

Estate Tax and Generation Skipping Tax Repeal

As you may have heard or read, effective January 1, 2010, the estate tax and the generation skipping tax is repealed. The gift tax will not be repealed, but will have its bracket reduced from 45% to 35%. Most observers assumed that Congress would pass legislation that would, at a minimum, carry forward the 2009 rates and exemptions into 2010. The repeal raises a variety of planning issues.

Elimination of the step up in basis rule

For decedents dying after December 31, 2009, the basis of property acquired from a decedent would be the lesser of the decedent's adjusted basis or the fair market value of the property on the decedent's death. This results in assets potentially being "stepped down" should FMV be lower than the asset's basis at date of death, which exposes modest estates that would not have been affected without an estate tax repeal to additional tax in the form of a capital gains tax. Calculating the date of death basis may be very difficult.

There are two exceptions from the carryover basis provisions:

- (1) The executor can allocate up to \$1.3 million (increased by unused losses and loss carryovers) to increase the basis of assets; and
- (2) The executor can also allocate up to \$3.0 million to increase the basis of assets passing to a surviving spouse, either outright or in a QTIP trust. This is an increased basis of \$1.3 and \$3.0 million, not assets having a value of \$1.3 or \$3.0 million, so the allocation process is complicated.

To properly account for these "step up" exceptions, many taxpayers with smaller estates who would not have had to file estate tax returns previously will now need to file. House officials have estimated that an extension of the 2009 estate tax into 2010 impacts only 6,000 estates, but the new carryover basis provisions will affect more than 70,000 estates.

Will the repeal actually happen?

There will likely be an estate and GST tax established sometime during 2010. The issue is whether there will be a "repeal window" available for donor and decedents. There has been a rumor that Senator Baucus, Chairman of the Senate Finance Committee, and Representative Rangel, Chairman of the House Ways and Means Committee, would sign a "letter of intent" to give notice to taxpayers not to rely on the repeal and to anticipate an estate tax that would be retroactively applied back to January 1, 2010. Pomeroy and Baucus are sponsoring similar bills (SB 722 and HR 4154) that would carry 2009 estate tax laws forward into 2010, serving as a band aid until more substantive action can be taken.

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There is some question, however, concerning the constitutionality of instituting an estate tax and GST tax system retroactively when no system exists, and many Senate Republicans will use this delay to push for either favorable estate tax changes (e.g., an increase of the estate tax lifetime exclusion to \$5 million) or a permanent repeal of the estate tax altogether. So this issue could continue well into 2010, and the result is uncertain.

What to Do Now?

Certain individuals may want to review their current wills and trusts with their estate planning legal professionals. Others may decide to wait till the new legislation is enacted. The catch 22 is that documents altered now may need to be revised again in the very near future, while waiting may result in testamentary intentions not being achieved if they die prior to enactment of new legislation.

We hope you appreciate the complexity of the situation and understand that there is no single solution for every individual. Our goal is to keep you informed so you can consider your options.

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