAT") would have been imposed. The Act, however, doesn't include any such provision, and short-term GRATs (e.g., two to three years) appear likely to be viable, at least in the immediate future. Note that GRATs can be particularly effective when interest rates are low, and the interest rate environment makes the use of GRATs current low particularly attractive in current estate planning.

Continued Uncertainty Regarding Federal Taxes in the Long Term

Changes resulting from the Act are generally effective for two years and will lapse absent new legislation prior to December 31, 2012. Due to the temporary nature of the Act's provisions, there remains a great deal of uncertainty regarding income and trust and estate taxes in the longer term.

Impact of the Act on Estates Located in or Holding Property in New Jersey

It's important to note that the Act did not affect New Jersey estate tax laws. Estates are required to file a New Jersey Estate Tax Return when the gross estate plus prior taxable gifts exceed $675,000. Transfers to charities, a surviving spouse, a surviving civil union partner or a surviving domestic partner are exempt from the New Jersey estate tax. Transfers to anyone else are taxable to the extent that the transfer exceeds $675,000. The New Jersey estate tax rate generally ranges from 0% to 16%, depending upon the amount of the transfer. The major exception is that for the first $52,175 over $675,000, there is a 37% tax. Moreover, even though a spouse may pass an unlimited amount of assets to his or her spouse during life or at death, the assets left to a spouse at death are included in the gross estate and may necessitate the filing of a New Jersey estate tax return.

Despite the increase of the federal estate tax exemption under the Act that permits aggregate transfers of $5 million per person without the imposition of taxes in 2011 and 2012, due to the New Jersey estate tax that is applicable to estates exceeding $675,000, we recommend that persons wishing to minimize aggregate estate taxes consult with their legal and tax advisers to determine how best to achieve their goals.

Social Security Provisions

For 2011, the Social Security payroll tax on individual wages is lowered by two percentage points, resulting in a tax savings of up to $2,136. For employees, the rate moved from 6.2% to 4.2%, and for self-employed individuals, the rate is reduced from 12.4% to 10.4%. There is no reduction in the employer's share of Social Security tax, which will remain at 6.2%.

Alternative Minimum Tax

Under the new law, for tax years beginning in 2010, the Alternative Minimum Tax (AMT) exemption amounts are increased to $72,450, $47,450 and $36,225 for married taxpayers filing jointly, single filers, and married taxpayers filing separately, respectively. For 2011, the amounts are increased to $74,450, $48,500, and $37,225, respectively.

Unemployment Benefits

The Act secures an extension of unemployment insurance for an additional 13 months.

Individual Extended Tax Rates

Current tax brackets will remain in effect until January 1, 2013. Without an extension, beginning in 2011, the 10% bracket would have ceased to exist, and taxpayers previously subject to it would have moved to the 15% bracket. In addition, the top four tax brackets would have increased from 25%, 28%, 33% and 35% to 28%, 31%, 36% and 39.6%, respectively. The chart below summarizes the rates specified in the Act in addition to the rates that could have been in existence but for provisions of the Act, along with corresponding levels of taxable income for married couples who file jointly.

Capital Gains and Qualified Dividends

The maximum tax rate on long-term capital gains and qualified dividends remains at 15% for most taxpayers and 0% for taxpayers in the 15% tax bracket or below. If the Act had not be enacted, long-term capital gains would have been taxed at a maximum 20%, and qualified dividends would have returned to being taxed at the taxpayer's marginal tax rate, up to 39.6%.

Itemized Deduction and Personal Exemption Phase-Outs Limits

The phase-out limits for itemized deductions and personal exemptions have been gradually reduced since 2001 and were completely eliminated in 2010. Under the Act, the elimination of the adjusted gross income ("AGI") limits for itemized deductions and personal exemptions continues for two years.

Child Tax Credit and Child and Dependent Care Credit

The Act retained the child tax credit of $1,000, per qualifying child. This credit will remain in effect for two more years and continues to be phased out for most taxpayers with AGI in excess of $110,000. The Act also retained the child and dependent care credit which permits taxpayers who pay expenses for children under age 13 or for incapacitated dependents or spouses to claim a nonrefundable credit for a percentage of their dependent-care expenses that enable them to work. The maximim percentage of the credit remains 35%, and the maximum amount of the credit remains $3,000 or $4,800 to $6,000 for families with two or more children.

