

ESTATE PLANNING CLIENT ALERT

CONTEMPLATING THE UNTHINKABLE – ESTATE TAX SUSPENSION HAS DAWNED

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As many of you likely know, beginning January 1, 2010, we entered a world that no American currently living has experienced – the suspension of the federal Estate Tax. The last time there was no federal Estate Tax tariff on death, Woodrow Wilson occupied the White House, the light switch had just been invented, Pancho Villa was invading New Mexico and the United States had yet to enter World War I.

This strange turn of events is the result of the Economic Growth and Tax Relief Reconciliation Act of 2001, which provided that in one year – 2010 – the federal Estate Tax and Generation-Skipping Transfer Tax are both suspended, for individuals dying in 2010. For those looking for the ultimate tax planning opportunity, look no further. However, the price of this savings opportunity – namely death in 2010 – is a high one. By contrast, for those who plan to transfer assets while escaping death this year, the federal Gift Tax, including the gift tax annual exclusion, will remain in full force, with a lifetime gift exemption of \$1.0 million and a 35% flat tax applicable to gifts in excess of that limit.

Much has been written about the strange turn of events, yet no one has seriously believed that Congress and the administration would allow it to happen. That day has arrived.

Among other planning considerations, income tax capital gains carry-over basis returns to the stage for the first time since a brief period in the 1970s. Taxpayers will have special spousal and non-spousal “basis allocations” beyond which income tax will be paid on subsequent asset disposition. This feature of the new law promises to ensnare a much broader cross-section of taxpayers than the Estate Tax it replaces, since so many more taxpayers will find themselves required to trace basis in the hands of the decedent. Basis allocation could have huge implications for future income tax liability.

To our many clients who have asked about the propriety of revisiting estate planning against the backdrop of estate tax suspension, we note the following:

- Although the common wisdom has been that Congress would “fix” the current situation by retroactively applying the 2009 \$3.5 million exemption equivalency and 45% maximum rate, in fact that may not happen. In that case, looking forward to 2011 and the re-institution of the \$1.0 million exemption and 55% rate, estate planning and estate minimization will be more important than ever.

• Even if Congress attempts to retroactively extend last year's exemption and rates into 2010, the constitutionality of such retroactivity could be challenged – creating uncertainty that could endure years as cases wind through the courts.

• In the meantime, we encourage clients who are concerned about the effect of the current unprecedented law changes on their own planning to consider the following:

- o In most instances, with equal division of community property and common “bypass trust” estate tax exemption trust planning that benefits the surviving spouse exclusively, no change will be needed.
- o For those clients seeking an opportunity to forever exclude the value of assets from further transfer tax if death should occur in 2010, mandatory inter-generational “dynastic” trust planning should be considered. (Remember, however, that under current law, this “opportunity” only arises if one passes away in 2010, and Congress does not make a retroactive “fix” that is determined to be constitutional.)
- o If the first deceased spouse desires to make “formula” estate-tax free gifts to persons other than a surviving spouse (e.g., gifts to children while the surviving parent continues to live), careful attention should be paid to the terms of such gifts (to avoid inadvertently giving one's entire estate directly to persons other than one's own surviving spouse).
- o Income tax basis allocation will be of paramount importance, and special care should be taken to evaluate income tax planning opportunities not present in the “stepped up basis” environment that prevailed before 2010.
- o For persons with very short life expectancies, a careful review of existing planning has never been more important.

If any of the above concerns you, consider reviewing the provisions of your existing trust or will to ensure appropriateness under the new and unprecedented temporary transfer tax regime.

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