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CHAPTER 1

Congress Plays 'The Guessing Game' with the Estate Tax Laws

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The law signed on June 7, 2001, by President George W. Bush—the Economic Growth and Tax Relief Reconciliation Act of 2001 (Tax Relief Act–2001)—remains the largest tax cut in over 20 years and significantly reduced or eliminated death taxes for millions of American's while substantially increasing the allowed contributions to various retirement plans.

Unfortunately, the Tax Relief Act–2001 has a sunset provision, which means that unless Congress extends this tax law, or makes it permanent, it will revert back to the old law on January 1, 2011. In fact, the Tax Relief Act–2001 provided for the elimination of estate taxes altogether beginning January 1, 2010. Obviously, Congress has no intention of allowing this to happen but their preoccupation with passing healthcare reform distracted them from focusing on estate tax law changes.

Cautionary Note

Prior to the 2009 trillion dollar-plus deficit, both Democrats and Republicans had arrived at a consensus opinion that the estate tax exemption (the size estate you can own before you are subject to death taxes) should be set at $3.5 million dollars and then indexed for inflation. The combination of focusing on passing healthcare reform and the almost incomprehensible rising national debt has now left the final decisions regarding new estate tax rules up in the air. In preparing this updated book revision, the author's chose optimism and we have therefore assumed that Congress will settle on a $3.5 million exemption. So, as

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you review our examples throughout this book, note that we are using $3.5 million as the size estate you can own before your estate is subject to death taxes.

As of the date of this book revision (October 2009), we expect Congress to react within a range of possibilities:

- Before the end of 2009, Congress will likely extend the current estate tax exemption for one year. Meaning that for 2010, the estate tax exemption will remain $3.5 million. We believe there is no chance they will do nothing and allow estate taxes to be zero (as scheduled under the current law). What if Donald and Melania Trump died? Instead of receiving billions in death taxes, the federal government would receive nothing! And think of all the wealthy people who are in hospitals on life support. Avoiding millions in estate taxes would give a whole new meaning to 'Pull the Plug'!
- Extending the 2009 estate tax limits will buy Congress time to focus on this issue, which will likely be one of the top campaign issues of the 2010 mid-term elections. Politicians running for re-election are likely to feel the pressure of cross-currents of voting in favor of a law that helps the rich avoid taxes (i.e. keeping the estate tax exemption at $3.5 million) versus doing nothing and allowing the current law to 'sunset' on December 31, 2010, which will cause millions of middle-class Americans to be subject to death taxes. The result would be that anyone dying with an estate exceeding $1 million, could be subject to death taxes as high as 55% on the excess. Many middle-class families who own a home and have adequate life insurance will quickly become subject to death taxes.

Whatever Congress finally decides, we'll keep you well informed. For the most up-to-date details on estate tax law changes, go to www.jklasser.com.

Retirement Savings and Pension Reform

Tax Relief Act–2001 provided for significant increases in contribution limits to various types of retirement plans. Below are current provisions and contribution limits for some of the more common retirement plans.

Traditional Individual Retirement Accounts and Roth Individual Retirement Accounts

Qualifying taxpayers can deduct $5,000 annually for Traditional IRAs. If you are age 50 or older, the law provides for a catch-up provision, allowing additional contributions of up to $1,000 per year. The purpose of the catch-up provision is to allow individuals to make up for missed retirement savings opportunities earlier in life. Table 1.1 illustrates the contribution limits for 2010.

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TABLE 1.1 Traditional IRA and Roth IRA Contribution Limits

Year	Maximum Contribution under Age 50	Additional Contribution under Catch-up Provision[1]
2010	$5,000	$1,000 (catch-up)

[1] For eligible individuals age 50 and older.

Unfortunately, income-based eligibility apply to both the Traditional IRA and the Roth IRA. For a refresher on these rules, review Table 1.2. Also, don't forget that alimony is considered earned income for the purpose of eligibility for contributions to both the Traditional IRA and the Roth IRA.

Employer-Provided Retirement Plans

The Tax Relief Act–2001 provided significant expansion of allowable contributions and rules to employer provided retirement plans. The types of plans covered include: 401(k), 403(b), SIMPLE (Savings Incentive Match Plan for Employees), and 457 plans. Table 1.3 provides a summary of the contribution limitations for these type of plans.

