KELLY, OLSON, MICHOD, DEHAAN & RICHTER, LLC

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Estate Tax Update

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Estate Tax Repealed for 2010

Will 2010 see a surge of deaths in the United States? That's what some prognosticators predict because of the elimination of the estate and generation skipping transfer taxes for 2010. Although most estate planners predicted that Congress would have passed a new estate tax law, or at least an extension of 2009's rates and exclusion amount, January 1 came and went without a change. Thus, the estate of anyone dying in 2010 is not subject to an estate or a generation skipping transfer tax. However, the gift tax was not repealed and still exists with its $1 million lifetime exclusion, though the top gift tax rate is now 35%.

As a result of Congress's inaction, heirs are envisioning extra millions of dollars from their parents. However, the picture is not so rosy (or bleak if you're a parent who skydives with your children). Many estate planners think Congress will enact an estate tax retroactive to January 1, 2010. Such a retroactive tax has precedent and has been deemed constitutional in the past. But if Congress does pass a retroactive estate tax, expect to see it litigated.

Of course, the possibility exists that Congress will again not act, and 2010 will end without any action on the estate tax. That would mean that in 2011, the estate tax returns as it was in 2001 – with a $1 million exclusion amount and a top rate of 55%.

Carry-Over Basis = Big Capital Gains

While the estate and generation skipping transfer taxes have disappeared for 2010, a more onerous income tax change has become effective; it is known as carry-over basis. It means many heirs will get hit with an extreme amount of capital gain taxes. For example, if dad died in 2009, the basis in that GE stock he bought in 1959 would be the value of the stock on the day he died in 2009. When his son went to sell the stock, he would only recognize the capital gains from the date of death forward.

In 2010, the basis will be whatever it was in 1959 when dad bought it. When the son goes to sell the stock, he will recognize capital gains from 1959 until the date he sold the stock. This could result in a huge income tax increase. That said, each estate is entitled to a $1.3 million basis adjustment, and a surviving spouse is entitled to an additional $3 million basis adjustment.

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Formula Clauses and Family Trusts

Many trusts established for married couples include a formula whereby the portion of the estate not subject to estate tax funds a Family Trust (also known as a "Credit-Shelter," "Residuary," or "B" Trust), while any assets subject to the estate tax are allocated to a Marital Trust (also known as the "A" Trust). In 2009, this would have allocated $3.5 million to the Family Trust and deferred the payment of federal estate tax on the excess until the surviving spouse died.

However, if someone with such a trust dies in 2010 with no estate tax, that formula will lead to all the decedent's assets being allocated to the Family Trust. If the surviving spouse is the beneficiary of both the Family Trust and the Marital Trust, this may not be a problem. As is often the case with second marriages, if the surviving spouse is only the beneficiary of the Marital Trust, while the kids from a prior marriage are the beneficiaries of the Family Trust, the surviving spouse will receive nothing. The entire estate passes free of estate tax, but it surely is not what the decedent intended.

Take this opportunity to review your estate plan, not just for the repeal of the estate tax for 2010, but also for changes in your personal situation.

What Should You Do?

We recommend an immediate review of your estate plan documents. However, given the possibility of retroactive legislation, we do not recommend everyone revise their documents for the current estate tax situation. If you are one of those individuals whose estate plan includes a Family Trust where your spouse is not a beneficiary, then you may want to revise or amend your trust.

No matter what happens in Congress, a periodic review of your estate plan is always a good idea. Not only do laws change, but so do your personal circumstances. An estate planning professional at Kelly, Olson, Michod, DeHaan & Richter, L.L.C. can review your documents, advise you as to your risks, and recommend changes, if necessary.

Roth Conversions – What's the fuss?

Beginning with 2010, everyone is eligible to convert a traditional IRA to a Roth IRA. The advantages of a Roth IRA are that the distributions are tax free and there are no required minimum distributions during life. However, if you convert your IRA to a Roth IRA, you will incur income tax on the amount converted. There are other factors that must be considered before you convert, but if you can pay the income tax from other assets (i.e. non-IRA assets) a Roth conversion may be something to consider.

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