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How restoration of the federal estate tax will affect you

President Obama has signed into law the "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010." Among the provisions in this law is legislation that restores the federal estate tax for two years. This is of interest to wealthy Americans, but also to those with relatively modest estates. If Congress fails to act on this law in the next two years, the estate tax issue will again leave a great deal of uncertainty among estate planners trying to provide for the best outcome for their clients. Elder Law Answers commented on this new tax-cut bill recently with links for more in-depth comments than this article can provide (www.elderlawanswers.com).

In Pennsylvania, there is a State inheritance tax to which all estates are subject. There is no inheritance tax assessed between spouses, and there is a 4.5 percent tax on assets inherited by direct lineal descendents (children, grandchildren, parents, grandparents). The tax increases to 12 percent for persons who inherit from a sibling, and to 15 percent for any other family or non-family member who inherits. Certain items are excluded or may serve as a deduction. However, the federal government can assert a claim to estates in the form of a federal estate tax. Due to changes made in the Bush administration, there was no federal estate tax in 2010. The law was due to "sunset" in 2011, in that the federal estate tax would return with a \$1 million exemption and a **55 percent** tax rate if an estate qualified for inclusion in the federal estate tax (in addition to PA inheritance tax).

The new law restores the federal estate tax for the next two years at a 35 percent tax rate, with estates up to \$5 million (\$10 million for couples) exempt from the tax. Furthermore, the new estate tax is retroactive to January 1, 2010. This means that heirs of persons dying in 2010 can choose either to follow the 2010 rules (no federal estate tax at all, but with a limited step-up in the cost basis of inherited assets), or to follow the new law with a \$5 million exemption and a step-up in cost basis. Allowing heirs to follow the new law can potentially save quite a bit of money for heirs who would have been required to pay significant capital gains tax on inherited assets over a certain threshold of value.

There are some other provisions of the new law that could be of interest to many persons. The estate tax exemption is "portable" between spouses. If the first spouse to die did not "use up" the entire \$5 million exemption, the estate of the surviving spouse can then use it to save tax for the eventual heirs. The new law also unifies the estate, gift and generation skipping tax exemptions at \$5 million. The gift tax exemption has been at \$1 million for a number of years; there is no change in the \$13,000 annual exclusion. A 35 percent tax rate will apply to transfers over the \$5 million threshold. This is a window of opportunity for the wealthy to protect huge amounts of assets for generations to come.

Many persons who do not consider themselves wealthy will also benefit by this new law. This is a great opportunity to consult with your attorney to see if your Wills are compliant with the new law, or if changes to how a 2010 decedent's estate should be handled. Many heirs may have been forced to pay much higher taxes at the death of a parent without these provisions, especially if Wills were not in place to take advantage of a potential marital deduction. Consultation with your attorney and a tax advisor is in order.