

# 2010 ESTATE & GENERATION SKIPPING TRANSFER TAX REPEAL

Until January 1, 2010, almost everyone expected Congress to act to prevent repeal of the estate tax. Many expected a simple patch to extend 2009 law into 2010.

In 2009's cliffhanger of an ending, Congress instead offered no resolution at all, leaving investors in a precarious situation – how to design a financial plan that best suits their needs in what is perhaps one of the most uncertain, confused and confounding planning environments in history.

Do you need to worry?

Regardless of whether you previously had in place a strategy for your estate, as of January 1, 2010, your estate plan is probably outdated.

## Traditional Estate Planning

Traditional estate planning documents refer to tax code concepts which no longer exist and apply tax strategies which no longer function as intended.

## Formula Clauses

Many modern estate plans used “formula clauses” to divide an estate at the death of the first to die of a married couple into two portions – one equal to the then-current exemption and the other set aside for the surviving spouse. These formula clauses are now, largely, obsolete.

**Example:** A popular formula clause provides for the maximum amount that can be transferred estate-tax-free into a “family trust.” The rest of the

assets go into a “marital trust” for the surviving spouse’s benefit. If there is no estate tax, everything may go to the family trust. There will be nothing left to fund the marital trust.

## Formal Document Review Highly Recommended

The law today, and perhaps tomorrow, is unlike prior law. Estate planning documents should be reviewed by an estate planning advisor, including:

- | Wills,
- | Trusts,
- | Pre- and Post-Nuptial agreements, and
- | Beneficiary designation forms.

Even if you expect to outlive 2010, the future of your estate is uncertain.

## Carryover Basis

Prior to 2010, the law allowed for an adjustment in basis – a step-up – to the fair market value (“FMV”) of inherited capital assets. Basis is deducted from sales proceeds to calculate the tax gain or loss on the sale of a capital asset like a common stock.

For 2010 only, the step-up has been replaced with a modified carryover basis (“MCB”), under which the heir’s basis will be the same as the deceased’s basis, unless the capital asset has depreciated in value. In that case, the heir’s basis will be reduced to the FMV as of the deceased’s death.

In addition to technical adjustments available in limited cases, there are two modifications to this rule.

First, each estate is entitled to a basis increase of up to \$1.3 million. Second, capital assets passing to a surviving spouse may be entitled to an additional \$3-million basis increase.

Estates able to fully utilize both modifications will realize a maximum \$4.3-million increase in basis (1.3 + 3). A married couple could realize a combined maximum \$5.6-million increase in basis (1.3 + 3 + 1.3).

#### Carryover Basis in a Nutshell

Carryover basis is simply the *lesser* of the:

- | Deceased's adjusted basis or
- | FMV on date of death.

#### Modifications

Additionally, a limited increase in basis is available on certain transfers. An increase, or step up, of up to:

- | \$1.3 million ("special adjustment") is available to every estate.  
*A reduced adjustment applies to non-resident, non-citizen heirs.*
- | Plus an additional \$3 million ("spousal adjustment") is available on outright transfers to a surviving spouse.  
*Restricted to transfers outright (free of trust) and certain trust transfers.*

#### Summary

Comprehensive financial planning was significantly altered on January 1, 2010, with the temporary "repeal" of the estate and generation skipping taxes. While much remains undetermined, it is clear that these are interesting times rife with planning opportunities.

#### Action Items

1. Obtain a formal review of all existing estate planning documents by your attorney, paying particular attention to any formula clauses employed.
2. Use the meeting with the attorney to update the estate plan to reflect changes in the family, changes in wealth, changes in goals or changes in fiduciary appointments.
3. Compile and share with your financial advisor a complete list of assets, including how the asset is owned (jointly, in trust, etc.), acquisition date and cost basis.

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