

May 1, 2010

NOW YOU SEE IT . . .

No. 22

Estate tax repeal may be temporary, or maybe not. A number of the members of the estate and trust legal community have been relying on the joint statement made February 2, 2010 by Treasury Secretary Tim Geithner and Senate Finance Committee Chair Max Baucus. They supported leaving the Estate/Gift/GST rules the same as they were last year and extending the 2009 estate tax rates to 2010. These changes would be retroactive to January 1, 2010. But now it's approaching the middle of the year. Nothing is happening or even proposed. What to do?

Most of our clients make their wills the focus of their estate planning. Most of the wills are "two tier" trust wills meaning the estate of the first-to-die shunts assets equal to the estate tax exemption to the Family Trust and everything else to the Marital Trust, essentially going outright to the surviving spouse. Now, in 2010 with no estate tax, these "two tier" trust wills pass everything to the Family Trust. This can be a nasty surprise to a surviving spouse. There are two common "fixes." One is to note in a codicil a limit on the amount passing to the first trust. For example, "the Family Trust gets \$1 million and the rest goes to the Marital Trust." Another solution is to rewrite the will so everything goes to the surviving spouse and she (or he) can "disclaim" whatever she (or he) wants to the Family Trust ... if they see some reason to. For example, "my wife gets everything and she can keep it or disclaim whatever she wants to the Family Trust."

Many people elect one of the choices above. A few say, "Let's not bother: the estate tax will be reinstated as an extension of the 2009 law." So they want to wait. That may or may not be a good choice depending on personal circumstances. So what does repeal give us?

Repeal gives us a new estate planning environment. The 2001 Tax Act that repealed the estate tax in 2010 has a radical impact:

- We now have a gift tax with a top gift tax rate of 35%.
- The step up in cost basis has gone away in 2010. Instead, the cost basis of the decedent carries over. Instead of capital gains being wiped out on death, they carry over to the surviving spouse or other inheritor. If there is more than \$4.3 million of appreciation in the value of the assets owned by the decedent, the carryover basis rules increase the potential income taxes on the surviving spouse's sale of appreciated property by more than the estate tax repeal eliminated the estate taxes payable on such property!
- The "old" estate tax is resurrected in 2011, with a top estate tax of 55% and a 5% surtax on transfers over \$10 million. The estate tax exclusion amount, which was \$3.5 million in 2009 becomes \$1M in 2011. The only good news is the reinstatement of the step up in cost basis.
- The state death tax credit also comes back in 2011, which automatically reinstates Colorado death taxes for Colorado residents.

Breathtaking, isn't it.

So will there be a new and different estate tax enacted in 2010 retroactive to January 1, 2010? Unknown. As for our clients' personal situations, it is worth reexamining your will and seeing how it works in 2010 and how it will work in 2011 if we do not get a retroactive estate tax bill during this year. Someone called this a time of "repeal limbo." We think a better description is "repeal hell."