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# Estate Planning Law

## ALERT

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*The TRUSTS AND ESTATES attorneys at Lindabury have provided estate planning and business counseling services to individuals and their families for more than fifty years. We work closely with our clients to prepare wills, living wills, trusts, powers of attorney, family limited partnerships and other documents necessary to accomplish their desired goals.*

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## Federal Estate Tax Repealed in 2010— But is the Death Tax Really Dead?

By Jonathan S. Chester

You might be hearing among your family and friends or in the media that when it comes to estate taxes, 2010 would be a good year to die. Although there is some cheeky humor in putting things this way, the reality is that the 2010 one-year repeal may actually create more problems than it solves.

The estate tax craziness started back in 2001, when Congress passed a law purporting to “repeal” the estate tax. What Congress actually did, however, was pass a law that gradually reduced the estate tax by lowering the tax rate while simultaneously increasing the estate tax exemption (the amount a person can leave free of estate tax). Back in 2001, the exemption was \$675,000, and the top tax rate was 55%. By 2009, the exemption had grown to \$3.5 million and the top rate had dropped to 45%. The law called for estate tax repeal in 2010, followed by reinstatement in 2011 – with only a \$1 million exemption and a maximum tax rate of 55%. For the past ten years, estate planners have been waiting for Congress to resolve the problem of the “now you see it, now you don’t...now you do again” federal estate tax. However, as the New Year approached, Congress once again failed to act, and as a result, the estate tax expired on January 1, 2010.

Year of Death	Estate Tax Exemption	Top Estate Tax Rate
2009	\$3.5 million	45%
2010	Unlimited	0
2011	\$1.0 million	55%

**Estate Tax Table** - Under current law, the estate tax is zero in 2010 but will come back in 2011. Estates under the exemption amount are not subject to the federal estate tax (but may be subject to state death taxes)<sup>1</sup>.

Of significance to those who have made estate plans are the unintended consequences of many of the common estate planning techniques that the tax “holiday” will have on their plans in 2010 and beyond. For example, many people have established “bypass trusts” in their wills which use a formula clause designed to leave the (cont’d ➔)

exemption amount in a trust for the surviving spouse and/or children and the rest of the estate to their spouse. The idea is to shelter the maximum amount from tax by using the exemption of each spouse.

However, under the new law, depending on how the will or trust was written, the bypass trust might get all the assets or none of them. In either case, this is not the intended result. If there is no estate tax (and no exemption) in 2010, is the bypass trust funded? If so, in what amount? If the trust is not funded, and the tax is reinstated in 2011, is the ability to use the exemption forever lost?

Another potential landmine in this year's estate-tax repeal concerns a long-standing tax break known as the step-up in cost basis. Cost basis is what you paid for an asset, plus or minus certain adjustments such as improvements made to real estate. Under the old rules, when a person died, the cost basis was "stepped up" to the fair market value on the date of death. When the asset was later sold, only the difference between the sales price and the date-of-death value was taxed. However, under the new law, the heirs would receive ownership of the property with the decedent's (typically lower) cost basis. This could lead to a significant capital gains tax for the heirs, especially for real estate, stocks, or a family business which may have been owned by the decedent for many years. The step up in basis rules used to apply to all the assets in the estate. However, for someone who dies in 2010, heirs can apply the step-up in basis to only \$1.3 million worth of appreciation. An additional \$3 million in appreciation can

pass to a surviving spouse. In addition, record keeping nightmares will be commonplace, as heirs attempt to verify the cost basis of assets that may have been purchased years or even decades earlier.

Another issue to consider is the possibility that Congress might impose an estate tax *retroactively* to Jan. 1, 2010, or do nothing and let the estate tax come back (with only a \$1 million exemption) in 2011.

### What's Next?

The unlimited step-up in basis is scheduled to return in 2011, along with the estate tax and the \$1 million exemption. Estate planning professionals are hoping for answers before then.

Will Congress act? Will congressional action be retroactive to January 1st? Will that retroactive action be held constitutional? No one knows for certain. In order to be prepared this year and in anticipation of the reinstatement of the estate tax in 2011, we suggest that people meet with their estate planning attorneys and financial advisors to review their current estate and business succession plans and discuss possible modifications.

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*The information provided here is necessarily general and is not intended as legal advice or a substitute for legal advice. If you have any questions regarding this Alert, please contact Jonathan S. Chester of the Trusts & Estates Group at [jchester@lindabury.com](mailto:jchester@lindabury.com).*

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<sup>1</sup>For example, New Jersey imposes a separate estate tax on estates over \$675,000.



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