

# Private Client Alert

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## Two Things That Are Still Certain – Death and Taxes The One-Year Repeal of the Federal Estate Tax

The estate planning world was turned on its head when Congress adjourned in December without reaching an agreement on estate tax reform. As the law now stands, unless and until Congress acts, the Federal Estate and Generation-Skipping Transfer (“GST”) Taxes have been repealed for one year beginning January 1, 2010. However, existing law provides that both taxes will return with a vengeance on January 1, 2011 at pre-2001 tax rates and exemption levels.

It is widely speculated that Congress will attempt to enact estate tax legislation during 2010. Some members of Congress have even stated their intention that such legislation will reenact the law in effect during 2009 retroactively to January 1, 2010, an action likely to be challenged on constitutional grounds. However, as we have all learned over the years, nothing in Washington, D.C. is certain—except, of course, for death and taxes.

The purpose of this Client Alert is two-fold. First, we want to assure our clients and friends that we will be communicating with you in the near future with additional Client Alerts to highlight changes to estate plans that *should* be made, changes to estate plans that should be *considered*, and the lifetime planning opportunities that may now exist. Our recommendations will vary

based upon a client’s net worth, state of domicile, family dynamics, risk tolerance and other factors.<sup>1</sup> While each client’s situation is different, most clients should undertake a review of their plans to ensure that these changes will not adversely impact the intended disposition of their assets in the event that death occurs in 2010.

Second, we want to provide a brief summary of the changes that have taken place as of January 1, 2010. In the absence of Congressional action, the Federal Estate, GST, and Gift Tax and related income tax landscape is as follows:

- The Federal Estate and GST Taxes are repealed for one year, effective January 1, 2010.
- The Federal Gift Tax is not repealed and continues with a \$1 million lifetime gift tax exemption, but with a tax rate that has been reduced to 35% from 45%. The annual exclusion amount of \$13,000 per donee continues in effect during 2010.

1. Some clients residing in Maryland, Virginia and the District of Columbia may have Wills containing a so-called “formula-type” clause which may need to be changed immediately. Clients residing in other states may need to consider changes if their Wills contain “formula-type” clauses.

- For income tax purposes, estates of decedents dying on or after January 1, 2010 and before January 1, 2011 will be subject to a complicated carry-over basis regime which may create income tax exposure, even for the beneficiaries of decedents whose estates would not have been subject to estate tax in 2009. Under the carry-over basis regime, assets passing through a decedent's estate will generally have a basis for income tax purposes equal to the decedent's income tax basis and will not be "stepped-up" to date-of-death value. The carry-over basis regime means that the beneficiaries of an estate will recognize gain for income tax purposes upon a sale of assets received from a decedent dying in 2010, and those assets must now be held by the beneficiary for more than one year in order to obtain favorable capital gains tax treatment. There are two exceptions to the carry-over basis regime which permit an increase (step-up) of tax basis for income tax purposes of a decedent's assets to the date of death value of such assets, contingent on an election made by the Executor or Personal Representative. The first exception permits a basis increase of up to \$1.3 million for any assets. The second exception permits an additional step-up of up to \$3 million for assets passing either outright to a surviving spouse or to a qualifying marital trust.

- Finally, the Federal Estate, GST and Gift Taxes are each scheduled to return in 2011 with a tax rate of up to 55% (60% for certain very large estates) with a \$1 million exemption for gift, estate and GST tax purposes (which is phased-out for very large estates). These are the rates and exemption levels that existed in the law prior to 2001, although the GST exemption will be indexed for inflation.

We will be publishing additional Client Alerts to address the broader ramifications of these changes and will highlight common situations which lend themselves to more immediate action to ensure that your current wishes are implemented. In the meantime, please feel free to contact Larry Chane or another member of the Private Client Group if you have any questions or concerns.

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Several commentators in the popular press have suggested that with no estate tax, 2010 is a good year to die. We strongly believe that the alternative is much better. Besides, personal planning should never be driven solely by tax considerations.

The members of the Private Client Group wish our readers a happy, prosperous and HEALTHY new year! ■

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