



Estate Planning Alert, January 2010

What a mess Congress has created! We are now in a year where there is no federal estate tax - but hold the cheers. Congress has substituted another method of taxation that will collect more taxes from many of our clients and families than the estate tax. Additionally, as has been reported in the local and national press,¹ these changes will, for some, greatly alter the planned for and anticipated distributions among family members and heirs.

A brief review of the law will help explain why this is so significant. The 2001 tax act, signed into law by President George W. Bush, gradually reduced the maximum rate of the federal estate tax (and the equally onerous generation-skipping transfer tax on transfers to grandchildren) from 55% to 45%. It also gradually increased the amount of property that you could pass free of federal estate tax from \$675,000 per person in 2001 to \$3.5 million per person in 2009. That means that with basic estate planning, a married couple could pass up to \$7 million free of federal estate tax, if they both died in 2009.

Then, *in 2010 only*, the 2001 tax act repeals the estate tax. But like a horror film character that just won't die, under the existing law, the estate tax returns again on January 1, 2011 – only at a much lower \$1 million exemption and a higher maximum 55% tax rate! This strange “now it's gone, no it isn't” effect is the result of a rule in Congress that attempts to limit budget deficits.

Paying for Estate Tax Repeal

To pay for this one-year vacation from the estate tax, Congress replaced the estate tax with an increased income tax. Before 2010, any assets that pass to someone when you die would be valued at fair market value at the date of death. Thus after death, when a surviving spouse or heirs sold any assets (like securities or a home) that had increased in value; they would not have to pay income tax on any of that growth that occurred during your life. This is referred to as a “step-up in basis.” For many heirs this means huge income tax savings, oftentimes tens of thousands of dollars or more.

Then in 2010, property that passes at death does not automatically receive this step-up in basis. Instead, each individual has a limited amount of property that can be “stepped-up” in value at the time of death. Property that does not receive this step-up value will be subject to tax on all increase in value *from the date you first acquired the*

¹ See *Estate-Tax Repeal Means Some Spouses Are Left Out*, January 2, 2010 Wall Street Journal and *A Bizarre Year for the Estate Tax Will Require Extra Planning*, January 8, 2010 New York Times.

property. This means that the property could be exposed to tens of thousands of dollars of income tax liability for your heirs!

Not surprisingly, these rules are convoluted and in many cases very different from the old law. In fact, Congress attempted to institute a similar tax structure in the 1980s and it was repealed, retroactively, because it was too difficult to administer. Because of past experience as well as the anticipated difficulties in calculating such a tax, the common belief was that Congress would change the law before January 1, 2010. To everyone's surprise, Congress didn't act in time.

How You Are Affected?

This law can affect you in several ways. For married couples as well as single clients, we need to first make sure that your property will be divided according to *your* desires, and not dictated by Congress. For more than 50 years, it has been common to use written mathematical formulas to divide the assets of a married couple when the first spouse dies to maximize estate tax savings. Likewise, formulas have been used to provide funds for charitable causes and to benefit family and friends. Now, in 2010 when there is no estate tax, these formulas may not work. If a spouse is not your sole beneficiary (for example, if you have children from a prior marriage), the existing formula could result in the disinheritance or substantial reduction of resources provided for the surviving spouse.

What Should You Do?

We strongly recommend that you meet with us as soon as possible to review your estate plan and make any changes that are necessary to make sure your estate planning objectives continue to be fulfilled. We also need to ensure that your property is positioned to receive the maximum step-up in basis increase available under current law. We have solutions that will meet your planning objectives with the least amount of tax impact.

Please contact our assistant, Angela Sierra, at (303) 320-1053 to schedule an appointment. We look forward to meeting with you to review your estate plan.

Sincerely,



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