



MEMORANDUM

TO:	Estate Plan Clients
FROM:	Santerre & Vande Krol, Ltd.
RE:	2010 Estate Tax Repeal
DATE:	January 5, 2010

In 2001, Congress enacted the Economic Growth and Tax Relief Reconciliation Act which gradually increased the estate tax exemption amount and reduced the estate tax rate over a period of 8 years. This 2001 Act also repeals the estate tax for 2010, but then the 2001 Act itself expires. The result is that the estate tax comes back in 2011, at substantially the same exemption amount and tax rates that existed back in 2001 (a \$1,000,000 per person exemption and a 55% top rate). Nearly all tax advisors believed that prior to 2010, Congress would undo this repeal and keep the law in effect for 2009 (with a \$3.5 million per person exemption and a 45% top rate) in place, at least temporarily. However, with the fight over health care reform, Congress has failed to address this crucial matter.

Unfortunately, the repeal of the estate tax does not mean that taxes will be eliminated or even be lower for the heirs of taxpayers who die in 2010, since the repeal also changes the income tax basis rules for property received from a decedent. Prior to 2010, property received from a decedent had a new tax basis (the amount used in determining any gain or loss from disposition) for income tax purposes equal to the value of the property at the time of the decedent's death. In 2010, property received from a decedent will retain the tax basis of the decedent, subject to some complicated rules for a personal representative to increase the tax basis of certain assets by a limited amount. As a result, the heirs of a taxpayer who would not have incurred estate taxes as a result of the 2009 exemption of \$3.5 million per person and who would have received a new income tax basis in the property received from the decedent may now, instead, incur income taxes when the property received from a decedent is sold.

There is talk of Congress enacting a new estate tax law in 2010 and making it retroactive to January 1, 2010; and most tax advisors believe that Congress will address this issue in the near future and enact a law with provisions that are similar to the 2009 provisions. However, at the present time, Congress' unwillingness or inability to act has created significant estate planning problems and issues for many of you.

As a result of the current repeal of the estate tax, most trust agreements (and/or wills containing trust provisions) for married persons should be modified to deal with the possibility of a death occurring during this period of time when there is no estate tax. Generally, trusts (and occasionally wills) for married persons divide the assets of the first spouse to die into two broad portions. One portion is equal to the deceased spouse's unused estate tax exemption amount; and the other portion passes directly to or in trust for the surviving spouse and qualifies for the "unlimited marital deduction". Under this arrangement and the previous estate tax laws, no estate tax was due when the first spouse died, e.g., the estate tax exemption portion (sometimes called the "credit shelter" or "bypass" portion) escaped tax because it took advantage of the estate tax exemption, and the balance of the assets qualified for the unlimited marital deduction. However, with the repeal of the estate tax as of January 1, 2010, it is unclear how these provisions of a trust agreement or will would be interpreted since there is no estate tax and therefore no "unlimited marital deduction" or "estate tax exemption". This is particularly a concern for a married couple if some portion of the assets of the first spouse to die passes to persons other than the surviving spouse (such as children from a previous marriage), since the financial interests of the surviving spouse and these other persons would be adverse.

Based on the law that exists at this time (i.e., the repeal and carry over of the decedent's old cost basis), it is advisable for most married clients to clarify in their documents whether all of the assets of the decedent should pass (either directly or in trust) to the surviving spouse, or whether some specific portion of the assets should be held in a "bypass" trust or for the benefit of other beneficiaries. Further, as a result of the change in the income tax basis of assets received from a decedent, it may be appropriate for the documents to be revised in order to take into account the carry over basis and the action that a personal representative can or should take in the allocation of new tax basis in the decedent's assets for the decedent's heirs.

Similarly, the will and/or trust agreement of an unmarried person which contains a bequest that makes reference to the "estate tax exemption" would also need to be amended to deal with the possibility of his/her death occurring during this period of time where there is no estate tax.

We want to emphasize that we believe the estate tax rules are likely to be amended to eliminate the repeal and to continue the estate tax laws similar to the 2009 provisions, including the provisions for new tax basis in the decedent's assets (Congress attempted the "carry over" basis approach once before and decided it was too difficult to administer). However, we certainly did not believe Congress would have allowed the current situation to occur; and with the politics involved in this issue, there is no assurance as to what the outcome will be or when Congress will act. Any modifications made to documents may ultimately not be applicable if Congress does act and eliminates the repeal prior to a death. Also, any such modifications will require a review of the current documents, a determination of the client's desires as to the disposition of his or her assets upon death, and perhaps some discussion as to the unrecognized gain of existing assets, all of which may require a meeting with your estate planning attorney.

If you have any questions about the foregoing, or if you would like to schedule a meeting with your estate planning attorney to discuss these and/or any other matters relating to your estate plan, please call our Legal Assistant, Nancy Tomczak.