

Estate planning: now more than ever

By Mitchell Eckel
mconcord@cnc.com

As you may have heard, we are currently in the anomalous position of having no federal estate tax. This is the result of Bush-era tax legislation dating back to 2001, which “sunset” last Dec. 31. Because of Congressional budgetary rules, there wasn’t enough budgetary authority to pay for total repeal, so while the exemptions allowed stepped-up over the last 10 years to \$3.5 million, repeal was only for this year — 2010. On Jan. 1, 2011, the estate tax reappears but this time with only a \$1 million exemption. Further, the top marginal bracket will be 55 percent and not the 45 percent that applied in 2009.

Up to now, I, along with nearly every other estate planner, have confidently told clients not to get too excited about the prospect of the expiration of the “death tax,” because Congress would certainly act to reinstate the tax, or at least extend the existing exemption before the end of 2009. So far that has not happened, and with Congressional gridlock in vogue it begins to appear as if nothing may happen this year.

Various legislative proposals are outstanding including raising the exemp-

tion to \$5 million or just freezing the exemption at the 2009 level of \$3.5 million. (Remember the exemption applies per person, so two spouses can dispose of twice the exemption amount.)

There is also the issue whether the estate tax can be reinstated retroactively. People are dying in 2010 with what would have been taxable estates. Are those estates going to pass to beneficiaries tax-free? Or can the estate tax be re-imposed and applied to those dying before re-enactment? Is that constitutional? The short answer is that there is substantial precedent for such a retroactive reinstatement if it is done within the current tax year. That would be known only after the inevitable court challenge, and, of course, Congress would first have to act to reimpose the tax.

Meanwhile what happens if there is no estate tax? The most important impact is that there is no “step-up” in tax basis to the date of death value of the assets included in the estate. I often have said to clients that the only benefit of dying is that your heirs or beneficiaries won’t have to pay income tax on gain (appreciation in value) that has occurred while you owned the assets. Under the now expired law that basis step-up benefit

Estate planning is and was always about taking care of your family and assuring that money passes to persons capable of receiving and managing it, and protecting those persons who cannot do so.

applied even if no estate tax was actually paid.

The result of repeal is the requirement that the estate must reconstruct what the deceased’s tax basis (purchase price plus cost of any improvements made) was for each asset. There is a complicated general basis adjustment allowed of \$1.3 million and an additional spousal basis increase of up to \$3 million for property passing to the spouse that was owned by the decedent at death. “Owned” does not include some trusts or other forms of ownership, and the executor is charged with the responsibility to allocate the exemption among the assets. Can you imagine trying to figure out what Dad or Grandma paid for all those stamps in his or her collection accumulated over 50 or more years ago?

Can we now forget about those trusts that lawyers have recommended all these years that divide into marital and family shares at death? Are these necessary any longer?

The answer is yes, they are still necessary. Estate

planning is and was always about taking care of your family and assuring that money passes to persons capable of receiving and managing it, and protecting those persons who cannot do so. Tax avoidance or savings is only part of the reason one does estate planning.

The answer is also yes, because, as indicated, “repeal” is only for one year. Estate tax will be imposed at much lower levels of assets in 2011 because of the reduced exemption of \$1 million. Use of the separate marital trust share for the surviving spouse will be very important to avoid tax at the death of the first spouse to die if decedent has assets of more than \$1 million.

Further, even if federal estate tax were not an issue, there is still the Massachusetts estate tax, which applies to taxable estates in excess of \$1 million. That Massachusetts tax has less “bite” than the federal estate tax but it still is not insignificant. For example, once the million-dollar exemption is exceeded, even if

by only one dollar, \$33,600 of tax is owed. At a taxable estate of \$1.5 million, the tax is \$74,400. At \$2 million, the tax is \$99,600.

Thus, all the usual reasons for the use of trusts remain applicable. Divide assets between spouses so regardless who dies first, there will be sufficient assets to fund each spouse’s trust and assure that the deceased spouse’s exemption is not wasted. Use a family (or credit-shelter) trust to receive the assets of the deceased spouse, where those assets can be used for the benefit of the surviving spouse but with creditor protection and without estate tax inclusion at the surviving spouse’s death. Send excess assets to the marital share trust, which will hold everything above and beyond the exemption and assure no estate tax is paid at the first death. Use formulas to adjust the relative shares if the exemption amount changes. Use a formula to create a Massachusetts-only marital share inside the federal family (credit-shelter share) trust to assure that no Massachusetts estate tax is paid at the first death.

For those who have an existing trust as part of their estate plan, an immediate action item includes checking to assure that the spouse is the beneficiary of

the credit shelter trust share. Sometimes in second-marriages, for example, the family (credit-shelter) trust is used to pass assets on only to the children of the prior marriage, because it was assumed that there would be funds in the marital share for the second marriage spouse. It is also important to assure that the executor is authorized to allocate the general basis step-up amount allowed for deaths occurring this year, and to immunize that person from any lawsuit by disgruntled heirs who are allocated a lesser or no basis step-up for assets they receive. And press Dad or Mom to begin to assemble all those old basis records, so that full income taxation of the value of property inherited and sold does not occur. Remember if you can’t establish tax basis, the basis is zero and you are income taxed on the full value of the asset.

Is estate planning and the use of trusts still necessary? The answer is unequivocally yes — just as much as ever, and more so, if the exemption amount allowed comes back at only \$1 million next year.

Mitchell Eckel is a Concord resident and a partner at the Acton firm of Eckel, Morgan & O’Connor.