



ESTATE PLANNING FOR 2010 AND BEYOND

As you may have learned in the news, the unexpected failure of Congress to address estate tax legislation before the end of 2009 has created great uncertainty for many estate plans. The 2001 tax cut signed into law by President George W. Bush set into motion a gradual increase in the federal estate tax and generation skipping transfer (gst) tax exemptions, culminating in repeal of both taxes in 2010. Due to budget constraints, the estate tax was reinstated after 2010 with the pre-2001 estate tax exemption of \$1,000,000 per person (with tax rates of up to 55%), and the gst exemption of \$1,000,000 per person adjusted for inflation (with a flat 55% tax rate). The gift tax exemption remains at \$1,000,000 per person throughout; however, the gift tax rate was reduced from 45% in 2009 to 35% in 2010, and thereafter is set at the pre-2001 rates of up to 55%. The gift tax annual exclusion remains at \$13,000 in 2010 (though it may be adjusted for inflation in future years).

It was long expected that Congress would enact legislation prior to 2010 to prevent the repeal. At the very least, it was expected that Congress in late 2009 would pass a stop-gap measure to keep the 2009 estate tax and gst tax exemption of \$3,500,000 per person and the 45% gift, estate and gst tax rate through 2010. That did not happen. It is not clear whether Congress will pass legislation this year and whether they will attempt to retroactively impose both taxes as of January 1, 2010. If so, it is not clear whether any such legislation would be constitutional.

Another aspect of the 2001 legislation is the elimination of the automatic “step-up” in income tax basis to date of death values for those dying in 2010. Instead, there is “carryover basis,” which means that your beneficiaries will have the same basis you had in the property before your death (though, if the value of any property went down, the basis of that property will be the value as of your date of death). However, there is a basis increase exemption of \$1,300,000 which allows your executor to increase the basis in assets up to that amount (not exceeding date of death value). This exemption is increased if you have unused loss carry-overs at your death. For married couples, there is an additional basis increase exemption of \$3,000,000; however, it only applies to property passing outright to your spouse or to certain types of marital trusts. Given that no one knows when they will die and no one knows what Congress will do, it would make sense for you to assemble a list of your income tax basis in all assets and to keep back-up records.

Connecticut passed legislation in Fall 2009 which increased the Connecticut gift and estate exemptions to \$3,500,000 per person effective January 1, 2010 and decreased the tax rates. In December, the legislature voted to delay the effective date until 2012; however, Governor Rell vetoed that measure and the legislature did not override the veto, though the issue may resurface. For a brief moment, we thought we might have simplicity with Connecticut and federal exemptions both at \$3,500,000!

Where does all of this leave your estate plan if you die while there is no federal estate or gst tax? Whether you should make any changes will depend upon how your documents are drafted. Many documents provide for trusts funded using formula clauses that refer to the federal estate tax or gst tax. It is not clear how those documents will be interpreted. For example, if your plan leaves the maximum amount that can pass free of federal estate tax to a spray trust for your spouse and children and the balance to your spouse, then your spouse may receive nothing except for any distributions from the trust. Moreover, if the amount in the trust exceeds the Connecticut exemption, then the trust will be subject to some Connecticut estate tax. (For our New York clients, since the New York estate tax exemption is only \$1,000,000, the trust will be subject to New York estate tax if it exceeds \$1,000,000.) On the other hand, if your plan leaves an amount equal to the federal estate tax exemption to the trust and the balance to your spouse, then your spouse may receive the entire estate. If your plan leaves your entire estate to your spouse (with or without a disclaimer trust option), or to a marital trust which pays out all income to your spouse, you will likely not need to change your plan.

In order to see if your documents work the way you intend, it is necessary for us to review them. We will review your document if you call us and request us to do so. In many cases, we can simply do a codicil to your will or an amendment to your revocable trust stating that if you die while there is no federal estate tax in effect, references to the federal estate tax and gst tax exemptions shall refer to those in place in 2009 (i.e., \$3,500,000). This would also eliminate any potential Connecticut estate tax on the first spouse's death since the Connecticut exemption is also \$3,500,000. For clients with substantial estates, the current environment may present some interesting planning opportunities.

Note that if Congress does nothing and the exemptions go back to pre-2001 amounts starting in 2011, then in most cases, your documents will work without any changes. However, if the amount passing to a beneficiary was based on the federal exemption amount, then the amount passing to that beneficiary will be much lower starting in 2011, and the amount passing to the remainder beneficiaries will be higher.

One last item to point out is that, beginning January 1, 2010, any taxpayer regardless of his or her income may convert his or her traditional IRA to a Roth IRA. You would pay the income tax over a two year period (or all this year in order to lock in 2010 rates), and the IRA would then grow income tax free and would not be subject to minimum distributions when you reach age 70½. There is an informative article on the subject in the *New York Times* from January 9, 2010 entitled "New Rules Ease Roth Conversions, But Benefits Vary" which you can access on their website.

We look forward to hearing from you.