



Client Advisory

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The 2010 Federal Estate Tax “Repeal”

As you may already know, much to the astonishment of the legal community, Congress has failed to pass legislation extending the federal estate tax into the 2010 tax year. Unfortunately, this inaction does not translate into permanent estate tax relief and will not result in a windfall for most taxpayers. We are writing to alert you to aspects of this situation that may affect your estate plan.

The Current State of the Federal Estate Tax

This federal estate tax "repeal" means that absent future (and possibly retroactive) congressional action, the federal estate tax will not apply to individuals dying in 2010. Note the tax "repeal" applies to the 2010 tax year only. The federal estate tax is scheduled to return on January 1, 2011; with it an undersized \$1,000,000 federal estate tax exemption for US Citizens (down from \$3,500,000 in 2009), and a maximum marginal tax rate of 55% (an increase from 2009's maximum 45% rate). Unfortunately, this is a much more oppressive and costly federal estate tax than we have seen in many years.

Additionally, the repeal of the federal estate tax and the federal generation-skipping transfer tax ("GST") in 2010 brings with it complex and potentially problematic "carryover basis" rules. It is also important to note that the federal gift tax and state estate taxes remain intact.

Congress may act this year to keep the federal estate tax and GST in place. No one knows, however, how and when Congress might act to resolve these problems, especially while in the midst of a contentious election year. Additionally, some believe that any retroactive reinstatement of these taxes for 2010 raises serious constitutional issues.

What does this mean to you?

In many cases, your Will or Revocable Trust may contain "formula clauses" which reference tax law concepts that have now been repealed or modified. This means that if you were to die in 2010, while federal estate tax might not apply to your estate, the temporary absence of a federal estate tax in the Internal Revenue Code could significantly affect who inherits from your estate and in what proportions. For example, assume that your Will provides a formula where your children (and not your spouse) are to receive the maximum amount that can be inherited by them free of federal estate taxes; and the remainder of your assets are to be distributed to your spouse (your intention being that your children

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would receive a certain amount sheltered from federal estate tax, and your spouse would receive the balance of your estate). In 2010, this formula clause could be interpreted to require that your children receive your entire estate (your entire estate being the maximum which could pass free of federal estate tax), and your spouse would be disinherited altogether. In addition to the obvious consequences this situation presents, this unintended distribution could also lead to significantly increased State estate taxes and capital gains taxes for your beneficiaries. Fortunately, these issues may typically be corrected by signing a revised Will, Codicil or Trust Amendment.

On the other hand, there are many Wills and Revocable Trusts containing formula clauses which remain adequate and do not need to be changed. Whether or not action on your part is required depends upon the particular facts and circumstances of your estate plan.

We understand that these issues are complex and may require further discussion. If you would like to speak with us regarding these matters and how they may affect your estate planning, please feel free to contact us.

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From time to time, we send out important news and legislative updates that have a bearing on estate planning. If you would like to receive these notifications via email, kindly send your email address to Jennifer Friedrich at jfriedrich@farrellfritz.com.

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