

STRAUSS & MALK LLP Newsletter



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"Like mothers, taxes are
often misunderstood, but
seldom forgotten." -
Lord Bramwell

THE ESTATE TAX: "I'LL BE BACK!"

By Michelle Gooze-Miller

As of January 1, 2010, the Federal (and, in the case of Illinois at least, state) estate tax and generation-skipping transfer tax ("GST tax") disappeared. That means no more taxes are payable as a result of death. Good news . . . right? Well, let's take a look at what is actually going on now, and how this came to be.

The 2001 Tax Act provided for the gradual phase out of the federal estate tax by 2010. The Act included a "sunset" provision to avoid the rule allowing the Senate to block legislation that significantly increases the federal deficit beyond a ten-year term. That means that in 2011 the estate tax comes back with a vengeance – much higher rates and much lower exemptions (55% estate tax rate and only a \$1 million exemption).

Most tax advisers thought Congress would extend the estate tax before the end of 2009, and the House actually passed such a bill in December, but Congress didn't finish the process and the year ended. Talk about retroactive legislation to set the exemption at 2009 rates abounds, but its constitutionality would undoubtedly be questioned if that were to occur.

So, you say, next year may be bad, but no estate tax in 2010 is good, right? Not so fast. The elimination of the estate and GST tax could have a disastrous impact on the estate plans of some married couples. Many plans are drafted with "formula clauses" designating that the amount free of estate tax passes to individuals other than the surviving spouse. If no estate tax is in place, this would result in the entire estate passing to the non-spouse beneficiaries. A similar problem would arise with a plan that gives the amount exempt from GST tax to grandchildren. With no GST tax, this bequest could constitute the entire estate.

What else? Well, with the end of the estate tax comes the end of a full step-up in basis for property owned by a decedent, a potential income tax nightmare. As a result, beneficiaries may need to retain decades of records in order to establish historic basis when they contemplate the sale of an inherited asset.

Uncertainty often leads to inaction, which could potentially be tragic. While we cannot predict the future, we recommend that all of our clients take the following steps:

- Even more diligently than before, **track the tax basis of your assets**; and
- **Review your plan.** While a review is beneficial for all clients, the following **risk factors** may indicate the existence of a problem:
 - * A second marriage
 - * A plan that gives significant assets, by formula, to non-spouse beneficiaries
 - * A plan created (or last restated) before 2005 (which may not reflect the changes in the law, including those prior to 2010)

If you believe you may be at risk, please do not hesitate to call. We will review your estate plan for a set fee and let you know if changes are necessary in light of the current state of the law.

We don't know if or when Congress will take steps to resolve the uncertainty it has created. Therefore, the time and expense incurred in reviewing estate plans now may turn out not to have been necessary. However, it is in everyone's best interest to review their documents every five years or sooner, especially if there is a significant change in the law or their personal circumstances. No matter the state of the law, it is likely that a review of your plan will prove to be time and money well spent.