

# Akerman Practice Update

TRUSTS, ESTATES & FAMILY SERVICES

January 2010

## Estate Tax Repeal

For 10 years we told clients the exemptions for the estate tax and generation-skipping transfer (GST) tax would increase to \$3.5 million in 2009, and then in 2010 – voila! –the estate and GST taxes would be repealed, even if for only one year. We never thought Congress would let that happen so we always mentioned it with a little roll of the eyes.

Well, the unthinkable has happened. Congress could not agree on a compromise, so for 2010 only, the estate and GST taxes are not in effect, but the gift tax will continue with a \$1 million lifetime exemption. It sounds great -no more death taxes- but proceed with caution. Members of Congress have already stated they intend to introduce legislation to retroactively reinstate the taxes as of January 1. If no new law is enacted in 2010, the estate and GST tax law reverts to a \$1 million exemption and a 55% maximum rate in 2011.

So, how does the tax repeal affect your estate planning? In the words of Senate Finance Chair Max Baucus, “there is massive, massive confusion.” In light of this confusion we recommend everyone discuss their estate plan with their advisor and make any necessary revisions.

### Review Existing Estate Plan

Virtually all tax-oriented wills and trusts for married couples minimize taxes with a formula that uses the estate and GST tax exemptions in effect at death. That formula works fine when there is an estate tax exemption in place, but may not make sense if there is no estate tax at all. In other words, because the words used in estate plans derive their meaning from tax laws that are not in effect this year, it is unclear how those words will be interpreted. The following unintended consequences could occur:

- **Disinheritance of Spouse.** While most estate plans allow the surviving spouse to benefit from all of the couple’s assets, the plans of some clients may leave the entire tax exempt amount to children or other beneficiaries with the balance passing to the spouse. However, if there is no limit on the amount exempt from estate tax, the entire estate could bypass the spouse and create a windfall for the children. This is clearly an unintended result, but may occur upon a death in 2010 without changes to the documents;

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- **Disinheritance of Grandchildren.** Many clients set aside amounts for grandchildren based on the GST exemption, which may not exist if they die this year. So without a GST tax the grandchildren might be left with no distribution.

### Planning Opportunities Under Repeal?

While the absence of an estate and GST tax may seem like the perfect time to “do something,” each family’s situation will require analysis to determine what actions may be appropriate. While transfers to grandchildren or trusts for their benefit with no GST tax may be appealing to some, the threat of retroactive reenactment casts doubt on its ultimate success. And the “die now!” strategy first enunciated in the health care context by Congressman Alan Grayson, besides having the obvious requirement of actually dying, may not avoid estate and GST taxes if they are retroactively reinstated. Legal challenges to any retroactive legislation can be expected, but the Supreme Court has upheld such retroactive tax laws in the past.

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### Gift Tax

Remember that the gift tax remains in effect, so any gifts in excess of the remaining lifetime exemption will still be subject to gift tax at 35%. While this is a lower rate than in past years and will be lower than the 55% rate that may apply in 2011 and later years, few clients are willing to incur gift taxes now to avoid potential estate taxes in the future.

### Carryover Basis

With the removal of the estate and GST tax in 2010 we are faced with “carryover basis” for capital assets owned at death. Until this year, assets owned by a decedent received an income tax basis equal to date of death value so that capital gains accrued during lifetime were eliminated. In 2010 the decedent’s basis in assets and the accompanying potential capital gains will carry over to those who inherit the property, with upward basis adjustments of up to \$4.3 million in certain circumstances. But most estate plans are not drafted to take advantage of those adjustments since this is a new provision.

### Valuation Discounts

Congress has proposed legislation that would eliminate the ability to discount the value of gifts of interests in limited partnerships and other entities to family members. While we fully expect this change to be included with any new

estate tax law, many feel this provision will not be retroactive. So there may still be a limited window of opportunity to utilize such discounts as part of a family gifting program.

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With all of these changes, there has never been a better time to review your existing estate plan to be certain that, with the estate tax changes, it continues to deal with your assets at death in the manner you intend. If you have questions about whether or how these changes may impact your estate plan, please contact us.

“So, how does the tax repeal affect your estate planning?... we recommend everyone discuss their estate plan with their advisor and make any necessary revisions.”

<b>Richard Hurt</b>	407.423.4000	richard.hurt@akerman.com
<b>Steve Dunegan</b>	407.419.8575	stephen.dunegan@akerman.com
<b>Hank Raattama</b>	305.982.5656	hank.raattama@akerman.com
<b>Jeff Kern</b>	305.755.5805	jeff.kern@akerman.com
<b>William Kalish</b>	813.223.7333	william.kalish@akerman.com
<b>Vitauts M. “Vit” Gulbis</b>	813.209.5007	vit.gulbis@akerman.com
<b>Frank “Sandy” Rief</b>	813.209.5073	sandy.rief@akerman.com
<b>Drew LaGrande</b>	813.209.5063	drew.lagrande@akerman.com
<b>Gus Van Eepoel</b>	813.209.5066	august.vaneepoel@akerman.com
<b>Jeff Gad</b>	813.223.7333	jeffrey.gad@akerman.com

The summary set forth herein is intended to be general in nature and does not constitute legal advice with respect to any particular situation. No legal or business decision should be based solely on its contents.

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For more information, please contact a member of our Trusts, Estates & Family Services practice.

**Dallas**

600 North Pearl Street, Suite S1900  
Dallas, Texas 75201  
214.720.4300

**Denver**

511 Sixteenth Street, Suite 420  
Denver, CO 80202  
303.260.7712

**Ft. Lauderdale**

Las Olas Centre II  
350 East Las Olas Boulevard  
Suite 1600  
Ft. Lauderdale, FL 33301-2229  
954.463.2700

**Jacksonville**

50 North Laura Street, Suite 2500  
Jacksonville, FL 32202-3646  
904.798.3700

**Los Angeles**

725 South Figueroa Street, 38th Floor  
Los Angeles, CA 90017-5438  
213.688.9500

**Madison**

One South Pinckney Street  
Suite 700  
Madison, WI 53703  
608.257.5335

**Miami**

One Southeast Third Avenue  
25th Floor  
Miami, FL 33131-1714  
305.374.5600

**New York**

335 Madison Avenue, Suite 2600  
New York, NY 10017-4636  
212.880.3800

**Orlando**

CNL Center II at City Commons  
420 South Orange Avenue, Suite 1200  
Orlando, FL 32801-3336  
407.423.4000

**Tallahassee**

Highpoint Center, 12th Floor  
106 East College Avenue  
Tallahassee, FL 32301  
850.224.9634

**Tampa**

SunTrust Financial Centre  
401 East Jackson Street, Suite 1700  
Tampa, FL 33602-5250  
813.223.7333

**Tysons Corner**

8100 Boone Boulevard, Suite 700  
Vienna, VA 22182-2683  
703.790.8750

**Washington, D.C.**

The Victor Building  
750 9th Street, N.W., Suite 750  
Washington, DC 20001  
202.393.6222

**West Palm Beach**

Esperante Building  
222 Lakeview Avenue, Suite 400  
West Palm Beach, FL 33401-6183  
561.653.5000

[akerman.com](http://akerman.com)