If you are age 50 or older you have an opportunity to contribute even more to these plans based on catch-up provisions. Table 1.4 illustrates your maximum contribution limits.

Eligible retirement plans offer employees the ability to make voluntary contributions into a separate account for their Traditional IRA and Roth IRA. We expect this to remain a popular feature, but a word of caution is in order. The primary advantage of this feature is that your contributions are made through payroll deduction. The disadvantage is that you will likely be limited to the investment choices currently available through your plan. Contrast this with your ability to open your IRA, for example, through a discount broker such as Charles Schwab and Company, where you would have access to over 5,000 mutual funds as well as individual stocks, bonds, and so forth. Generally, the

TABLE 1.2 Expected Adjusted Gross Income (AGI) Limitations for Deductible Contributions for 2010

	Traditional IRA	Roth IRA
Single	$55,000–$65,000	$105,000–$120,000
Head of Household	$55,000–$65,000	$105,000–$120,000
Married-Filing Separately	$0–$10,000	$0–$10,000
Married-Filing Jointly	$89,000–$109,000	$166,000–$176,000
Non-working Spouse[1]	$156,000–$176,000	$166,000–$176,000

[1] This AGI phase-out of deductibility limitations apply to nonworking spouses whose working spouse is an active participant in an employer-sponsored retirement plan.

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TABLE 1.3 Expected Contribution Limitations for Certain Contributory Retirement Plans for 2010

Year	401(k); 403(b) Plans	SIMPLE Plans	457 Plans
2010	$16,500	$15,000	$16,500

better choice will be to maintain control of your IRA outside of your company's retirement plan.

The Tax Relief Act–2001 provided additional incentives for low-income taxpayers to contribute to their retirement plan [401(k), 403(b), 457(b), Traditional IRA, or Roth IRA] by providing tax credits for contributions, but the Pension Protection Act of 2006 made it permanent. For those who are eligible, this is an excellent opportunity to get Uncle Sam to pay a portion of your retirement plan contribution. This credit would be claimed on the individual's tax return. Table 1.5 outlines how the tax credit works.

An interesting option provided under the Tax Relief Act–2001 permits employers to add a feature that allows employees to elect Roth status for all or part of their contributions to their employer's 401(k) or 403(b) plan. This means that your contribution would be includable as income, but future distributions would be tax-free.

The Tax Relief Act–2001 raised the ceiling on the total dollar contributions for profit-sharing plans, money purchase pension plans, and contributory plans such as the 401(k). For 2009 and 2010, the limit is $49,000. Future years contribution limits are indexed for inflation.

Marginal Tax Rates

The Tax Relief Act–2001 increased the number of tax brackets from five to six by introducing a 10 percent tax bracket to replace a portion of the current 15 percent bracket. The law then reduced the 28, 31, 36, and 39.6 percent brackets over six years to 25, 28, 33, and 35 percent, respectively. The Obama

TABLE 1.4 The "Catch-up" Provisions: Retirement Plan Contribution Limits for Plan Participants Age 50 and Older (amounts described include base contribution, plus "catch up" contribution)

Year	401(k); 403(b); 457(b) Plans	SIMPLE Plans
2009	$22,000	$14,000
2010	Indexed[1]	Indexed[1]

[1] Indexing is based on allowable contributions excluding any catch-up contributions. See Table 1.3.

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TABLE 1.5 Tax Credit for Low-Income Taxpayers Contributing to a 401(k), 403(b), 457(b), Traditional IRA, or Roth IRA

	Adjusted Gross Income (AGI)		
Credit %[1]	Single and Married–Filing Separate	Head of Household	Joint
50	up to $15,500	up to $23,250	up to $31,000
20	$15,501–$17,000	$23,251–$25,500	$31,001–$34,000
10	$17,001–$26,000	$25,501–$39,000	$34,001–$52,000

Example: Jim's employment income is $25,000 per year and his wife, Janice, is a stay-at-home mom. They decide to contribute $2,000 to an IRA. Because their adjusted gross income is less than $31,000, they will receive a $1,000 tax credit. This tax credit will offset dollar-for-dollar $1,000 of earned income.

