Estate Planning Strategies

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STRATEGIES TO PROTECT ASSETS AND PERSONAL NET WORTH

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Repeal of the Estate Tax – Here's the Catch and Why It Matters to You

When the clock struck midnight this past New Year's eve, the unthinkable happened in the estate planning world. Despite predictions that common sense would prevail, Congress allowed the federal estate tax to expire on January 1, 2010, albeit for just one year. While no estate tax -- even for one year -- may sound like good news, this state of affairs poses several risks and has created, m the words of Senate Finance Chair Max Baucus, "massive, massive confusion." So, what exactly has happened and what does this all mean for you?

Where We Are and How We Got Here

We are now in the final stage of the 10-year phase-out and repeal of the federal estate and generation-skipping transfer (GST) taxes put in motion by the Economic Growth and Tax Reconciliation Relief Act of 2001. That legislation increased the estate and GST tax exemptions from $1 million to $3.5 million over the period 2002-2009 and reduced the rates on those taxes over the same period from 55 percent to 45 percent. The legislation repealed the estate and GST taxes in 2010, and left the gift tax in place in 2010 with a reduced rate of 35 percent. As noted above, however, this is for only one year. As of January 1, 2011, the estate and GST taxes are scheduled to be back in place along with the gift tax, but with the 2001 exemptions and rates.

What's Next

Senate leaders have vowed to address this one-year gap in the application of estate and GST taxes early this year and to pass retroactive legislation. Whether that will happen, and if so whether retroactive legislation will survive constitutional challenge is anybody's guess. What we do know is that if Congress takes no action, the more onerous pre-2002 transfer tax regime will be reinstated in 2011.

What's at Stake?

Virtually all wills and trusts for married couples contain formulas designed to minimize the federal estate tax. A vast majority of these wills and trusts contain a formula giving the surviving spouse (or a trust for the surviving spouse's benefit) "the minimum amount

Repeal of the Estate Tax – Here's the Catch and Why It Matters to You *(continued)*

that will reduce the federal estate tax to the lowest possible amount." This flexible formula automatically adjusts to increases in the estate tax exemption, which has steadily gone up over the last 15 years, allowing the wills and trusts to remain effective without constant modification. But the formula may now have unintended and potentially disruptive effects on anyone who has a surviving spouse and who dies while no federal estate tax is in effect. Such unintended consequences could include the disinheritance of your spouse and/or the disinheritance of your grandchildren if amounts are set aside for them based on the GST exemption.

It is also possible that current formulas will not accommodate the full additional basis available under the new carryover basis rules. The trade-off for elimination of the estate tax is the introduction of carry-over basis, which means that assets held at death will no longer acquire a new tax basis for income tax purposes equal to fair market value at date of death. Instead, assets will retain the cost basis they had in the hands of the decedent. The new rules -- effective while the estate tax remains repealed -- provide a limited basis step-up in the amount of $1.3 million, plus an additional basis step-up of $3 million for "qualified spousal property." The concern is that the credit shelter or family trusts funded under existing formulas probably would not qualify for the $3 million spousal basis step-up otherwise available if the assets passed outright or in a marital trust to the surviving spouse.

What Should You Do?

Because we cannot predict the timing or content of further Congressional action, we can only advise you to plan for the here and now. To ensure that you avoid the risks explained above, we recommend that your wills and trusts be amended to (1) direct how your formulas should operate if no estate tax is in place at your death, and (2) include special language to take advantage of the additional basis step-up under the new rules. The new provisions could be drafted to adjust or deactivate as appropriate, so that your documents will cover all possible tax regimes and avoid the need for further modification.

I would be happy to speak or meet with you on a complimentary basis to discuss your particular situation. Please contact my assistant, Tina Fritz, at (954)364-6074, or tfritz@becker-poliakoff.com, and she will arrange a mutually convenient date and time for the consultation.

Andrew Berger is a tax and estate planning attorney with Becker & Poliakoff, P.A. He received his LL.M. in Taxation from New York University School of Law, his J.D. from Fordham University School of Law, and his B.A. from Emory University. He is admitted to practice law in Florida, New York and New Jersey.

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