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News Alert
As of January 1, 2010, the Federal Estate and GST Taxes Were Repealed - What Does This Mean For Your Estate Planning?

As you may be aware, as of January 1, 2010, the federal estate and generation-skipping transfer ("GST") taxes were repealed for one year, under a law originally put into effect in 2001. While the federal gift tax was retained, it now has a flat, 35% rate, which is significantly lower than the rates which applied in prior years. In addition, and as you may not yet be aware, as part of the repeal of the federal estate and GST taxes, significant changes were also made to the income tax rules.

The repeal of the federal estate and GST taxes currently means that, if a person passes away during 2010, no federal estate tax or GST tax will be imposed on assets which pass from that person to others, without regard to the size of the deceased person's estate and the identity of the persons who receive assets. While some states do have their own estate or inheritance taxes which can still apply, Georgia is not currently one of those.

Under the pre-2010 income tax rules, inherited assets were said to receive a "step up" in basis. This generally meant that a person who inherited an asset would use, as his basis for the purpose of determining capital gains or losses or, for some business related assets, the amount of ordinary income, on a sale of the asset, the fair market value which the asset had at the prior owner's date of death. If the asset had appreciated in value during the prior owner's lifetime, those built in gains were effectively wiped out by the step up.

The new income tax rules have created a modified carry-over basis system. Under the new rules, assets will no longer automatically receive a step up in basis. Instead, the new owner's basis for an inherited asset will be determined under a complex set of rules which start with both the prior owner's basis and the value of the asset as of the prior owner's date of death. If the date of death value of the asset is lower than the prior owner's basis, the new owner's basis will still be the date of death value (a step down in basis). However, if the date of death value of the asset is greater than the prior owner's basis, the executor of the prior owner's estate is given some ability to wipe out the built in gain by allocating basis increase to the asset. The initially available amount of basis increase is $1,300,000, which means that, if the total amount of built-in gain on the assets in the prior owner's estate is $1,300,000 or less, all of the built-in gain can be wiped out and the beneficiary of an asset can still receive it with a basis equal to its date of death value. If the amount of built in gain in the prior owner's estate is more than $1,300,000 (which can easily be the case where, for example, there is a closely held business, highly appreciated real estate, or a lot of highly appreciated investment assets held in regular brokerage accounts), then it may not be possible to eliminate all of that gain. In cases where the prior owner has a surviving spouse, an additional $3,000,000 of basis increase will be available. However, unlike the initial $1,300,000 basis increase, the additional $3,000,000 basis increase will be available only for certain types of transfers to or for the sole benefit of the surviving spouse. Please note: this is an extremely simplified summary of the new rules.

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The new income tax rules, the lower gift tax rate, and the lack of a federal estate tax create both potential problems and potential opportunities for many people, especially the wealthier ones. In addition, the lack of a federal GST tax for 2010, and the accompanying lack of any GST tax exemption, create both potential opportunities and potential problems for those whose existing plans incorporate planning based on the use of their GST tax exemptions.

Finally, all of the changes to the estate, gift, and GST tax rules which went into effect on January 1, 2010, are scheduled to "sunset" (i.e., expire) at the end of this year. As of January 1, 2011, the pre-2001 estate, gift, and GST tax rules are scheduled to come back into effect as if the 2001 changes never occurred. The pre-2001 federal estate tax will come back into effect, with an exemption amount of $1,000,000 and a top marginal rate for most estates of 55%. The pre-2001 federal GST tax will also come back to life, with an exemption amount of at least $1,120,000, plus adjustments for inflation since 2003, and a flat 55% rate. At this time, while either a temporary or permanent change to the rules could still be made during 2010, it appears increasingly likely that no permanent changes will be made this year, and that the old rules will return for 2011. If a change is made, it could be made effective only on or after the date it was enacted, or it could be made retroactive to January 1, 2010. (While it is not completely clear whether a retroactive change in these laws would be Constitutionally permitted, we currently believe, based on prior cases regarding retroactively effective laws, that the federal government is likely to win that argument.) Of course, no one knows for sure what the future holds.

What does all this mean for you? It means that you should contact us to come in for a review of your existing estate planning documents, especially if it has been a few years since your current documents were prepared. The review should consider your existing assets and your current estate planning desires, so that we can help you determine the effect of these changes on your estate plan and what changes, if any, you may need or want to make.