[1] Credit applies to the first $2,000 of contribution.

Administration has pledged no new taxes on middle-class Americans while promising greater tax relief for poor Americans. Clearly, the government will need additional tax dollars to tackle an $11 trillion national debt that continues to rise at an alarming rate. If, as the Obama Administration promises, that tax burden will be born only by families with incomes exceeding $250,000 it's hard to imagine how this small group of taxpayers can pay enough taxes to adequately address the problem. Our best guess is higher tax rates on a broader base of taxpayers. See Table 1.6 for a complete review of the schedule for joint and single tax filers.

Although the Jobs and Growth Act–2003 accelerated the income tax marginal rate reductions, all of the rate reductions are subject to the Tax Relief Act–2001 sunset provision, which would return the rates to 15, 28, 31, 36, and 39.6 percent after 2010 unless Congress takes some affirmative action.

TABLE 1.6 Schedule of Reduction of Individual Income Tax Rates (bracket cut-off amounts could slightly change in 2010)

Year	$0–$16,700	$16,701–$67,900	$67,901–$137,050	$137,051–$208,850	$208,851–$372,950	$372,951+
Joint Filers						
2009–2010	10%	15%	25%	28%	33%	35%
Year	$0–$8,350	$8,351–$33,950	$33,951–$82,250	$82,251–$171,550	$171,551–$372,950	$372,951+
Single Filers						
2009–2010	10%	15%	25%	28%	33%	35%

Tip

Use these lower rates as an opportunity to increase your contributions to your company's retirement plan. When it's time to retire, you'll be glad to have the additional money in your account.

Education Funding Incentives

Saving and paying for educational costs became a lot easier under the Tax Relief Act–2001. The act made significant modifications to both Education IRAs and Section 529 plans. What follows is an overview of both plans.

Education IRA

Under prior law, you could make a nondeductible contribution of up to $500 per year to an Education IRA, more commonly known as Coverdell Education Savings Accounts. Your earnings grew tax-free and the distributions, when used for qualified educational expenses, were taxed at the student beneficiary's tax bracket. While this Education IRA was beneficial, it was only a partial solution to the problem of funding today's education costs.

With the passage of the Tax Relief Act–2001, Congress took a giant step toward providing real assistance in reducing the costs of education. The most significant provisions included the following:

- Increased the contribution limits from $500 per year to $2,000 per year.
- Provided that distributions, when used to pay for qualified education expenses, would be tax-free.
- Allowed tax-free withdrawals for elementary (including kindergarten) and secondary public, private, and religious school tuition and expenses.
- Included tuition, room and board, tutoring, uniforms, extended day program costs, computer technology hardware and software, Internet access, and special needs services for special needs beneficiary as qualifying expenses.
- Allowed HOPE Scholarship Credit and Lifetime Learning Credit for other expenses.
- Extended the time in which the contribution can be made to April 15 of the following tax year.
- Your ability to contribute to an Education IRA is phased out above certain income levels. The Tax Relief Act–2001 increased the phase-out range for joint filers with adjusted gross income (AGI) of $190,000–$220,000. The phase-out range for single tax filers is AGI of $95,000–$110,000, the same as the prior law.

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- Repealed the excise tax when a contribution to an Education IRA is made in the same year as a contribution to a qualified tuition plan for the same beneficiary.

This enhanced Education IRA provided—and still provides—significant incentives to prefund education expenses. However, the $2,000 contribution amount is scheduled to drop to $500 after 2010. Unless the law is changed before that time, it is expected that Education IRAs will be a less attractive way to save for college expenses.

Tip

If you would like to make a contribution to an Education IRA for your child but does not qualify because your AGI is too high, consider having your child contribute to his or her own account. Unlike other IRAs, a person does not have to have earned income to contribute to an Education IRA nor is there a minimum age requirement.

Section 529 Plans

Section 529 plans (also referred to as qualified tuition plans) received a dramatic boost under the Tax Relief Act–2001. Because of the importance of these programs in both funding the costs of higher education and estate planning, they will be covered in detail in this section.

WHAT IS A SECTION 529 PLAN?

