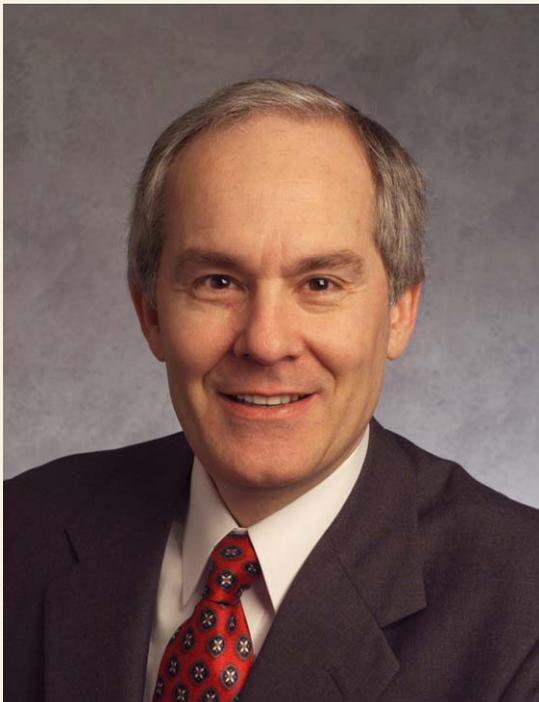


Congressional Malpractice: The Effect of Estate Tax Repeal in 2010



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1. Wealth Transfer Tax Implications of Repeal

- **What happened? Or more accurately, what did not happen?**
 - Congress did not enact an extension of the estate tax before January 1, 2010.
 - Hence, there is now a one-year repeal of the estate tax and GST tax, subject to future Congressional legislation that might reinstate the tax at any time (including retroactively).
- **Is there still a federal gift tax?**
 - Yes, imposed at a rate of 35% (reduced from 45% in 2009) for taxable gifts in 2010, subject to future Congressional legislation that might increase the rate of tax at any time (including retroactively).
 - The gift tax annual exclusion (\$13,000 per donee per year) and \$1.0 million lifetime gift tax exemption remain in effect.

- **What happens after 2010 if Congress does nothing in 2010?**
 - Pre-2001 tax law will apply.
 - Hence, beginning January 1, 2011, the estate tax and GST tax are reinstated with only a \$1.0 million exemption and a 55% top rate (plus a 5% surtax for certain large estates).

2. Income Tax Implications of Repeal

- **What income tax consequences arise as a result of the one-year repeal?**
 - Under prior law, the cost basis of an asset following an individual's death was equal to the value of the asset on the individual's date of death (or, in certain cases, on the six month anniversary date of the death). In contrast, under the one-year repeal, assets transferred at death generally retain the same basis as in the hands of the decedent, or fair market value, if lower ("carryover basis").
 - Hence, capital gains on the sale of any asset with "built-in-gains" as of the date of death in 2010, may be recognized, including sales required to raise cash for expenses, debts and contingent tax liabilities.

- Importantly, the 2010 law allows the estate's personal representative to increase the basis of the decedent's assets by as much as \$4.3 million if he or she has a surviving spouse, with at least \$1.3 million to increase the basis of any asset even if there is no spouse.
- Technical rules also provide that a decedent's unused capital loss carryovers and certain other unused losses may be added to the \$1.3 million available to increase basis.
- In addition, as noted, a maximum of \$3 million is available to increase basis of assets transferred outright to a surviving spouse or to certain qualified trusts for the spouse's benefit. An individual's existing plan may not take these provisions into account and may include trusts that do not qualify as a recipient of the \$3.0 million basis increase.

3. Possible Legislative "Solutions"

- **What is Congress going to do?**
 - No one really knows and that uncertainty creates risk. President Obama and certain members of Congress have called for a prompt extension of the 2009 estate tax and GST tax law retroactive to January 1, 2010. Others, including some Democrats, are reluctant to reinstate the tax retroactively. Others still want permanent repeal or an increase of the estate tax exemption to at least \$5.0 million per decedent with a maximum rate of not more than 35%.

- The AALU predicts there will be a two year patch but cannot say whether this temporary extension of the 2009 estate tax law would be retroactive.
- President Obama's "Greenbook" of revenue proposals was recently published. These proposals seek to legislate other "reforms" to minimize estate tax planning dependent on valuation discounts and techniques such as GRATs. It remains to be seen if these changes will be enacted and when any changes will be effective.
- **What is the Nebraska Unicameral considering in light of the one-year repeal?**
 - The Unicameral is considering a bill that may impact many estate plans of Nebraska residents. The proposed legislation requires that to the extent an estate plan references the federal estate tax laws and definitions, the plan provisions must be interpreted and applied as the law existed in 2009 (i.e., as if there were an unlimited marital deduction and an estate tax exemption amount of \$3.5 million in effect during 2010). The bill provides, however, that this mandatory interpretation will not apply if the decedent dying in 2010 expresses a clear contrary intent.

4. Planning Implications for 2010

- **What is a person to do in light of this uncertainty and the one-year repeal?**
 - There are numerous gift planning ideas that could be considered, but nearly every idea intended to take advantage of the 2010 hiatus in estate tax and GST tax involves downside risk under some legislative scenarios. Although the gift tax is currently reduced to 35%, it could be increased at any time and while the GST tax is currently repealed, it also could be reinstated retroactively.
 - All uncertainties aside, some lifetime gifting strategies may be worth the risk, particularly for wealthier individuals. For example, such individuals may want to consider GRATs and charitable lead annuity trusts, especially in view of the exceedingly low interest rate environment.
 - Individuals with estate tax based formulas used in their plan documents to determine the amounts of marital and charitable bequests should promptly review their documents to determine what plan amendments, applicable for 2010, should be considered and made.

- For example, a document might direct an amount equal to the maximum marital deduction to pass to the surviving spouse with the balance of the estate passing to children. Absent the passage of the Nebraska legislative bill or a plan amendment, these provisions could mean that the children would inherit all of the decedent's assets. This scenario may be more likely in the second marriage situation where the residue of the estate is oftentimes directed to the children only.
- Another example is a document that directs an amount equal to the GST tax exemption to a trust for the decedent's grandchildren. Since the GST tax exemption does not exist for 2010, arguably no amount would pass to the grandchildren's trust even though the decedent had no intent to disinherit the grandchildren.

5. Conclusion

- **What should you do?**

- Immediately meet with your tax counsel to review your plan documents for a stop-gap amendment to address the implication of the one-year repeal on your objectives for your estate.
- Also consider what gift or other planning opportunities may be worthwhile in view of the possibilities that the estate tax and GST tax are either not reinstated in 2010, or reinstated on a prospective basis.