Some people may need or want to make changes to their estate plans to help plan for maximum availability of the basis increase which may be available. Others may want to try and take advantage of the new rules by making certain types of transfers now. In general, we don't believe that most of our clients will have to make any changes right away, and, for those people, taking a wait-and-see approach may be the best course of action. For many people, the $1,300,000 of initially available basis increase will likely be sufficient to allow any built in gains to be eliminated to the furthest extent possible. In drafting documents which used estate tax reduction planning over the past nine years, we tried to ensure that they would work as well as possible if the estate and GST tax rules continued to exist in a form like they had both before January 1, 2010, and are scheduled to have again beginning January 1, 2011. However, this past focus on estate tax and other benefits means that, while we believe our documents will still work well to accomplish most clients' estate planning desires, they likely will not allow clients to maximize the use of the additional $3,000,000 in basis increase which would be potentially available for a surviving spouse under the rules in effect for 2010. If your documents were prepared prior to 2001, you may want to consider making updates in any case, both

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because of the number of significant changes to the law which have taken place and because your plan may no longer be what is most consistent with your overall estate planning needs and desires.

Who is most likely to <u>need or want</u> to make changes or take other actions in 2010?

- <u>Those who want to ensure that the additional $3,000,000 of basis increase for spousal transfers will be available at the first spouse's death.</u> Married people who used estate tax reduction planning measures in their main estate planning documents, and who want to help ensure that the surviving spouse will be able to maximize the benefits of the additional $3,000,000 basis increase available in 2010 for at-death transfers to the surviving spouse.

- <u>Those whose current estate plan used the estate or GST tax exemptions as a way to divide estate assets between different beneficiaries.</u> Anyone whose estate plan uses a formula based on the available estate or GST tax exemption to carve out amounts going to different groups of beneficiaries (for example, if you were setting aside an amount solely for your children based on the amount of property which could be transferred under your estate tax exemption, with the rest going solely for the benefit of your surviving spouse).

- <u>Anyone who has been making lifetime gifts to an irrevocable trust ("Family Trust") which was designed to use his or her GST tax exemption.</u> A person who has been making lifetime gifts to an irrevocable trust designed to be GST tax exempt may want to either skip the gift for 2010 or use other techniques to get assets to the trust without causing a gift during 2010, since there is a question about how these trusts will be treated if and when the GST tax returns in the future.

- <u>Anyone who created or is the Trustee of an existing, non-GST tax exempt trust.</u> The lack of a GST tax for 2010 creates a potential window of opportunity to get assets out of an existing, non-GST tax exempt trust to grandchildren or other, lower-generation beneficiaries without the very stiff GST tax. Remember, the GST tax is a flat tax applied at the top estate tax rate - as of 2011, this is scheduled to be a 55% flat tax. Of course, there is a risk that the GST tax will be reinstated retroactively.

- <u>Anyone who would like to transfer a large amount from their own, non-trust assets, to grandchildren or other, lower-generation beneficiaries.</u> As mentioned in the preceding paragraph, a potential window of opportunity for transfers to grandchildren or other, lower-generation beneficiaries currently exists for 2010, since the GST tax was repealed. Various techniques may be available. Of course, as mentioned above, the GST tax may be reinstated retroactively. Other risks could also apply.

- <u>Anyone with a higher-than-normal chance of dying during 2010.</u> The income tax basis rules in effect for 2010 create some opportunities for income tax basis planning. It may be possible to sell an asset which has a value less than its basis during life, and by doing so harvest a loss which can then be used after death to increase the basis in other assets when they pass to the intended beneficiaries. It may also be possible for one spouse to transfer appreciated assets to the other spouse while both

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spouses are living, and then for the transferor spouse to receive the assets back after the transferee spouse passes away with an increased basis for income tax purposes. There may be other potential opportunities for income tax planning. Of course, if the pre-2010 income tax rules are reinstated retroactively, these potential opportunities could disappear, and other risks could also apply.

Please review this message carefully, review your existing documents (at least the cover letter and memoranda which were provided to you with those documents), and contact us for an appointment to review your current situation and your existing estate plan.

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