

# AN ESTATE TAX ALERT UPDATE

## 2010 ESTATE TAX REPEAL

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### REPORT FROM COUNSEL

#### **2010 FEDERAL ESTATE TAX AND GENERATION-SKIPPING TRANSFER TAX**

The first quarter of 2010 is over, the DOW is closing in on \$11,000, a healthcare bill has been passed providing 32 million uninsured Americans health insurance, yet we are still awaiting the necessary remedies to the federal estate tax system. Since the inception of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) Congress has failed to remedy the uncertainty of what would happen on January 1, 2010 when the federal estate tax and generation skipping transfer tax (GST) were repealed for a year. Although the repeal created a number of substantial benefits in 2010, there are a myriad of planning and administration problems associated with the 2010 federal death tax rules. What happens if Congress reenacts the prior tax rules, alters the 2011 rules or even worse, reenacts the prior tax rules retroactively to the beginning of this year.

#### ***EGTRRA:***

EGTRRA provided a number of estate and gift tax breaks by raising the unified credit

exemption amount incrementally to \$3.5 million in 2009, lowering the marginal federal tax rate from 55% to 45%, and providing a one year repeal of the estate tax and the GST tax in 2010. The increased unified credit allowed individuals to transfer a greater amount of assets tax free at death and lowered a decedent's estate tax bill.

***Benefits of 2010 Repeal of the Estate Tax and GST Tax:***

In 2010, EGTRRA crescendoed: it repealed the federal estate tax and GST tax, reduced the gift tax marginal tax rate to 35%, and altered the step up in basis rules. This is substantially beneficial for decedents who pass away in 2010 as property transferred in 2010 can escape the estate tax and GST tax. In 2010 it may also be beneficial to divert assets from a spouse and have them pass directly to children or grandchildren. It may also be beneficial to create generation skipping trusts for the benefit of grandchildren to avoid a hypothetical second layer of tax if the property is transferred from parent to child and then from child to grandchild. Further, gifting in 2010, may be beneficial by deferring a portion of gift taxes to a future period. If the marginal tax rate reverts back to 55% in 2011, one can obtain the 20% deferral (the difference between the 55% marginal tax rate and the current 35% gift tax rate) that will be paid at death or on a future gift. Thus, this does have substantial benefits, however, nothing in life is as good as it appears as outlined below.

***Basis Step Up Issues:***

With a repealed estate tax and GST tax, the original IRC § 1014 step up in basis is limited, meaning the death time beneficiaries of assets may be burdened with future income taxes arising from previously appreciated assets. This creates planning issues resulting in a nightmare for estate administration in 2010. Under § 1022, there is now a modified carryover basis meaning the basis step up is now limited to \$3 million for a spouse and \$1.3 million for non spousal beneficiaries. As a general rule, it is now best to allocate this to property that has appreciated substantially and would be subject to ordinary income tax rates of 35% as opposed to the current capital rates of 15%. Thus, if property, such as a family business, has substantial appreciation above these limits, the beneficiaries that receive such property will be forced to pay taxes on the appreciation at a future sale.

This creates further problems and issues about fairness of distributions among beneficiaries. An example would be a decedent having a \$3 million distributable estate that distributes \$1 million of cash to Child 1, \$1 million of capital assets with a basis of zero to Child 2, and \$1 million of non-capital assets with a basis of zero to Child 3. Under the new § 1022, only \$1.3 million of basis can be increased. Ideally, for tax purposes, it would be best to allocate \$1 million to the non-capital assets Child 2 receives and \$300,000 to the capital assets that Child 3 receives as it is best to allocate this to property that would be subject to ordinary income tax rates of 35% first and then to property taxed at current capital rates of 15%. However, this creates inequity for Child 3. He receives less than \$1 million as he will need to pay capital gains income taxes on \$700,000 of remaining appreciation (\$1 million FMV- \$300 thousand step up allocated) at a sale of the assets whereas Child 1 and Child 2 would not have any taxes to pay with a fully stepped up basis. Even if a proper allocation was made so the children receiving the capital and non-capital assets receive the same amount after tax, the child receiving cash will still receive more and this would be an inefficient use of the basis step up amounts. Under the original IRC § 1014, this problem does not exist as these assets will each have a basis of \$1 million at the decedent's death. The new rule may create family discord.

Last, the modified carryover basis rules create a nightmare for executors. To implement the new rule the executor must find proof of the basis for every asset the decedent owns or else it may be presumed at zero. What is the basis of an original oil painting that a relative gave you nearly two decades ago? This requires much unnecessary research and work to go through documents and receipts that may not be there. It increases the cost and complexity of estate administration. Under the original § 1014, this is avoided as everything is merely marked up to a FMV at the decedent's date of death.

