your money

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Advice from the experts...

Tax News

Extension of many of the 2001 Tax Act provisions

–Gerald M. Morello Jr.

Once in awhile, the federal government passes a law that just plain makes sense. And as the old saying goes: if it doesn't make dollars, it doesn't make sense. Well, the 2010 Tax Act, more formally known as the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 allows taxpayers to keep more money in their pockets, and that sure makes sense.

On December 17, 2010, just one day after it was passed by Congress, President Oboma signed the 2010 Tax Act - a bill that will have a substantial impact on income tax, unemployment insurance, and estate and tax planning for at least the next two years. why only two years? Because many of the tax provisions within the law only stay in affect for two years – until the next presidential election cycle. However, some of the provisions in the 2010 Tax Act are set to stay in place beyond 2013. With these issues in mind, I have put together a brief list of tax considerations that are impacted, either temporarily or permanently, by the 2010 Tax Act.

FEDERAL ESTATE TAX

Despite many bold predictions to the contrary, the federal Estate Tax remains alive and well. The Estate Tax imposes a tax on a person's money and property when they pass away. In calendar year 2011, the 2010 Tax Act provides that a decedent is allowed to pass assets of up to $5.0 Million in value free from Estate Tax. This is called the estate tax exemption amount. Only the value of a decedent's taxable estate that exceeded the estate tax exemption amount are subject to the estate tax. One's estate consists of the fair market value of all assets, including life insurance, less debts and expenses. The current maximum federal estate tax rate is 35%.

As you may recall, the Estate Tax suffered its own one (1) year demise in year 2010. However, the 2010 Tax Act provides that the $5.0 Million exemption amount and 35% tax rate does apply to estates of decedents who died in 2010, unless their personal representative chooses to have the 2010 Tax Act not apply. But there is a catch – if the 2010 Tax Act is elected to not apply, the decedent's estate will be subject to convoluted "carry-over" basis rules. As such, if a decedent has passed away leaving an estate that exceeds $5.0 Million, but much of the property left had a built-in gain (such as a business or real estate), the personal representative of the estate must calculate the potential effects of applying the Estate Tax to the estate, or the Capital Gains Tax to the assets that have a built-in gain, before choosing which election to make.

However, the Estate Tax, as noted above, is not "set in stone." Rather, unless the federal government enacts a law to the contrary, in calendar year 2013, the federal Estate Tax returns to pre-2001 levels, meaning the estate exemption amount decreases to $1.0 Million and the highest estate tax rate increases to 55%. That means that the federal government could take 5¢ of every dollar that you leave over and above the exemption amount. But at least for the next two years, the Estate Tax appears to be at a level that will only affect the ultra-wealthy.

GIFT TAX

In an effort to reduce potentially taxable estate, taxpayers often make gifts to children or other beneficiaries. However, the federal Gift Tax imposes a tax on large gifts made to recipients other than your U.S. citizen spouse (i.e. a gift to a U.S. citizen spouse, no matter what the value, is exempt from gift tax). Note, however, that if your spouse is a non-U.S. citizen, you amy only gift your spouse assets totaling $134,000 free from gift tax in calendar year 2011. The value of gifts: (i) to a spouse who is a non-U.S. citizen, and (ii) that exceed $134,000 for the year, are subject to the gift tax.

In calendar year 2011, the 2010 Tax Act provides that a person can make gifts of up to $13,000 per beneficiary per year, free from gift tax and with no limit on the number of beneficiaries to whom you can give gifts. This is called the annual gift tax exclusion amount. Such gifts are not considered income to the recipients. However, even if you give a beneficiary more than $13,000 in gifts in a single year, the gift may still avoid gift tax because the 2010 Tax Act currently allows a person to give up to $5.0 Million free from gift tax over the course of your lifetime. This is called the lifetime gift tax exemption amount. But be aware that if you utilize any of your lifetime gift tax exemption amount, the amount of your estate tax exemption amount will decrease dollar-for-dollar. For example, if you gave $5.0 Million in otherwise taxable gifts to your children during your lifetime, and elected to utilize $5.0 Million of your lifetime gift tax exclusion amount pursuant to those gifts, but then you died in year 2012 with an estate valued at $5.1 Million, no gift tax would be due in the years that you made the gifts but your estate would be required to pay an estate tax of $23,800 [$5.1 Million (total estate) minus $5.0 Million estate tax exemption amount for year 2012 minur $5.0 Million dollar-for-dollar deduction for lifetime gift tax exemption amount utilized) = $100,000] x 23.8% (estate tax rate for $100,000) = $23,800 (estate tax due).

