McDonald & Kanyuk, PLLC

Memo

To: McDonald & Kanyuk Estate Planning Clients

From: Joe McDonald & Amy Kanyuk

Date: January 2010

Re: Estate and Income Tax Alert: Changes Effective on January 1, 2010

To our great surprise, on January 1, 2010, Congress allowed the federal estate and generation-skipping transfer (GST) taxes to "sunset" for one year. However, the gift tax, which currently has a $1M exemption and a 35% rate, has not been repealed. Unless Congress takes action this year, the estate and GST taxes will return on January 1, 2011, with $1M exemptions and a top rate of 55%. It's possible (perhaps even likely) that before 2011 Congress will enact new estate tax legislation that is retroactively effective to January 1, 2010.

We know that these changes are confusing, and that our elected representatives' failure to do something to avoid this unfortunate situation raises difficult estate planning issues. We hope that this memo will answer the questions you may have about planning steps you might consider in early 2010.

Should our wills and revocable trusts be updated to adapt to the 2010 changes?

The revocable trusts we prepare for married clients generally divide the estate of the first spouse to die into two separate shares. One share is equal to the deceased spouse's unused estate tax exemption amount, and held in a "Family Trust". The remaining property is held in a "Marital Trust".

Under the prior (pre-2010) system, this division of assets would avoid any federal estate tax on the first spouse's death. The Family Trust property also would escape estate tax when the surviving spouse dies, but at that time the Marital Trust property would be subject to estate tax. This was the common way most married couples have disposed of their wealth for many years. If you have such a plan, we continue to believe that it is most likely appropriate for you. The revocable trusts prepared for our unmarried clients should likewise need no changes under the new system.

Another tax change that took effect on January 1, 2010 relates to the income tax basis of inherited assets. Your income tax basis is the value from which gain or loss on assets sold is measured. For example, if you purchased a share of stock for $10, and sold it for $15, your basis would be $10 and your taxable gain would be $5. Until now, the income tax basis of an asset generally was "stepped-up" to its value when its owner died. Thus, if at the time of your death the stock you purchased for $10 was worth $15, before 2010 your heirs would receive the stock with a $15 basis, and could sell the stock without paying any capital gains tax.

As of January 1st, this automatic change in basis will not occur. Instead, the deceased owner's income tax basis in appreciated assets will "carry over" to the persons who inherit the assets, or "stepped-down" to the date of death value if the asset is depreciated. However, the executor of a deceased person's will has the power to allocate some additional amounts of basis to a decedent's assets, to step-up their value. It may be appropriate for your documents to be revised in order to take into account the possibility of carry-over basis and to provide some guidance to your executor on the allocation of basis to your assets.

I have heard that many states have recently enacted their own "death taxes." Should my plan be revised to address state tax issues?

Although the federal estate tax has been repealed for one year, state estate and inheritance taxes remain a concern for many of our clients. New Hampshire has no estate or inheritance taxes. However, every other New England state has its own estate tax. If you live or own real property in a state other than New Hampshire, or anticipate moving from New Hampshire, you may want us to review your estate planning documents to determine if special planning is appropriate for you.

If, for example, you are a resident of New Hampshire and own vacation or business real estate in Massachusetts, there may be some steps you can take now to defer or even eliminate the Massachusetts estate tax that otherwise would be payable if you did nothing. Beware: many of our clients mistakenly assume that they need not concern themselves with this issue if the value of their property in the other state is less than that state's estate tax exemption amount (e.g., $2 million in Massachusetts).

Will I have a window of opportunity to make asset transfers and save taxes for my heirs early in 2010?

Maybe—assuming Congress doesn't retroactively reinstate the estate and GST taxes to January 1, 2010. We are looking at several possible strategies that may capture what might be a fleeting opportunity for our clients who are not risk-averse.

Let's sit down and talk.

Based on all of these changes, we think it's important for you to consider coming in and discuss what you might do to adjust your plan. If you'd like to meet, please call us to arrange an appointment. We look forward to seeing you.