

INFORMATION FOR KAUFMAN & CANOLES CLIENTS IN LIGHT OF ESTATE TAX REPEAL

Winter 2010

Effective January 1, 2010, the federal estate tax has been eliminated. Confusingly, next year on January 1, 2011 the estate tax returns, with an exemption only for estates under \$1 million. When Congress enacted these changes back in 2001, estate and tax planners widely predicted that Congress would never allow the estate tax to end, but in fact Americans now find themselves facing an estate tax law which is changing, frustratingly complex and extremely difficult to plan for. In these unprecedented times, the lawyers of the Kaufman & Canoles Private Client Services Group want to provide you with this update and some concrete suggestions for reacting to the current law.

Details of the Current Law

For calendar year 2010, the federal estate tax and generation skipping transfer taxes have been repealed. Both of these taxes will be reinstated on January 1, 2011 with a \$1 million exemption (well below the \$3.5 million exemption in effect before repeal of the estate tax).

In 2011, the highest tax rate applicable to estates will be 55%.

The repeal of the estate tax carries with it an end to the stepped up basis rules. Historically, assets held by a decedent at death could be valued for tax basis purposes at their value as of the time of the decedent's death. This step up in basis provided a substantial capital gains tax savings when inherited assets were sold. The law effective during 2010 permits an increase in basis limited to \$1.3 million per estate, and an additional \$3 million step up for assets passing to a surviving spouse. Thus many heirs will face substantial capital gains taxes which they did not face in the past.

Some pundits predict that Congress will reenact the estate tax this year, making it retroactive to January 1, 2010, producing even more uncertainty. Changes in state law are possible as state legislatures struggle to react to this unprecedented development at the federal level. For example, there is legislation proposed in Virginia which would allow interpretation of wills and trusts signed before December 31, 2009 as if the prior federal estate tax law and exemptions remained in effect.

What You Should Do in Response to These Changes

Many clients have wills and/or living trusts which contain estate tax plans affected substantially by these changes in the law. Not every trust or will is identical, however, and thus the best advice is to review your estate planning documents with us in order to determine the impact of the law. A common provision in estate tax planning documents calls for creation of a trust (often labeled the "Family Trust" or a "Bypass Trust") at the death of the first spouse. The new law affects the language in wills and trusts which determines how much of an estate is passed into these trusts, as opposed to being distributed to the surviving spouse. This division is a critical factor in estate tax planning and will be the focus of our review of your documents.

Other issues for review include the allocation of assets between spouses and spouses' trusts. There is an additional importance now in gathering records regarding the basis in assets such as purchase prices for land,

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stocks and other capital assets. Will and trust revisions may be necessary which take into account a number of possibilities for the tax laws in effect at the date of one's death, allowing an executor to toggle between several tax plans set forth within a document.

Conclusion

These changes in the law do not create turmoil for every client. A simple and inexpensive review of your documents and asset holdings is exceedingly important, however, in order to keep pace with these changing times in estate taxation. Unfortunately, these days one can no longer sign a will or trust and tuck it away permanently without the need for periodic review and updates. Our goal is to remind clients of the importance of such updates and to keep you apprised of these developments in the law. Thank you for the opportunity to work with you in regard to your estate planning.



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