Cooley

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The purpose of this *Alert* is to advise you of significant developments affecting the Federal estate, gift and generation-skipping transfer (GST) taxes.

The Federal estate tax has been repealed for decedents dying in 2010, but some members of Congress have announced their intention of reinstating it retroactive to January 1, 2010.

In some instances, particularly for married couples, immediate action may be needed in order to prevent unintended and possibly undesirable effects to their estate plan.

We believe that in many, if not most, cases, no action will be required. However, it is important to confirm this.

In addition, there are potential planning opportunities which should be considered by those with significant wealth, particularly for those with short life expectancies.

What has happened

In 2001, Congress repealed the Federal estate tax, effective for persons dying in 2010, but only for that year.

This "repeal", along with all the other tax changes enacted in 2001, will "sunset" (i.e., be reversed) after December 31, 2010, with the result that the Federal estate tax will return to its pre-2001 structure.

This would mean a return to a maximum estate tax rate of 55% (up from 45% in 2009) and an exemption of $1 million (down from $3.5 million in 2009). While it was expected by many that Congress would act in 2009 to reinstate the estate tax for 2010, possibly by "freezing" it at 2009 levels, it did nothing.

Although Congress did not act before the end of 2009, it could reinstate prior law or change it, and may attempt to do so retroactively to January 1, 2010.

No one can predict whether that will happen and, if the changes are meant to be retroactive, whether such changes will be sustained by the courts. In short, the planning environment is chaotic and likely to remain that way for an indefinite period.

Immediate problem for married couples

A basic estate planning goal for married couples is to minimize or eliminate any estate tax at the first death, without "wasting" the exemptions and credits that can be used to minimize estate tax exposure on the death of the second spouse.

Wills and trusts for married couples usually include special tax-driven provisions designed to take advantage of these planning opportunities.

Depending upon when the documents were prepared and how they read, the plan may not deal effectively with the possibility of there being no Federal estate tax, and may produce completely unexpected and unintended consequences.

Therefore, if a death occurs in 2010 and before Congress changes the law, an estate could be thrown into confusion with unpredictable results, such as these:

- The division of assets between the surviving spouse and other beneficiaries, or between the surviving spouse and a trust for his or her benefit, may be very different than originally intended.
- The estate may be subjected to much higher state estate taxes than necessary.

Additionally, while "repeal" has created opportunities for significant tax savings at the second death in later years, a couple's estate plan may need to be modified to take advantage of this development.

Also, the possible return in 2011 to pre-2001 rates and exemptions may have unintended adverse consequences, a result which may be avoided with careful planning.

Income tax effects

Along with the temporary "repeal" of the Federal estate tax, there are changes in the way inherited property is taxed upon a later sale. These changes are generally unfavorable and may mean higher capital gains taxes on inherited assets. Planning methods are available which can reduce the impact of this change.

Other planning opportunities

In addition to estate tax repeal, the gift tax rate has been reduced from 45% to 35%, and the GST tax has also been repealed, but only for the year 2010, unless Congress acts. This opens up a possible limited-time opportunity to make significant gifts and create significant benefits for grandchildren and other "lower generation" beneficiaries, on favorable terms.

However, no one can guarantee that actions taking advantage of these opportunities will not be subject to retroactive change.

Recommendation

Every individual and family presents a unique situation.

Our goal is to make sure that each client has a plan in place that is appropriate for that client and his or her family, no matter what happens with the tax laws. To do this, we recommend a review of your existing documents to determine if changes are appropriate in light of your current family situation and goals.

We especially counsel this review when one or more of the following are a part of your estate plan:

- If you have children of a prior marriage and they are provided for either at your death or the death of your spouse.
- If persons other than your surviving spouse—such as children, friends or charities—receive benefits on your death.
- If you and your spouse have separate sets of beneficiaries who eventually receive property.

If you would like us to undertake such a review for you, please contact one of the attorneys below in our Estate Planning and Personal Representation group.

East Coast Contacts	West Coast Contacts
Renee Schwartz	Myron Sugarman
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We wish you a Happy and Healthy New Year.

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