If you make a gift that is taxable (i.e. your annual gifts to the recipient exceed $13,000 and you have already utilized your entire lifetime gift tax exemption amount), you must file a Gift Tax return with the IRS by April 15th of the following calendar year. If you make a taxable gift this year, in 2011, the amount of your gift that exceeds the annual gift tax exclusion amount will be taxed at a rate starting at 18%, and could be taxed at a rate as high as 35%.

Just like the federal Estate Tax, if the federal government fails to enact a law to the contrary, in year 2013, will reset back to pre-2001 levels, meaning the lifetime gift tax exemption amount decreases to $1.0 Million, the highest gift tax rate increases to 55%, and the annual gift tax exclusion amount will remain at $13,000 (subject to inflation).

GENERATION SKIPPING TAX

The federal GST tax imposes a tax on transfers of assets to grandchildren and those deemed to be two or more generations below that of the person making the transfer. These people are called skip persons. People who are in the same or one generation below the person making the transfer ("non-skip persons") do not have to worry about the GST tax.

In calendar year 2011, you can transfer up to $5.0 Million in value to skip persons free from the GST tax. This is called the *GST tax exemption amount.* In 2011, transfers to skip persons that exceed the GST tax exemption amount will be taxed at a flat rate of 35%. However, unless the federal government enacts a law to the contrary, in year 2013, the federal GST tax returns to pre-2001 levels, and the GST tax exemption amount decreases to $1.0 Million (subject to inflation), and the GST tax rate increases to the flat rate of 55%.

The GST tax can have a substantial impact on your property. For example, if you died in year 2013 and left $1.5 Million to your great-grandchildren, thereby skipping your children and grandchildren as beneficiaries, your estate would be required to pay a GST tax of $275,000 [$1.5 Million (total GST transfers) minus $1.0 Million (GST tax exemption amount in effect for years 2013) x 55% (GST tax rate) = $275,000 (GST tax due)]. As such, you could only pass $1.225 Million of your estate to your great-grandchildren, instead of its entire $1.5 Million value. This amount would be further diminished by the federal Estate tax, which is assessed separately from the GST tax.

CAPITAL GAINS TAX – SHORT LIFESPAN OF CARRY-OVER BASIS

Although it technically was in effect for a portion of the year, the carry-over basis rules regarding inherited assets have been repealed. What does that mean for you? Probably nothing. Under the 2010 Tax Act, which is applicable to all of year 2010, inherited property receives a "stepped-up" basis, which means the cost basis of property transferred as a result of an individual's death generally equals its fair market value as of his or her date of death. As a result, the beneficiaries recognize no capital gain if assets are sold for "date of death" value.

INCOME TAX

Under the 2010 Tax Act, the Bush-era Income Tax cuts remain in place for two more years. That means that the highest tax bracket remains 35%, instead of 39.6%. Also, many of the tax credits and deductions in place over the past ten years will remain for two more years. The good news is that taxpayers will keep more of their hard earned income in their pockets.

ALTERNATIVE MINIMUM TAX

Finally, the federal government addressed the Alternative Minimum Tax (AMT) – a tax that often catches upper-middle class income makers, who fall below the classification of "rich." These people are typically the working-class professionals and small business owners. Under the 2010 Tax Act, the floor amount on which the Alternative Minimum Tax is levied is subject to inflation, meaning the cost of living is factored into whether a person will be subject to AMT. Accordingly, many people who would otherwise be subject to the AMT, can now feel relieved that they will not need to write Uncle Sam a big check on or before April 18, 2011 (Tax Day, which is typically on April 15th, has been extend three days in observance of Washington, D.C.'s Emancipation Day).

MAKE INFORMED DECISIONS

I encourage you to speak with your financial advisor and tax professionals to fully understand all of the new tax planning opportunities and issues that have arisen due to the 2010 Tax Act. Remember that there are many issues to address, so make sure you are fully informed of what is right for you. If you would like a copy of any prior articles I have writte, please contact our offices. ■

For further information or to schedule an appointment, please contact Morello Law Group, P.C. and Gerald M. Morello, Jr., Esq. at (734) 281-6464 or on the web at www.morellolawgroup.com.