A Section 529 plan is a program that allows individuals to (1) purchase tuition credits or certificates on behalf of a designated beneficiary, entitling the beneficiary to a waiver or payment of the beneficiary's higher education expenses; or (2) make contributions to an account that is established for the sole purpose of meeting qualified higher education expenses of the designated beneficiary of the account.

PLAN CONTRIBUTIONS

A Section 529 plan may only accept contributions in the form of cash and not in property. However, a Section 529 plan may accept payment by check, money order, credit card, or other similar methods.

There are no limits as to the amount of money that can be contributed to a Section 529 plan (unless limited by the plan sponsor); however, there are penalties for distributions not used for qualified education expenses. Most important, unlike the Education IRA, there are no income phase-out rules that prevent high-income taxpayers from contributing to a Section 529 plan.

TAX-FREE GROWTH

Earnings in a Section 529 plan grow tax deferred until distributions are made, at which time the distributions are tax-free if used to pay qualified education expenses. For example, suppose you and your spouse contributed $100,000 to a Section 529 plan on behalf of a one-year-old grandchild. This $100,000 would grow tax-free until such time as it is distributed for higher education expenses, presumably beginning at the child's age 18. If your plan sponsor averaged a 9 percent return, the account value would exceed $400,000 by the time you are ready to begin drawing funds for your grandchild's college. When the funds are then used to pay for qualified education expenses, there will be no income taxes due on those distributions. Qualified higher education expenses include tuition, books, supplies, equipment, fees, expenses for special needs services, and room and board (within certain limits). The amount of qualified higher education expenses is reduced by scholarships and amounts paid by the beneficiary or others that qualify for the HOPE Scholarship or Lifetime Learning Credits.

Tip

If you are currently using a Uniform Gift to Minors Account (UGMA) or a Uniform Transfer to Minors Account (UTMA) as a funding vehicle for your child's education, consider the Section 529 plan or an Education IRA instead. By doing so, you'll not only avoid current taxation on earnings (remember the so-called kiddie tax?), but distributions used for education expenses will be tax-free.

PENALTIES ON NONQUALIFIED DISTRIBUTIONS

If distributions from a Section 529 plan are not used for qualified education expenses, a 10 percent penalty is imposed on the recipient of the funds. In addition, the *earnings portion* of the distribution is subject to ordinary income taxes. Usually, the tax will be triggered when distributions exceed the educational expenses of the designated beneficiary. According to some states' plans, any funds not distributed prior to the beneficiary attaining the age of 30 will be deemed a nonqualifying distribution (some exceptions apply for a special needs beneficiary). Exceptions to this penalty apply for payments made due to the beneficiary's death, disability, or receipt of a scholarship.

INVESTMENT OPTIONS

One potential downside of Section 529 plans is that you are unable to direct the investments of the plan. The investment accounts are operated as blind pools where you have no input over specific investment decisions. Most plan sponsors do, however, indicate the general investment approach they use. Often, contributors have the ability to select from a variety of investment strategies, with some Section 529 plans offering as many as 10 options. An important feature

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added under the Tax Relief Act–2001 is the ability to switch from one state-sponsored program to another every 12 months. This significantly increases your ability to change your broad investment strategy to meet your particular needs.

GIFT TAX CONSEQUENCES

A contribution to a Section 529 plan is considered a completed gift from the account owner to the designated beneficiary at the time of the contribution and is thus eligible for the annual gift tax exclusion (currently $13,000 or $26,000 in the case of a joint gift by spouses). If the contribution exceeds the annual gift tax exclusion, the amount not exceeding five times the current annual exclusion may be applied pro rata to annual exclusions over five years.

For example, you could make an initial contribution of $65,000 for each designated beneficiary without incurring gift tax liability for the contribution. The $65,000 contribution would be treated as if you made a $13,000 contribution in each of the next five years. Note that this presumes that no other gifts are made to the beneficiary during this five-year period. Any additional gifts would be subject to gift taxes. However, because the annual exclusion amount is indexed for inflation, this amount could increase in future years. Married couples can join together in making gifts, thus increasing the potential contribution to $130,000 without incurring gift taxes.