***Future Planning and Current Document Modification Issues:***

In addition to the § 1022 modified carryover basis rules, there are many planning and administration issues relating to how Wills created under the non-2010 rules will be treated and what the estate tax will look like for the rest of the year as well as in 2011. Advanced Estate Planning techniques of using a marital trust and a residuary trust with clauses called "pecuniary" and "reverse pecuniary" clauses may be problematic. These were used to take into account that the unified credit amount changed from year to year in recent years, and allowed a trust to automatically account for changes in the unified credit. This is further complicated in that many clients use the non-marital/ residuary trust to immediately fund trusts for children after their death. Pecuniary clauses may bequeath the lowest amount to a marital trust to reduce estate taxes and place the rest in a residuary trust or reverse pecuniary clauses may place an amount equal to the unified credit exemption into a residuary trust and give the balance to a marital trust. Under the aforementioned first clause, \$0 will be placed in the marital trust as this is the lowest amount that would not raise federal estate taxes in 2010. This potentially may leave a widow with no funding as the residuary trust is for the children. Under the second clause, since there is no exemption amount, the residuary trust will receive \$0 and the marital trust tax will be overfunded at the expense of the children's trust. This can result in a misallocation of assets.

In addition, it is uncertain whether and how to modify such provisions as it is uncertain whether Congress will retroactively re-enact the estate tax and GST tax or what the estate tax will look like in 2011 and thereafter. In 2011, the estate tax and GST tax is to return, but with a marginal tax rate of 55%, a unified credit amount of \$1 million, and the old step up in basis rules under § 1014. Thus many of the administration and planning problems discussed above may be resolved then.

However, today it is uncertain whether to take advantage of the favorable GST or gift tax rules or to patch one's Will for one year. The benefits modifying a Will may be outweighed by the costs of modification. Many individuals are taking a wait and see approach as Congress may accelerate the 2011 rules, treat 2010 as under the 2009 rules, or any number of other possibilities. Further, it is uncertain whether Congress will apply these changes retroactively to January 1, 2010, so that transfers made in hopes of taking advantage of the 2010 rules will be now fully taxed at a higher rate. For example, if Congress makes the rules retroactive, then someone gifting large sums to take advantage of the lower marginal tax rate of 35% may now be forced to pay 55%. Someone making a direct skip usually subject to GST in other years may now be subject to an additional 55% GST under retroactive application.

Further, it may not be worth reviewing the costs of modifying a Will if you do not expect to die in 2010 or if Congress will eventually remedy the issues created by the 2010 rules. Thus, it is uncertain how to modify Wills and determining what Congress will do. It is like looking into a crystal ball especially where this crystal ball is an amalgamation of a compromise between many public and private interests. It may require the creation of many contingencies in a Will

based on Congress' actions which may be expensive and futile as no one can see into the future of what Congress may do.

### **Conclusion**

In summary, the repeal of the estate tax and GST tax may appear to be beneficial on the surface. However, by allowing these issues to sit and die like an unattended patient in the hospital emergency room while an insured patient receives immediate medical attention, Congress has created a number of estate administration and planning issues for both the client and professionals involved in estate planning and administration. By not remedying this, Congress has placed yet another burden of uncertainty on the same individuals who have created much of the wealth and jobs for this country. If you feel strongly that these rules should be remedied immediately as millions of people are in limbo waiting to see what changes and actions will be taken, please write your local Congressional representative asking for immediate action to be taken. Our focus now needs to be on jobs, closely held businesses, and taxes. A list of representatives is below.

