



Various aspects of the estate and gift tax laws were slated for repeal or dramatic change in 2010. Practitioners and commentators expected Congress to pass legislation to stop these changes before adjourning at the end of 2009. Congress did not act. Consequently, we have laws in effect in 2010 that must be understood and applied in order to take advantage of opportunities and avoid pitfalls.

## **Repeal of Estate Tax and GST Tax for 2010 Only**

For those whose death occurs in this year only (2010), there is no Federal estate tax or generation-skipping transfer tax (GST Tax), although Ohio will retain its independent estate tax system. Beginning on January 1, 2011, the estate and GST taxes are scheduled to be reinstated. The maximum tax rate is scheduled to be 55% and the exemption is scheduled to be \$1 million adjusted for inflation.

## **Surprising, Unintended, (and Often Undesirable) Consequences of Repeal**

Many client estate plans use tax-based formula provisions to divide assets. The repeal of federal estate taxes and GST taxes could have the surprising, unintended (and undesirable) consequences of allocating the client's assets in ways contrary to a client's intent. For example, if there is no estate tax or GST tax at a client's death, a tax-based formula for asset division might allocate all or a substantial portion of a client's estate to children or a trust for children (and little or no portion of the estate to a surviving spouse) or to grandchildren (and little or no portion of the estate to children).

## **Carryover basis**

Income tax basis is the value from which gain or loss on assets sold is measured. Under prior law, the general rule was that income tax basis for the recipient of an inherited asset was determined by the asset's fair market at date of death. However, for deaths occurring this year, the decedent's income tax basis will "carryover" to the person who inherits the asset. This carryover basis can, however, be stepped-up by \$1.3 million with respect to assets passing to anyone and by an additional \$3 million with respect to assets that pass on to the surviving spouse.

## **Gift tax**

The gift tax will remain in effect for gifts made in 2010. However, gifts will be taxed at only 35%. A lifetime cumulative exemption for gifts still exists in the amount of \$1 million, with gift tax annual exclusion amounts of \$13,000 per donee. On January 1, 2011, the gift tax maximum rate is scheduled to be 55%, as contrasted with 45% in 2009 and 35% in 2010.

## More change on the horizon

It is anticipated that Congress will enact new legislation to address estate and gift taxes. Unfortunately, it is unclear when this will occur and whether such changes will apply retroactively to estates of decedents dying or gifts made prior to the enactment of new legislation. If in fact Congress does reinstate the estate and GST taxes retroactively, this reinstatement could be challenged on constitutional grounds. Opinions vary on the likelihood of success of any such challenge. In any event, we are faced with the possibility that Congress takes no action in 2010, modifies the law prospectively, or attempts to modify the law retroactively.

## What is my next step?

Because each estate plan and family situation is unique, we recommend reviewing your plan to ensure that you continue to strike a desirable balance between your personal goals and your tax-related goals. This is particularly true of individuals in poor health. Failure to do so can lead to a host of unintended consequences or a lost opportunity to save your family estate and GST taxes. Accordingly, we recommend at least the following:

1. All estate plans should be reviewed to assess whether or not estate tax-based formula bequests work as anticipated.
2. Clients should take steps to determine tax basis in their assets. Further, estate-planning documents should be reviewed to address these issues from the perspective of giving the executor discretion to allocate basis step-up to the extent provided by the law.
3. Assess the opportunities available to maximize estate and GST tax savings in the event death occurs in 2010 and prior to enactment of legislation by Congress, if any.
4. Assess the appropriateness of making gifts in 2010 to take advantage of the 35% tax rate while otherwise leveraging the repeal of estate and GST taxes.

All of this is very complicated and very difficult to summarize in a short writing. Accordingly, we urge you to contact any one of the following members of our estate-planning group to coordinate a review of your current circumstances and governing documents.

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