ESTATE TAX CONSEQUENCES

Even though the donor retains the right to change the designated beneficiary (to another member of the donor's family) and to receive distributions from the account if no other person is designated, funds invested in the Section 529 plan are not included in the donor's gross estate unless the funds are in fact returned to the donor. Thus, once you contribute an amount to a Section 529 plan, that amount is out of your estate(s), as is the future appreciation on that amount. However, if a contribution exceeding the annual exclusion is applied pro rata to the annual exclusion over five years but the donor dies before the fifth year, that portion of the contribution that has not yet been applied to the annual exclusion for the years following the donor's death will be included in the donor's estate.

For example, suppose Mr. Leonard contributes $65,000 to a Section 529 plan and elects to have this applied pro rata over the next five years to the annual exclusion. Furthermore, assume Mr. Leonard passes away in the fourth year following the contribution. The amount of the annual exclusion to be applied in the fifth year ($13,000) would be brought back into Mr. Leonard's estate.

COORDINATION WITH THE HOPE SCHOLARSHIP AND LIFETIME LEARNING CREDITS

Taxpayers will be able to use HOPE Scholarship and Lifetime Learning Credits during the same year distributions are taken for a Section 529 plan as long as the monies are used for different qualified education expenses. In other words,

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you cannot claim the HOPE Scholarship Credit for room and board and then use Section 529 funds to pay for room and board.

Tip

Creditor Protection for Section 529 Plans?

Funds held in a Section 529 plan may be subject to the claims of creditors and divorce proceedings. Typically, state law will prevail. If you are concerned about creditor protection, consider using a Section 529 plan sponsored by a state that has strong creditor protection laws.

For more information on Section 529 plans go to the Resource Center at www.welchgroup.com; then click on 'Links'.

SOME FINAL THOUGHTS ON SECTION 529 PLANS

Note that under the Section 529 plan, you are able to change your beneficiary. This is important because one child may choose not to attend college or may attend a relatively inexpensive college while another child may attend a very expensive college. A Section 529 plan allows you to move your funds around as needed. The Tax Relief Act–2001 included "cousins" in the definition of family member. However, be sure to check the applicable plan's rules and restrictions for changing beneficiaries.

Tax Relief Act–2001—Miscellaneous Provisions Relating to Education

Several other provisions of the Tax Relief Act–2001 are worth noting:

- Employers are now allowed to offer education assistance programs providing up to $5,250 per year for an employee. The payment is deductible by the employer and not includable in the income of the employee. Undergraduate and graduate courses qualify, and the courses do not have to be related to the employee's job-related field.
- The new law loosened the requirements for deductibility of student loan interest.

The Jobs and Growth Act–2003 provided significant capital gains tax relief. The law immediately dropped the maximum net capital gains rate by 5 percentage points from 20 percent to 15 percent. The 10 percent capital gains rate for lower-income taxpayers fell to 5 percent. The lower rates are expected to continue through December 31, 2010, at which time the 'sunset' provision of the Tax Act–2001 provides for capital gains taxes to revert back to 20%.

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Tip

Review all assets where you have a long-term capital gain to determine if it is advisable to sell before the current capital gains tax (15% federal) reverts back to the old capital gains tax rate of 20% (January 1, 2011).

The Jobs and Growth Act–2003 also provided significant tax relief for certain dividends from domestic or qualified foreign corporations. Such dividends received are now taxed at a 15 percent rate. This special rate terminates on December 31, 2010, and the pre–Jobs and Growth Tax Act rates return in January of 2011. A tax advisor should be consulted to determine whether a dividend qualifies for the lower tax treatment.

Business and Corporate Tax Relief

The Jobs and Growth Act–2003 provided certain business and corporate tax relief. For business property placed in service in 2009, the business taxpayer can immediately deduct (rather than depreciate) up to $250,000 in qualified property placed in service for the year under Section 179 of the Internal Revenue Code.

For certain new property (instead of used property that may be new to the business), there may be an available 50 percent bonus depreciation depending on the type of property involved. This deduction is scheduled to end after 2009, except for certain property, which will remain eligible until the end of 2010.

