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2010
"NO ESTATE TAX" SHOULD BE A GOOD THING
BUT BEWARE OF THE 2010 CARRYOVER BASIS RULES
AND UNINTENDED BEQUESTS/DISPOSITIONS

- As of January 1, 2010, there is no federal estate tax ("FET") and no generation-skipping transfer tax ("GST"). Both taxes are repealed for this year only.
- Congress is expected (?) to reinstate the FET and the GST but the timing and the constitutionality of the retroactive application of any reinstatement is unclear.
- For decedents dying on or after January 1, 2010 and before January 1, 2011, there are very complicated carryover basis rules.
    - There is no longer a full automatic step-up in basis for assets included in a decedent's estate. Now the assets' value on date of death is the lesser of either (1) the fair market value on the date of death or (2) the decedent's basis.
    - To ease the resulting capital gain consequences, the personal representative ("PR") may allocate up to $1.3 million of "gain" to step up the basis of particular assets selected by the PR.
    - In addition, if the decedent is survived by a US citizen spouse, the PR may allocate up to $3 million of "gain" to step up the basis of assets selected by the PR that pass either outright to a spouse or to a QTIP Trust.
    - Also, the decedent's $250,000 exclusion for gain on the principal residence is extended to the estate or devisee.
    - Under the law prior to January 1, 2010, most assets in an estate received a new tax cost basis equal to the assets' fair market value on the date of death. Capital gain was not much of a concern in estate administration.
- Gift tax is not repealed in 2010 and the gift tax exemption remains at $1 million.
    - The 2010 gift tax rate is 35% (previously 45%).
    - It is expected that the 45% gift tax rate will return when Congress acts.
- Congress' failure to act in 2010 means that federal estate tax and a federal estate tax exemption of $1 million return in 2011. The estate tax rate on assets exceeding the exemption will rise to 55% in 2011. (Prior to 2010, the estate tax rate was 45%.)
- Even though there is currently no federal estate tax or generation-skipping transfer tax, Maine's estate tax remains in effect on assets exceeding Maine's $1 million exemption. The Maine estate tax rate ranges from 6% to 16%.
- The 2010 annual exclusion is the same as the 2009 annual exclusion - - $13,000 per person. A gift to a non-U.S. citizen spouse can be made up to $133,000 as was the case in 2009. Payments for tuition and medical expenses made directly to the educational institutional and medical care providers continue to be exempt from gift tax.

HOW DO THE 2010 LAWS AFFECT YOUR ESTATE PLAN?

1. Changing wills/revocable trusts may not be essential in this period of uncertainty.

    - In general, if you're married and have a disclaimer plan or a plan done after July 2005 using formulas based on Maine's estate tax exemption (including a State Marital Trust or QTIP Trust), your documents may not need to be changed as we wait for Congress to act.

- If you are single and your assets have a total value less than $1.3 million, and your documents do not refer to the federal estate tax exemption or the federal generation skipping transfer tax exemption, your documents are probably fine in this interim period.
- If you are in a non-traditional family or if you have significant assets, it is advisable that you take the time to look at your documents. The tax formulas in your will or revocable trust are probably based on the federal estate tax exemption or the generation-skipping transfer tax exemption. If so, your assets may not pass in the way you originally intended. If you have any questions after reviewing your will or your revocable trust, please call.

2. If there is a death in this interim period, before Congress acts, beware:
   - Personal Representatives shouldn't automatically do what was considered "prudent" and "best practice" in 2009. (In 2009, the decedent's assets often were liquidated as soon as possible to minimize the risk of a decline in the market.)
   - The new carryover basis rules necessitate an analysis of gain on all assets in any estate having a value above $1.3 million. This should be done before any assets are sold to pay debts or specific bequests.
   - More estates will be required to file returns with the IRS (estates over $1.3 million) in 2010 than were required to file with the IRS (estates over $3.5 million) in 2009. The difficulty (time and expense) of administering an estate under the 2010 rules is much greater (with attendant higher costs and delays).
   - Disclaimers should be fully analyzed.
   - If the tax-based formulas in the will or trust result in a disposition that was not the decedent's intent (e.g. the spouse receives nothing), a construction proceeding in the probate court is an option. This is not a great solution because of the delays, additional cost and uncertainties involved with a proceeding to construe a will or a trust, but there may be no alternative.

3. A few financial and tax professionals are looking at this "mess" as a planning opportunity.

   - Planning opportunities exist only if Congress is not successful in making the new estate tax, generation-skipping transfer tax and gift tax law retroactive to January 1, 2010.
   - If you have used your full gift tax exemption ($1 million) on lifetime taxable gifts, you may consider an additional taxable gift now (those gifts that exceed the $1 million gift tax exemption) because the current gift tax rate is 35% (10% less than the 2009 rate and the gift tax rate projected for future tax laws).