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Estate Tax Uncertainty

Over the last nine years, we have written numerous articles about the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). Among other things, we have addressed the fact that, over time, it incrementally increased the federal estate tax exemption, to $3.5 million in 2009, and reduced the maximum tax rate from 55% to 45%. Moreover, while EGTRRA eliminated federal estate taxes entirely for one year, 2010, beginning in 2011, the tax will be reinstated for all estates in excess of $1 million at a rate of 55%!

After passage of EGTRRA, it was generally believed that Congress would not permit the repeal of the estate tax for even one year, or its reintroduction the following year on estates valued in excess of $1 million, and that Congress would effectuate a more permanent change before the end of 2009. However, much to the surprise of the pundits, that never happened. While there have been reports that Congress expects to address these issues during 2010, there are no guarantees -- either that Congress will act or that it will make the changes retroactive to January 1. This has created a“perfect storm” in estate planning for people who have used the federal tax exemption amount as a measuring stick for the share or shares of their estates which have been earmarked for particular beneficiaries.

Examples will better illustrate the potential problems. Take, for instance, a married couple with an estate in excess of $3.5 million dollars. Their existing estate plan probably incorporates a tax-savings strategy. What if their goal was to leave an amount equal to the federal tax exemption to the children and the balance to the spouse. Last year, if one of them passed away, the children would have inherited $3.5 million and the spouse the rest. This year the kids get it all!

That scenario is even more devastating for a couple in a second marriage where each spouse has children from their first marriage. Their plan may have been that an amount equal to the federal exemption would be distributed to the children of the first to die and the remainder would be held in trust for the survivor and, at the survivor’s death, this too would be distributed to the children. Because under EGTRRA, in 2010 *everything* passes free of federal estate tax, under this plan, all of the asserts of the first spouse to die will go to his or her own children and nothing will remain to fund the trust for the benefit of the survivor.

A third example concerns the reverse, a couple with a significant estate who want to give as much as possible to the children without incurring estate tax. Their plan may have capped the gift to children at $3.5 million because of the 2009 limitation. Now, during 2010, they could conceivably pass an unlimited sum to their children free from tax. Again, and unless they make a change in the plan that takes into account the current status of the law, if either of them dies during 2010, the plan will not accomplish their goal.

Finally, those who have designated charities to receive a portion of their estates may have done so exclusively to minimize the federal estate tax bite. People in this situation may want to evaluate whether the planned charitable gifts make sense under the current tax laws.

There are difficulties relating to the temporary repeal of the federal estate tax and, of course the federal tax exemption. But that is only half the battle. There is also a state estate tax. In New York, the amount that can pass free from New York State estate tax, the exemption amount, remains at $1 million notwithstanding the federal tax repeal. Thus, even in 2010, property in excess of $1 million that is given to a non-spouse beneficiary upon the death of the owner, will incur a *state* estate tax.

We, at Berwitz & DiTata LLP, recognize that our clients' plans are affected by changes in the law. Other factors that affect estate planning over time include personal circumstances, marriages, divorces, births, deaths, a move to a new home, inheritances, increases or decreases in the size of the estate and general economics. For this reason, we feel strongly that an estate plan should be regularly reviewed. We offer our clients a complimentary estate plan review every three to five years.

If you feel that the changes in the law may provide planning opportunities for you, or if you feel that your plan may no longer reflect your goals, it's time to make an appointment. If you are a client whose circumstances have changed warranting an earlier review, or if you are not already a client of ours, there is a nominal fee to review your estate plan. But this is the best way to be ensure peace of mind. Whether three (3) years have passed since your last review or your plan no longer meets your needs because of changes in the law, your family, your wealth or your goals, you owe it to yourself to call us today.