Estate, Gift, and Generation-Skipping Transfers

The Tax Relief Act–2001 provides some relief from the death tax imposed on estates of individuals who have paid taxes their entire lives. Although the estate and generation-skipping taxes are repealed in 2010, the repeal is not permanent. This uncertainty creates planning problems that we will address in this book. To accentuate the problem the new law presents for planners, see if you can answer the question in the next box.

Under the Tax Relief Act–2001, what amount of federal estate tax will be owed on an estate of $5,000,000?

- **a. $675,000**
- **b. $0**
- **c. $2,045,000**

TABLE 1.7 Potential Estate (Death) Tax Savings under Tax Relief Act–2001 as Compared to Death in 2011

	$5 Million Estate	$10 Million Estate	$20 Million Estate	$50 Million Estate	$100 Million Estate
2010 tax	$0	$1,350,000	$5,850,000	$19,350,000	$41,850,000
2011 tax	$1,997,000	$4,549,000	$10,408,200	$26,453,750	$54,408,200
Savings	$1,997,000	$3,199,000	$4,558,200	$7,103,750	$12,558,200

Please note that estimated tax liability stems from joint estate tax liability of husband and wife, assuming first spouse to die sheltered maximum credit amount available. The 2011 data assumes Congress allows the Tax Relief Act–2001 to 'sunset' and revert back to prior tax law.

Give up? The answer is that all three answers are correct! The first answer, *a*, is correct if you die in 2010 (assuming the $3.5 million exemption is extended by Congress); *b* is correct if you die in 2010 (the estate tax is repealed for *one* year!); and *c* is correct if you die in 2011. We hope you are beginning to see the importance of carefully developing your estate plan.

Please don't misunderstand. The Tax Relief Act–2001 does provide potentially significant tax relief, assuming that death occurs prior to January 1, 2011. Table 1.7 illustrates the estate tax savings under current law versus what taxes will be if the current law reverts to prior law on January 1, 2011 under the sunset provision.

Following is a list of select provisions that could affect your estate planning:

- The tax law lowered the maximum estate, gift, and generation-skipping tax rates, and it raised the amount of assets that are not subject to estate taxes (applicable exclusion amount). Table 1.8 outlines the applicable exclusion amount and the estate tax rates based on current law as of October 2009.
- Although the new tax law repealed the estate and generation-skipping taxes in 2010, *the gift tax will remain in effect with a $1,000,000 unified credit effective exemption amount* unless Congress changes the law. The highest gift tax rate will equal the highest income tax rate then in effect. As a result, family gifting plans may need to be adjusted.

TABLE 1.8 Tax Relief Act–2001 Applicable Exclusion Amount

Year	Applicable Exclusion Amount	Maximum Estate Tax Rate (%)
2009	$3,500,000	45
2010[1]	Estate tax repealed	0
2011	$1,000,000[2]	55

[1] Congress is likely to extend the 2009 exemption limits through 2010.
[2] Tax Relief Act–2001 is automatically repealed unless Congress extends the law.

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- Under prior law and under the Tax Relief Act–2001 for calendar years 2005–2009, a decedent's heirs receive a new tax basis (called a *step-up basis*) in property received from the decedent equal to the property's fair market value as of the date of death (or six months after the date of death if elected by the executor). As a result, if the property has appreciated, the heirs can sell the property shortly after the decedent's death without recognizing taxable gain. Under the Tax Relief Act–2001, *for calendar year 2010, heirs will not receive a new tax basis, regardless of when assets were purchased* unless Congress takes action. Instead, with limited exceptions, heirs will take the property subject to the decedent's old tax basis, which could result in the heirs recognizing taxable gain when and if the property is sold. However, due to two exceptions to this new rule, some taxable gain will be avoidable. First, $1,300,000 worth of certain assets can receive a new, fair market value basis. Second, the estate can increase the basis of an additional $3,000,000 worth of certain assets transferred to a surviving spouse. *As a result, it is critically important that taxpayers begin compiling accurate records to document the income tax basis of their property. These records will determine future generations' income tax liability*.
- Additionally, accurate tax basis records must be kept beginning in 2010 because a decedent's personal representative and/or trustee will be required to report detailed information to the Internal Revenue Service (IRS) of transfers at death in excess of $1.3 million and for certain transfers of appreciated property. Noncompliance will result in financial penalties.
- Although the tax law repeals the estate and generation-skipping taxes in 2010, the law also allows the Tax Relief Act–2001 to automatically "sunset" after December 31, 2010. In effect, the tax law repeals the estate tax and the generation-skipping tax for one year—2010. Due to budgetary restrictions, the law allows the estate tax rules, rates, and exemptions in effect prior to passage of the Tax Relief Act–2001 to come back in force in 2011. In 2010, Congress can choose to do nothing and thereby impose a new level of taxes on millions of Americans included the middle-class by allowing the law to revert to pre-Tax Relief-2001 tax law or they can proactively make changes such as fixing the estate exemption amount at $3.5 million.

