

DEALING WITH THE NEW “SEE-SAW” RULES OF ESTATE PLANNING

The Current State of Affairs:

Congress has added to the economic uncertainty that prevails today by failing to act before the end of last year to eliminate a confusing set of see-saw tax rules. When Congress passed the 2001 law that provided for a one-year elimination of the estate tax in 2010, no one expected the estate tax actually to disappear. Everyone thought Congress would act before 2010 to prevent this from happening. Unfortunately, Congress never acted to change the 2001 law, giving rise to many unintended consequences. While there has been talk of retroactive legislation to correct this problem, no one knows what form this legislation might take or if retroactivity could withstand Constitutional challenge. Given this state of affairs, we would like to provide you with some information about the current state of the tax laws that may affect your estate plan. We encourage you to contact us with any questions that you may have about these issues.

2009 Rule:

Under the laws in effect in 2009, every individual could transfer up to \$3.5 million of assets at death without incurring estate tax, and the estate tax rate was 45%. In addition, during an individual's lifetime, he or she could transfer up to \$13,000 in assets to as many people as desired each year without incurring gift tax. An individual could make additional gifts over these annual amounts without incurring gift tax until the aggregate amount of all such additional gifts exceeded \$1 million, when a maximum gift tax rate of 45% would apply. Any gifts during life or at death to grandchildren or younger generations would also incur a generation-skipping transfer tax at a 45% rate once the aggregate amount of such gifts exceeded \$3.5 million. The recipient of a gift during life generally would have the same – or “carried over” – income tax basis in the gifted assets as the person making the gift. However, the basis of appreciated assets transferred at death would be “stepped up” to fair market value for the recipient, thereby reducing the income tax due when those assets were sold.

2010 Rules:

There is no estate tax or generation-skipping transfer tax in 2010. The gift tax remains in effect with the same rules as in 2009, except that the tax rate is lowered to a flat 35%. Lifetime gifts in 2010 continue to have a “carried over” basis, but appreciated assets transferred at death may no longer have a fully “stepped up” basis. Instead, for assets transferred at death, there is a limited step up in basis of \$3 million for gain on assets transferred to a spouse and an additional \$1.3 million for gain on other transfers of assets at death. As a result, complicated allocations may need to be made and beneficiaries may need to track down a deceased loved one's financial records going back many years to properly determine their income taxes upon the sale of the assets they receive, if death occurs in 2010.

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2011 Rules:

The estate tax and generation-skipping transfer tax return in 2011, but in modified form. The estate tax exemption will be reduced to \$1 million and the maximum estate tax rate will be increased to 55% (with a 5% surtax on estates between \$10 million and \$17.184 million). Similarly, for the generationskipping transfer tax the lifetime exemption will be \$1 million and the tax rate will be 55%. The gift tax will have the same rules as in 2009, except that the maximum tax rate will be increased to 55%. The income tax basis rules revert to the way they were in 2009.

Illinois Rules:

The changes in the federal estate, gift and generation-skipping transfer taxes also complicate the application of the Illinois estate tax. In 2010, there is no Illinois estate tax. When the federal estate tax returns in 2011, the Illinois estate tax will be back as well, with a \$1 million exemption.

How We Can Help:

Simply stated, Congress has left in place a bizarre tax system that may have vastly different consequences for a person's family depending on the year of his or her death. Because of the see-sawing income, estate, gift and generation-skipping transfer tax laws in effect from 2009 through 2011, we recommend that all of our clients review their estate plans. Most estate plans contain formula provisions that assume that there is a federal estate tax. Depending upon your situation, these formulas may have unintended results during 2010. In addition, the basis provisions in effect during 2010 require attention to complicated allocation rules and may cause your beneficiaries to pay additional taxes that would not have applied in the past. We recognize that the circumstances of each of our clients is different and deserves individualized attention.

Please contact any of our attorneys who specialize in estate planning if you would like further information about the changes in the federal tax rules that may affect your estate plan and if you would like us to review your estate plan to ensure in 2010 and after that it continues to meet your goals and needs.



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