

January 26, 2010

A Special Notice To  
Our Clients About  
the Federal Estate Tax

If you are married, and your estate plan includes a trust, you should contact us to review your estate plan. The failure of Congress to continue the federal estate tax makes it necessary to change many estate plans.

In 2001 the economy was booming. The Treasury forecasted large surpluses. Congress, supported by government research indicating that the tax was counter-productive, voted to wipe out the federal estate tax.

The vote was part of the Economic Growth and Tax Relief Reconciliation Act of 2001, known as "EGTRRA." Before EGTRRA the first \$1,000,000 of assets was exempt from tax and the top tax rate was 55%. A certain amount of state estate taxes could be taken as a credit against the federal estate tax.

EGTRRA provided that the amount of assets exempt from tax would rise, to \$3,500,000 in 2009, the top tax rate would drop to 45%, and the credit for state death taxes would disappear. In 2010, unless Congress voted otherwise, the federal estate tax would disappear entirely, but would return in 2011 as it had been in 2001 – the exempt amount would drop to \$1,000,000 per estate and the top rate would rise to 55%.

In 2009 more than 40 bills were filed in the House of Representatives to extend the federal estate tax, in most cases just as it was. Tax legislation originates in the House of Representatives and then must be passed by the Senate. No estate tax bill made it through the Senate.

Probably Congress will act this year to restore the federal estate tax, but we do not know if and when this will happen and in what form the federal estate tax may return. Usually we can rejoice when a tax goes away, but what we are left with is worse than what we had.

When the federal estate tax was in effect, inherited assets received a stepped-up cost basis for income tax purposes. If Uncle Charlie bought stock for \$1,000 and it was worth \$100,000 when he died and left it to his nephew, his nephew's cost basis "stepped-up" to \$100,000, and if the nephew sold the stock for \$100,000 he did not have to pay tax on the gain.

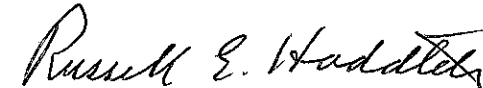
There is a provision in the law to increase the basis of inherited assets so as to mitigate the loss of the stepped-up basis but this is itself complicated. In many cases trying to determine the basis of assets bought years earlier may be difficult or impossible.

The most serious problem created by the absence of the federal estate tax is in the language of marital deduction trusts that refer to the federal estate tax. Phrases such as "The trustee shall allocate to my spouse such amount of the trust assets as shall be necessary to reduce my estate tax to zero" are commonly used.

Now that we have no federal estate tax, there is no amount necessary to reduce the federal estate tax to zero, and the result could be that no amount is allocated to the surviving spouse.

We will inform you about further changes in the federal estate tax. In the meantime, it is important for you to contact us to review your estate plan to determine if changes are needed.

Yours truly,



REH/ms

Russell E. Haddleton