### **Pennsylvania:**

<b>Senator/Representative</b>	<b>Phone Number</b>	<b>Fax Number</b>	<b>Email/Webmail Address</b>
<a href="#"><u>Senator Arlen Specter (D- PA)</u></a>	202-224-4254	202-228-1229	<a href="mailto:senator_specter@specter.senate.gov"><u>senator_specter@specter.senate.gov</u></a>
<a href="#"><u>Senator Robert P. Casey, Jr. (D- PA)</u></a>	202-224-6324	202-228-0604	<a href="http://casey.senate.gov/contact/"><u>http://casey.senate.gov/contact/</u></a>
<a href="#"><u>Representative Robert Brady (D - 01)</u></a>	202-225-4731	202-225-0088	<a href="http://www.house.gov/formrobertbrady/issue.htm"><u>http://www.house.gov/formrobertbrady/issue.htm</u></a>
<a href="#"><u>Representative Chaka Fattah (D - 02)</u></a>	202-225-4001	202-225-5392	<a href="http://fattah.house.gov/index.cfm?sectionid=8&amp;sectiontree=8"><u>http://fattah.house.gov/index.cfm?sectionid=8&amp;sectiontree=8</u></a>
<a href="#"><u>Representative Kathy Dahlkemper (D - 03)</u></a>	202-225-5406	202-225-3103	<a href="https://forms.house.gov/dahlkemper/webforms/issue_subscribe.htm"><u>https://forms.house.gov/dahlkemper/webforms/issue_subscribe.htm</u></a>
<a href="#"><u>Representative Jason Altmire (D - 04)</u></a>	202-225-2565	202-226-2274	<a href="https://forms.house.gov/altmire/webforms/issue_subscribe.htm"><u>https://forms.house.gov/altmire/webforms/issue_subscribe.htm</u></a>
<a href="#"><u>Representative Glenn Thompson (GT) Thompson (R - 05)</u></a>	202-225-5121	202-225-5796	<a href="https://forms.house.gov/thompson/contact-form.shtml"><u>https://forms.house.gov/thompson/contact-form.shtml</u></a>
<a href="#"><u>Representative Jim Gerlach (R - 06)</u></a>	202-225-4315	202-225-8440	<a href="https://writerep.house.gov/writerep/welcome.shtml"><u>https://writerep.house.gov/writerep/welcome.shtml</u></a>

<a href="#">Representative Joe Sestak (D - 07)</a>	202-225-2011	202-226-0280	<a href="https://forms.house.gov/sestak/webforms/issue_subscribe.htm">https://forms.house.gov/sestak/webforms/issue_subscribe.htm</a>
<a href="#">Representative Patrick J. Murphy (D - 08)</a>	202-225-4276	202-225-9511	<a href="http://www.patrickmurphy.house.gov/index.php?option=com_content&amp;task=view&amp;id=55&amp;Itemid=86">http://www.patrickmurphy.house.gov/index.php?option=com_content&amp;task=view&amp;id=55&amp;Itemid=86</a>
<a href="#">Representative Bill Shuster (R - 09)</a>	202-225-2431	202-225-2486	<a href="http://www.house.gov/shuster/zipauth.htm">http://www.house.gov/shuster/zipauth.htm</a>
<a href="#">Representative Christopher P. Carney (D - 10)</a>	202-225-3731	202-225-9594	<a href="http://carney.house.gov/contact.shtml">http://carney.house.gov/contact.shtml</a>
<a href="#">Representative Paul E. Kanjorski (D - 11)</a>	202-225-6511	202-225-0764	<a href="mailto:paul.kanjorski@mail.house.gov">paul.kanjorski@mail.house.gov</a>
<a href="#">Representative Vacant (- 12)</a>	202-225-2065	202-225-5709	None Currently Available
<a href="#">Representative Allyson Y. Schwartz (D - 13)</a>	202-225-6111	202-226-0611	<a href="http://schwartz.house.gov/issue_subscribe.shtml">http://schwartz.house.gov/issue_subscribe.shtml</a>
<a href="#">Representative Mike Doyle (D - 14)</a>	202-225-2135	202-225-3084	<a href="mailto:rep.doyle@mail.house.gov">rep.doyle@mail.house.gov</a>
<a href="#">Representative Charlie Dent (R - 15)</a>	202-225-6411	202-226-0778	<a href="https://dent.house.gov/?p=ContactForm">https://dent.house.gov/?p=ContactForm</a>
<a href="#">Representative Joe Pitts (R - 16)</a>	202-225-2411	202-225-2013	<a href="mailto:pitts.pa16@mail.house.gov">pitts.pa16@mail.house.gov</a>
<a href="#">Representative Tim Holden (D - 17)</a>	202-225-5546	202-226-0996	<a href="http://holden.house.gov/contactform_zipcheck.shtml">http://holden.house.gov/contactform_zipcheck.shtml</a>
<a href="#">Representative Tim Murphy (R - 18)</a>	202-225-2301	202-225-1844	<a href="http://murphy.house.gov/index.cfm?sectionid=7&amp;sectiontree=47">http://murphy.house.gov/index.cfm?sectionid=7&amp;sectiontree=47</a>
<a href="#">Representative Todd Russell Platts (R - 19)</a>	202-225-5836	202-226-1000	<a href="http://www.house.gov/platts/email.shtml">http://www.house.gov/platts/email.shtml</a>
<b><u>New Jersey:</u></b>			
<b>Senator/Representative</b>	<b>Phone</b>	<b>Fax</b>	<b>Email/Webmail Address</b>

