Client Alert

TRUSTS AND ESTATES DEPARTMENT | JANUARY 2010

WIGGIN AND DANA

Counsellors at Law

Federal Estate Tax Changes

The fate of the federal estate, generation-skipping transfer (GST) and gift taxes has been the subject of much discussion in recent months. While most estate planners expected that Congress would act in 2009 to avert the dramatic changes to the tax system which became effective on January 1, 2010, it failed to do so. This *Alert* outlines some of the key issues that have arisen as a result of the changes. Note that state taxes may still be due for persons transferring wealth in 2010 by death or gift.

CHANGES

Estate Tax. Effective January 1, 2010, the federal estate tax was repealed in it entirety. If no further legislative action is taken, the tax will be reinstated on January 1, 2011 with a 55% rate and a $1,000,000 exemption.

Gift Tax. The federal gift tax was not repealed. Instead, as of January 1, 2010 the federal gift tax rate was decreased to 35%. The federal gift tax exemption remains at $1,000,000. If no further legislative action is taken, the gift tax rate will rise back to 55% on January 1, 2011.

Generation-Skipping Transfer Tax. As of January 1, 2010, the GST tax was repealed in its entirety. If no further legislative action is taken, the GST tax will be reinstated on January 1, 2011 with a 55% rate and a $1,000,000 exemption.

Repeal of "Stepped Up" Basis. Under pre-2010 law, the income tax basis of most inherited assets was "stepped up" to their fair market value as of the date of death. As a result, under pre-2010 law, when heirs sold inherited assets there were frequently no capital gains, and, hence, no capital gains taxes. Effective January 1, 2010, this stepped up basis rule was repealed and replaced with the rule of "carryover basis." Under carryover basis, the income tax basis of inherited assets is their cost basis in the hands of the decedent prior to death. There are two key exceptions to the "carryover basis" rule. First, the Executor of a deceased individual is permitted to add up to a total of $1,300,000 to the basis of the assets held at death (but not in excess of the actual fair market value). Second, if a decedent leaves assets to a surviving spouse or to certain kinds of trusts for the benefit of the surviving spouse, the Executor may increase the basis of the assets passing to the surviving spouse or to such trusts by up to an additional $3,000,000. If no further legislative action is taken, the carryover basis rule will be repealed, and the stepped up basis rule will be reinstated on January 1, 2011.

SHOULD YOU REVIEW OR REVISE YOUR PLAN IN LIGHT OF THE NEW LAW?

Every estate plan and every family are unique, so it is impossible to give specific

continue next page

WIGGIN AND DANA

Counsellors at Law

advice regarding your plan in an *Alert* such as this. If you have any questions about this *Alert* or how or whether the tax law changes discussed here might apply in your situation, we urge you to call us. With that caution in mind, the following general comments may be helpful in assessing your own planning:

Clients With "Credit Shelter/Marital" Formulas in Their Wills or Revocable Trust Agreements.

Many married couples have estate plans that provide for the creation of a trust based on the estate tax exemption amount and give the balance of a spouse's estate to the surviving spouse, either outright or through a marital trust. The trust is usually called an "Estate Tax Sheltered Trust" or a "Credit Shelter Trust" and the plans are generally called "formula plans" because the amount which passes to the trust is based on a formula keyed to the estate tax exemption amount in effect on the date of death. With the repeal of the federal estate tax, it is unclear how some of these formula plans will be interpreted by the tax authorities during 2010.

A possible interpretation is that the Estate Tax Sheltered Trust or the Credit Shelter Trust should receive all of the decedent's property, leaving nothing to pass exclusively to (or for the benefit of) the surviving spouse. Alternatively, the Estate Tax Sheltered Trust or the Credit Shelter Trust might receive nothing, with everything passing exclusively to the surviving spouse. The precise language of the governing instrument will play a role in this determination.

What is clear, however, is that if your spouse is not a beneficiary of the Estate Tax Sheltered Trust or the Credit Shelter Trust, you may want to revise your plan to avoid a situation where your surviving spouse may be unintentionally disinherited. While most of our clients do include the surviving spouse as a beneficiary of the Estate Tax Sheltered Trust or the Credit Shelter Trust, some choose not to. Alternatively, if you and your spouse have adopted a tax-sensitive plan that is intended to preserve what you can for descendants and other family members, but you want your surviving spouse to be the beneficiary of the bulk of your assets, your plan should be reviewed to be sure this is what will happen.

We recommend that you make an appointment with your Wiggin and Dana attorney if any of the following apply:

- Your spouse is not a beneficiary of the Estate Tax Sheltered Trust or the Credit Shelter Trust and you want her or him to benefit from your estate plan.

- You want assurance that your spouse will inherit some property outright at your death to maintain her or his accustomed level of financial independence.
- You want greater clarity about how your plan will work in light of the recent changes to the estate tax.

Clients Whose Wills or Revocable Trust Agreements Include Generation-Skipping Formula Bequests.

Some of our clients have adopted plans which maximize the use of their available GST exemptions. The GST funding clauses are generally based on formulas which are keyed to the GST exemption amount and are similar to the formula clauses described above. Problems may arise in the interpretation of these clauses in light of the repeal of the GST tax. If you have a plan which is intended to maximize your GST exemption, you may want to have your plan reviewed, and perhaps revised, to be sure that it will operate as you intend.

PLANNING OPPORTUNITIES

Planning opportunities may also exist in 2010 as a result of these changes, including taking advantage of the reduced 35% gift tax rate to make taxable gifts. In addition, transfers designed to take advantage of the one year repeal of the GST tax may be advisable. However, there is some risk in moving quickly to take advantage of the 2010 changes, because certain members of Congress have said that Congress may act to retroactively raise the gift tax rate or reinstate the GST tax. The likelihood (and constitutionality) of such action is unknown.

If gifting assets fits with your overall estate planning goals, we urge you to contact your Wiggin and Dana attorney to discuss whether you can benefit from the 2010 changes to the tax law.

CONCLUSION

It is hard to imagine a more challenging estate planning environment than what exists today. Attorneys at Wiggin and Dana are available to help you sort through the issues and opportunities, develop appropriate strategies and provide greater certainty in the interpretation of your documents. Also, while the current federal estate tax law is a temporary anomaly, the burden of uncertainty is greatest for individuals who die during 2010. If you believe that the changes to the tax law could affect your situation you may want to meet with your Wiggin and Dana attorney to discuss how the issues addressed in this *Alert* will impact you and your family.

WIGGIN AND DANA

Counsellors at Law

TRUSTS AND ESTATES DEPARTMENT

Leonard Leader, *Chair*
203.363.7602, lleader@wiggin.com

Robert W. Benjamin
212.551.2602, rbenjamin@wiggin.com

Elisabeth H. Cavanagh
203.363.7637, ecavanagh@wiggin.com

Michael T. Clear
203.363.7675, mclear@wiggin.com

Karen L. Clute
203.498.4349, kclute@wiggin.com

Daniel L. Daniels
203.363.7665, ddaniels@wiggin.com

Mark E. Haranzo
203.363.7640, mharanzo@wiggin.com

Helen C. Heintz
203.363.7607, hheintz@wiggin.com

Phyllis Maloney Johnson
203.498.4529, pjohnson@wiggin.com

Arsineh Kazazian
212.551.2632, akazazian@wiggin.com

David W. Kesner
203.498.4406, dkesner@wiggin.com

Charles C. Kingsley
203.498.4307, ckingsley@wiggin.com

David T. Leibell
203.363.7623, dleibell@wiggin.com