Education Savings Accounts

An education savings account is a trust established to pay qualified education expenses of a designated beneficiary. The Act extended the following limits and provisions through 2012: annual contribution limit of $2,000, AGI phase-out from $160,000 to $220,000 for married filers,

and eligibility of contributions made by corporations, tax-exempt organizations and other entities to education savings accounts. Qualified expenses continue to include elementary and secondary costs.

Summary of Certain Provisions Pertaining to Businesses

The following is a summary of key provisions of the Act that pertain to businesses:

Bonus Depreciation

The Act extended the bonus depreciation allowance provision from the Small Business Jobs Act of 2010 through tax year 2011 and increased the depreciation amount from 50% to a full 100%. It also extended the provision through 2012, with the bonus depreciation amount returning to 50%.

Section 179 Expensing

The Act extended the 2010 maximum expensing amounts set under the Small Business Jobs Act through 2011. For property placed in service in 2010 and 2011, the maximum expense limit of $500,000 is decreased by the amount of total property that exceeds $2,000,000. For 2012, the maximum expense limit is reduced to $125,000 and decreased by the amount of total property that exceeds $500,000. No deduction will be available for property of over $625,000 in 2012.

Certain Other Business Tax Breaks Retroactively Reinstated for 2010 and Extended Through 2011

- 15-year write-offs for qualified leasehold improvements and restaurant buildings (and certain improvements to such restaurant buildings)
- Employer wage credit for activated military reservists
- Active financing exception from the Code's Subpart F rules for a controlled foreign corporation predominantly engaged in the conduct of a banking, financing or similar business
- Look-through treatment of payments between related controlled foreign corporations
- Expensing of environmental remediation costs
- Enhanced deduction for contributions of food and book inventories, and computer equipment for educational purposes
- A favorable rule for S corporations making charitable donations
- Extension through 2011 of the temporary exclusion of 100% of gain on the sale of certain small business stock

Summary of Certain Estate and Gift Tax Provisions

The following more fully describes the provisions of the Act pertaining to estate, gift and GST taxes that are highlighted at the beginning of this article.

Tax Appeals Have the Potential to Reduce Real Estate Taxes

Have you reviewed the assessment on your residential or commercial property lately? The current economic situation has recently depressed real estate values for many residential, warehouse, industrial and commercial properties. With respect to commercial property, whether you own or rent the property where your business is located, you most likely pay the real estate tax, which is probably your single greatest operating expense.

Real estate taxes are based on the value of the real estate: the higher the value, the higher the tax. New Jersey laws limit the values that municipalities can legally use as the basis for determining real estate tax. Due to the recently declining real estate market, in many cases these values may have declined substantially. As a result, current real estate tax assessments may be based on incorrect and excessive valuations. In many situations, these assessments can be reduced by a successful real estate tax appeal, resulting in the reduction of real estate taxes. Saiber attorneys in the tax practice group are experienced in reviewing real estate assessments, and when warranted, prosecuting successful tax appeals on behalf of clients. Real estate tax appeals can be brought in connection with warehouse, commercial office, retail, residential, industrial, and other commercial properties throughout New Jersey.

The annual deadline by which tax appeals must be filed to reduce [2011] New Jersey real estate taxes is [April 1, 2011], after which [2011] real estate taxes probably cannot be reduced as the deadline is rarely extended.

Many clients who commence real estate tax appeals opt to pay legal fees on a contingent fee basis depending on the outcome of the appeal. In a contingent fee arrangement, if real estate taxes are not reduced, no legal fees re owed. Hourly billing in connection with real estate tax appeals can also be arranged.

At this time Saiber offers prospective clients the opportunity to review their real estate tax assessments with the firm's tax attorneys and obtain advice regarding the feasibility of reducing such assessments. There are no fees or commitments associated with initial consultations for real estate tax appeals.

Clients and prospective clients who have questions regarding real estate tax appeals or any other tax-related matters, should feel free to contact us.