	<b>Number</b>	<b>Number</b>	
<a href="#">Senator Frank R. Lautenberg (D- NJ)</a>	202-224-3224	202-228-4054	<a href="mailto:Frank_Lautenberg@Lautenberg.senate.gov">Frank_Lautenberg@Lautenberg.senate.gov</a>
<a href="#">Senator Robert Menendez (D- NJ)</a>	202-224-4744	202-228-2197	<a href="http://menendez.senate.gov/contact/">http://menendez.senate.gov/contact/</a>
<a href="#">Representative Robert E. Andrews (D - 01)</a>	202-225-6501	202-225-6583	<a href="http://www.house.gov/andrews/contact_form_za.shtml">http://www.house.gov/andrews/contact_form_za.shtml</a>
<a href="#">Representative Frank A. LoBiondo (R - 02)</a>	202-225-6572	202-225-3318	<a href="mailto:lobiondo@mail.house.gov">lobiondo@mail.house.gov</a>
<a href="#">Representative John Adler (D - 03)</a>	202-225-4765	202-225-0778	<a href="http://forms.house.gov/adler/webforms/issue_subscribe.htm">http://forms.house.gov/adler/webforms/issue_subscribe.htm</a>
<a href="#">Representative Chris H. Smith (R - 04)</a>	202-225-3765	202-225-7768	<a href="http://chrissmith.house.gov/zipauth.html">http://chrissmith.house.gov/zipauth.html</a>
<a href="#">Representative Scott Garrett (R - 05)</a>	202-225-4465	202-225-9048	<a href="http://garrett.house.gov/Contact/">http://garrett.house.gov/Contact/</a>
<a href="#">Representative Frank Pallone, Jr. (D - 06)</a>	202-225-4671	202-225-9665	<a href="http://www.house.gov/pallone/contact.shtml">http://www.house.gov/pallone/contact.shtml</a>
<a href="#">Representative Leonard Lance (R - 07)</a>	202-225-5361	202-225-9460	<a href="http://lance.house.gov/index.cfm?sectionid=48&amp;sectiontree=348">http://lance.house.gov/index.cfm?sectionid=48&amp;sectiontree=348</a>
<a href="#">Representative Bill Pascrell, Jr. (D - 08)</a>	202-225-5751	202-225-5782	<a href="http://pascrell.house.gov/contact/">http://pascrell.house.gov/contact/</a>
<a href="#">Representative Steve Rothman (D - 09)</a>	202-225-5061	202-225-5851	<a href="mailto:steven.rothman@mail.house.gov">steven.rothman@mail.house.gov</a>
<a href="#">Representative Donald M. Payne (D - 10)</a>	202-225-3436	202-225-4160	<a href="http://www.house.gov/payne/TMA/email.shtml">http://www.house.gov/payne/TMA/email.shtml</a>
<a href="#">Representative Rodney Frelinghuysen (R - 11)</a>	202-225-5034	202-225-3186	<a href="mailto:rodney.frelinghuysen@mail.house.gov">rodney.frelinghuysen@mail.house.gov</a>
<a href="#">Representative Rush Holt (D - 12)</a>	202-225-5801	202-225-6025	<a href="mailto:rush.holt@mail.house.gov">rush.holt@mail.house.gov</a>
<a href="#">Representative Albio Sires (D - 13)</a>	202-225-	202-226-	<a href="https://forms.house.gov/sires/webforms/issue">https://forms.house.gov/sires/webforms/issue</a>

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***“A GRAYING POPULATION: ESTATE PLANNING FOR THE AGING MIDDLE CLASS SUBURBAN CLIENT”*** presented by ***JOSEPH R. POZZUOLO, ESQUIRE AND LISA A. LEGGIERI, ESQUIRE*** on ***FRIDAY, MAY 7, 2010 AT NEUMANN UNIVERSITY***

***“CURRENT TRENDS IN EMPLOYMENT LAW: DISCRIMINATION THROUGH THE FAMILY MEDICAL LEAVE ACT”*** presented by ***JUDITH P. RODDEN, ESQUIRE AND LESLEY M. IBANEZ, ESQUIRE*** on ***FRIDAY, MAY 13, 2010 AT NEUMANN UNIVERSITY.***

***“HOW TO INTEGRATE AN ESTATE PLAN FOR SUCCESSION PLANNING FOR A SUBURBAN CLOSELY HELD BUSINESS INCLUDING ETHICS”*** presented by ***JOSEPH R. POZZUOLO, ESQUIRE AND JEFFREY H. SMITH, ESQUIRE*** on ***FRIDAY, MAY 21, 2010 AT NEUMANN UNIVERSITY***

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