2010 NOW WHAT?

Estate Tax Planning in 2010 and Beyond

Phase out of the Federal Estate Tax

What a mess Congress has created!

We are now in a year where there is no federal estate tax - but hold the cheers. Congress has substituted another method of taxation that will collect more taxes from many of our clients and families than the estate tax. Additionally, as has been reported in the local and national press,[1] these changes will, for some, greatly alter the planned for and anticipated distributions among family members and heirs.

A brief review of the law will help explain why this is so significant. The 2001 tax act,[**Economic Growth and Tax Reform Reconcilliation Act of 2001 EGTRRA]** signed into law by President George W. Bush, gradually reduced the maximum rate of the federal estate tax (and the equally onerous generation-skipping transfer tax on transfers to grandchildren) from 55% to 45%. It also gradually increased the amount of property that you could pass free of federal estate tax from $675,000 per person in 2001 to $3.5 million per person in 2009. That means that with basic estate planning, a married couple could pass up to $7 million free of federal estate tax, if they both died in 2009. (See Applicable Exclusions Amount (Unified Credit))

EGTRRA was basically designed to provide significant tax relief, including "permanent" relief from the federal estate tax (with its then $675,000 exemption and maximum 55% tax rate). The new law steadily lowered the maximum estate tax and GSTT rate to 45%, while increasing the exemption amounts to $3.5 million in 2009 and eliminating federal estate tax and GSTT altogether in 2010. But because of a special Senate rule that limits budget deficits, EGTRRA was enacted with a "sunset" provision. Under this sunset provision, on January 1, 2011 the law will revert back to pre-EGTRRA law. This means that the federal estate and gift tax exemptions will be unified at $1 million (the unified credit was scheduled to increase under prior law) and the GSTT exemption will be $1 million, adjusted for inflation. The maximum tax rate will be 55%.

Then, *in 2010 only*, the 2001 tax act repeals the estate tax. But like a horror film character who just won't die, under the existing law the estate tax returns again on January 1, 2011 – only at a much lower $1 million exemption and a higher maximum 55% tax rate! This strange "now it's gone, no it isn't" effect is the result of a rule in Congress that attempts to limit budget deficits.

Paying for Estate Tax Repeal

---

[1] See *Estate-Tax Repeal Means Some Spouses Are Left Out*, January 2, 2010 Wall Street Journal and *A Bizarre Year for the Estate Tax Will Require Extra Planning*, January 8, 2010 New York Times.

To pay for this one-year vacation from the estate tax, Congress replaced the estate tax with an increased income tax. Before 2010, any assets that pass to someone when you die would be valued at fair market value at the date of death. Thus after death, when a surviving spouse or heirs sold any assets (like securities or a home) that had increased in value, they would not have to pay income tax on any of that growth that occurred during your life. (This is referred to as a "step-up in basis.") For many heirs this means huge income tax savings, oftentimes tens of thousands of dollars or more.

But in 2010 property that passes at death does not automatically receive this step-up in basis. Instead, each individual has a limited amount of property that can be "stepped-up" in value at the time of death. Property that does not receive this step-up value will be subject to tax on all increase in value *from the date you first acquired the property*. This means that the property could be exposed to tens of thousands of dollars of income tax liability for your heirs!

Not surprisingly, these rules are convoluted and in many cases very different from the old law. In fact, Congress attempted to institute a similar tax structure in the 1980s and it was repealed, retroactively, because it was too difficult to administer. Because of past experience as well as the anticipated difficulties in calculating such a tax, the common belief was that Congress would change the law before January 1, 2010. But it didn't.

How You Are Affected?

This law can affect you in several ways. For married couples as well as single clients, we need to first make sure that your property will be divided according to *your* desires, and not dictated by Congress. For more than 50 years it has been common to use a written mathematical formula to divide the assets of a married couple when the first spouse dies to maximize estate tax savings. Likewise formulas have been used to provide funds for charitable causes and to benefit family and friends. Now, in 2010 when there is no estate tax, these formulas will not work. If a spouse is not your sole beneficiary (for example, if you have children from a prior marriage), the existing formula could result in the disinheritance or substantial reduction of resources provided for the surviving spouse.

What Should You Do?

We encourage you to meet with us as soon as possible to review your estate plan and make any changes that are necessary for this law. We need now to ensure that your property is positioned to receive the maximum step-up in basis increase available under current law. This is a time that demands a new approach to your planning with new thinking and building in flexibility to see that your wishes are fulfilled no matter what Congress will throw at us this year or next. We have solutions that will meet you planning objectives with the least amount of tax impact.

Call my office at (562) 494-2828 to make an appointment for a free consultation or e-mail me at laura@claveranlaw.com I look forward to hearing from you soon. **ACT NOW!! See our Winter/Spring Special which ends April 30, 2010.**