



Grant Coleman comments on estate planning tax rule changes

By J. Grant Coleman

As many of you no doubt have been reading about in the financial press, Congress failed to act prior to the end of 2009 to prevent a temporary modification of the federal transfer tax rules from coming into effect. Back in 2001, when Congress initially enacted a phased-in repeal of the federal transfer tax, certain procedural issues required that the legislation sunset after a period of time. Similar sunset provisions apply to the so-called Bush tax cuts that established reduced income tax and capital gains rates over the last several years. It was intended and expected that either the sunset would be repealed or the transfer tax rules would be modified. However, that did not occur and now we are faced with what we never imagined would happen, a complete repeal of the federal estate tax for decedents dying in 2010, followed by a return to pre-2001 levels of estate tax for decedent's dying in 2011 and thereafter.

What does this mean to you?

The effect of this, for decedents dying in calendar year 2010 at least, is there will be no estate tax. This compares to a 45% estate tax rate for decedent's dying in 2009 to the extent of taxable estates exceeding \$3,500,000 and estate tax rates up to 55% for decedent's dying in 2011 and thereafter for taxable estates exceeding \$1,000,000. The gift tax remains in effect for gifts made during 2010, however, at a reduced rate of 35% of gifts in excess of a cumulative exempt amount of \$1,000,000. This compares to a 45% rate for gifts in excess of the exempt amount made in 2009 and rates ranging up to 55% for gifts in excess of the exempt amount made in 2011 and thereafter.

What's the problem?

The main concern is many wills have been written containing formula bequests that do not anticipate that there will be no estate tax at the time of the death of the testator. For example, a will may provide that the amount that can pass free of estate tax goes to one legatee with everything else going to another legatee (usually the surviving spouse, since bequests to surviving spouses were not subject to estate tax). If a decedent with such provision in her will were to die in 2010, her entire estate would go in accordance with the first bequest and perhaps none of the estate would go to the surviving spouse, which may not be intended. Similar issues can arise in the context of charitable bequests where the effect of a formula bequest would be to deprive a charity of an intended legacy. Complicating the matter further is the possibility that Congress will enact legislation sometime this year, which may or may not be retroactive, reestablishing the estate tax for decedents dying in 2010 or after some date in 2010. Even if Congress does so act, it is possible that any attempt to retroactively impose the estate tax would be unconstitutional.

What should you do?

While certain problems may be rectified by post-mortem actions, such as disclaimers, you should review your estate planning documents to make certain that they still provide for what you intend in the event that you were to die in 2010. Perhaps no change would be warranted or perhaps a simple codicil that is effective only during the period that there is no estate tax will be all that is necessary. Maybe you would like to take advantage of some intriguing tax planning opportunities that may be available during this time.

What about carryover basis?

Another impact of the Congress's failure to act is the (at least temporary) end to the resetting of income tax basis at death. Prior to 2010, many types of assets of a decedent received a new income tax basis equal to fair market value at date of death. For 2010, the general rule no longer applies and is replaced by a limited amount of basis adjustment for everyone and an additional amount of basis adjustment for transfers between spouses. Under the current legislation, the full basis adjustment rules will return for decedents dying in 2011 and thereafter. As in the case of the estate tax, there are some interesting basis increase planning opportunities that may be available, particularly in community property states.

Do you want more information?

Please contact me if you have any questions or if you want assistance in reviewing your estate planning documents and determining if you should take any action.

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