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2010 ESTATE PLANNING OPPORTUNITIES

Congress recessed in 2009 before passing legislation that would extend current favorable estate and gift tax rates and exemptions to 2010 and beyond. Their inaction has left open potential opportunities for individuals to take advantage of gifting plans that will avoid gift taxes before new tax legislation is adopted, and also save considerable estate and generation skipping transfer (“GST”) taxes in the process.

Such inaction also has resulted in the risk of unintended loss of estate and GST tax exemptions, and of the marital deduction available to a surviving spouse. This should compel review and possibly revision of existing wills and trust documents to ensure that this year’s elimination of estate tax exemptions does not result in the unintended consequence of reducing estate distributions to spouses or children.

The Economic Growth and Tax Relief Reconciliation Act passed in 2001 increased the tax exemption of gifts and estates from \$1,000,000 in 2001 to \$3,500,000 million in 2009, while reducing estate and gift tax rates over the same period. The 2001 Act then eliminated all estate and gift taxes in 2010, only to revert in 2011 and beyond to the higher pre-2001 estate and gift tax rates and lower exemption amounts. Since 2001, most estate planners and their clients have expected that the 2010 and beyond provisions of the 2001 Act would be eliminated by Congress in some manner before 2010.

On December 3, 2009, the U.S. House of Representatives approved the “Permanent Estate Tax Relief for Families, Farmers, and Small Businesses Act of 2009” (H.R. 4154) by a party line vote. A parallel Senate Bill (S. 2784) would also extend the 2009 estate and gift tax rate and exemption levels, but was not acted upon before the Christmas recess. Congress adjourned before Christmas 2009, not to return until January 19, 2010, without completing action on gift and estate tax legislation. If both Bills had passed, the estate, gift, and GST tax rates and exemptions that applied in 2009 would have been extended to 2010 and beyond. In addition, such legislation would also have made both the state death tax credit and the qualified family-owned business deduction permanent under the 2001 Act.

Unless action is taken by Congress in 2010, the result, described above, will be that gift, estate and GST tax rates and exemptions will return to pre-2001 levels on January 1, 2011. That would mean that the favorable gift, estate and GST tax rates that had dropped during 2001 through 2009 from 55% to 45%, and the tax exemption of gifts and estates discussed above, would be lost.

It is anyone's guess what, if anything, Congress may do about gift, estate and GST tax laws given their recent track record, but it is widely expected that some stabilizing legislation will be adopted. There are several schools of thought as to what form such legislation will take. Indications from the White House and both houses of Congress suggest the 2009 gift, estate and GST tax rates and exemptions will be made permanent. There are members of Congress who have proposed a \$5,000,000 exemption of estates from tax, and others who wish the repeal of estate tax laws in effect during 2010 to remain permanent. Congress may not act at all and gift and estate taxes would permanently soar to pre-2001 levels. Some Congressional leaders have voiced intent to enact legislation that would retroactively reinstate gift, estate and GST taxes back to January 1, 2010 levels.

As stated above, many taxpayers, particularly those with estates exceeding, or which had the promise of exceeding, \$3,500,000 through inheritance, appreciation of assets and other means, revised estate plans to benefit from their expectations that Congress would have acted by now on gift and estate tax legislation. Many such plans include wills and trusts that use formulas to determine amounts to pass from a decedent's estate to a spouse, children and grandchildren. Such formulas may cause a large part or all of the estate to pass to the spouse or to the children and grandchildren without taking full advantage of estate and GST tax exemptions or the marital deduction available to the spouse.

The most reliable, but undesirable, manner in which to take full advantage of the gift, estate and GST tax repeal during 2010 may be to die before Congress adopts new tax legislation. One never knows what the future may bring. Aggressively pursuing gifting to family, directly or through family entities, personal residence trusts, and through grantor retained annuity trusts, among other strategies, particularly using assets subject to significant future appreciation in value, quickly while there is no gift, estate or GST tax would allow one to take full advantage of the current tax repeal if Congress does not adopt retroactive legislation. Regardless of what Congress does, as suggested above, reviewing and modifying estate plans that use distribution formulas may save considerable estate taxes.

The key to taking advantage of the current uncertainty in gift and estate tax law is speed. Congress will likely take considerable time to finally adopt a new law, with the possible application of any unfavorable new tax law only to estate plans completed somewhere later in that process.