**Mary Carter Financial Services**
An Independent Firm
Mary Carter, ChFC, CFP
131 2nd Avenue North
Suite 200
Jacksonville Beach, FL 32250
904-246-0346
mary.carter@raymondjames.com
marycarterfinancialservices.com

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# Estate Tax Changes Under the 2010 and 2012 Tax Acts

***For 2013, the gift and estate tax exemption is $5,250,000 per person, and the top tax rate is 40%.***

This article summarizes the changes made to the federal gift and estate tax and the federal generation-skipping transfer (GST) tax under the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the 2010 Tax Act) and the American Taxpayer Relief Act of 2012 (the 2012 Tax Act). A chart at the end of the discussion summarizes the effects of this law.

## Background

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) was a sweeping piece of legislation that significantly changed the federal gift and estate tax and the GST tax for the years 2001 through 2010. The maximum tax rates gradually decreased from 55% to 45% (35% for gift tax) and the exemptions gradually increased from $675,000 to $3.5 million ($1 million for gift tax). The provisions of EGTRRA repealed the estate and GST taxes (but not the gift tax) for 2010; then, for 2011, EGTRRA provisions expired, effectively reinstating the tax rules that were in effect prior to 2001.

## Estates of persons who died in 2010

The 2010 Tax Act reinstated the federal estate tax for 2010, retroactively applying a 35% maximum estate tax rate and a $5 million estate tax exemption. The 2010 Tax Act also allowed the estates of persons who died in 2010 to opt out of the tax. If an executor chooses to elect out of the estate tax, estate property will receive a modified carryover income tax basis, and not a step-up (or step-down) in basis. Step-up (or step-down) generally means that the tax basis of the estate's assets increases (or decreases) to fair market value at the date of death. The modified carryover basis regime carries over the cost basis of the deceased individual to the heir. It is "modified" because cost basis can be supplemented by a step-up in basis of $1.3 million of property, with a step-up in basis of an additional $3 million of property received by a surviving spouse.

The GST tax was also reinstated for 2010 with a $5 million exemption, but with a tax rate of 0%.

The gift tax remained the same: a top rate of 35% and a $1 million exemption.

## Exemptions and top tax rates in 2011 and 2012

For 2011 and 2012, the gift and estate tax exemption is $5 million per person (the $5 million is indexed for inflation in 2012, and thus is $5,120,000); the top tax rate for these years is 35%.

Similarly, for 2011 and 2012, the GST tax exemption is $5 million per person (the $5 million is indexed for inflation in 2012, and thus is $5,120,000), and the GST tax rate for these years is 35%.

## Exemptions and top tax rates in 2013

For 2013 and later years, the gift and estate tax exemption is $5 million per person (the $5 million is indexed for inflation in 2013, and thus is $5,250,000); the top tax rate for these years is 40%.

Similarly, for 2013 and later years, the GST tax exemption is $5 million per person (the $5 million is indexed for inflation in 2013, and thus is $5,250,000); the GST tax rate for these years is 40%.

## Portability of gift and estate tax exemption

The 2010 Tax Act introduced a new estate planning concept--exemption portability. In short, the estate of a deceased spouse can transfer to the surviving spouse any portion of the federal estate tax exemption that it does not use. The surviving spouse can then add that amount to the exemption he or she is otherwise entitled to, increasing the total amount that can be passed on tax free. This new feature makes it easier for married couples to minimize the potential impact of gift and estate tax.

***The portability feature is in effect for 2011 and later years.***

Prior to the 2010 Tax Act, if a spouse died without having planned for his or her exemption, the deceased spouse's estate would have passed tax free to the surviving spouse under the unlimited marital deduction (assuming all assets passed to the surviving spouse), and the deceased spouse's exemption would be lost or "wasted." The surviving spouse's estate could then only transfer an amount equal to his or her own exemption free from federal estate tax. To solve this dilemma, married couples typically set up what is commonly referred to as a credit shelter trust (or bypass trust) that sheltered or preserved the exemption of the first spouse to die. Portability can achieve a similar result without the use of a credit shelter trust.

To use the exemption portability, the estate of the first spouse to die must elect to use portability on the estate tax return. An estate tax return must be filed by the estate of the first spouse to die to use portability even if the return is not otherwise required to be filed.

Exemption portability is available only from the last deceased spouse. The exemption of the first spouse will be lost if the surviving spouse remarries and is predeceased by the second spouse. In other words, if the surviving spouse survives Spouse 1, the surviving spouse can use Spouse 1's unused exemption even if the surviving spouse marries Spouse 2. However, if Spouse 2 also predeceases the surviving spouse, the exemption of Spouse 1 can no longer be used. However, the surviving spouse can then use the unused exemption of Spouse 2.

***Tip:*** *The portability feature is available to the estate of a deceased spouse dying in 2011 and later to transfer the unused exemption of the deceased spouse to the surviving spouse.*

***Caution:*** *The portability feature applies only to the gift and estate tax; it does not apply to the GST tax. Without a trust, any unused GST tax exemption of the first spouse to die will be lost.*

## Summary of Provisions 2011 - 2013

| | 2011 | 2012 | 2013 |
|---|---|---|---|
| **Top Gift and Estate Tax Rate** | 35% | 35% | 40% |
| **Top GST Tax Rate** | 35% | 35% | 40% |
| **Gift and Estate Tax Exemption** | $5,000,000 | $5,120,000 | $5,250,000 |
| **GST Tax Exemption** | $5,000,000 | $5,120,000 | $5,250,000 |
| **Is Gift and Estate Tax Exemption Portable?** | Yes | Yes | Yes |
| **Is GST Tax Exemption Portable?** | No | No | No |

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