Table 1.9 provides a summary of the changes under Tax Relief Act–2001.

Estate Planning Issues under the Tax Relief Act–2001

Because of the uncertainty surrounding the current status of the estate tax laws, everyone with a net worth of more than $1,000,000 should review their estate plan. An approach we favor is for the client to contact one of their professional advisors on the estate planning team, whether the estate planning

TABLE 1.9 Applicable Exclusion Amount

Year	Exclusion Amount (Death)	Exclusion Amount (Gifts)	Compared to 'Old Law' under the Sunset Rules. Old Law Exclusion Amount	Increase from Previous Amount (Death)	Increase from Previous Amount (Gift)	Tax Rate Reductions (%)
2009	$3,500,000	$1,000,000	$1,000,000	$2,500,000	0	45
2010[1]	100%	$1,000,000	$1,000,000	100% of estate	0	35 gifts only
2011[2]	$1,000,000	$1,000,000	$1,000,000	0	0	55

[1] Assuming Congress does not extent 2009 Applicable Exclusion Amount limits for calendar year 2010.
[2] Effective January 1, 2011, the TRA-2001 "sunsets" and the prior law is reinstated.

lawyer, financial planner, life insurance agent, accountant, or trust officer. Authorize that team member to assemble the team in a preliminary meeting to review the listing of the assets and liabilities (financial x-ray), review the current documents, and then meet with the client and the client's spouse to make team recommendations. This approach maximizes the creative input and communication and often aids in identifying important new alternatives to consider. The financial x-ray would show what assets are titled in the name of each spouse; what, if any, assets are titled in joint names; and, ideally, what assets are in the children's names.

As has been said previously, what will be the estate or death tax is really elective. By making annual gifts during your lifetime, then transferring the maximum tax free amount (applicable exclusion amount) to your children and grandchildren at death, and finally bequesting your remaining estate to a family charitable foundation, your estate tax would be zero.

Here are two areas to focus your attention:

1. Does each spouse have the new tax-free amount in his or her separate name? The first and simplest step of estate planning is to obtain two tax-free amounts for the family instead of one. This requires, however, not only the proper words in the documents, but that the first spouse to die have titled in his or her name (not jointly) assets with a fair market value (other than qualified retirement plans or IRAs) equal to the tax-free amount ($3,500,000 in 2009). This step can basically save the family up to $1,400,000 in taxes.
2. The client should also focus on what is currently to be done with the tax-free amount at the client's death. Will it simply go in trust for the surviving spouse? Will it go in trust for the benefit of the surviving spouse, children, and grandchildren? Will it go outright to children and grandchildren?

In summary, you should take the following three steps as you undertake your estate planning review based on 2010 estate tax laws and the likely alternative changes in 2011:

1. Contact your advisor(s) and request a review of your current estate plan in view of the range of changes most likely. Your plan will need to be flexible enough to deal with a variety of possible outcomes.
2. The most prudent assumption for you to make, considering the changes scheduled for 2011, is that the amount of assets that you will be able to pass to nonspousal heirs will be $1,000,000. By providing adequate liquidity under this circumstance, you assure your heirs that you will have adequate resources to pay estate taxes no matter what year you die.

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3. Let your voice be heard! Congressional indecisiveness makes it practically impossible to properly plan your estate. Contact your congressional representatives and request resolution to the question mark surrounding the current estate tax law. Go to the Resource Center at www.welchgroup.com; then click on 'Links'; then click on 'Congressional Representatives Contact List'.

In this chapter we have provided an overview of both the complications surrounding the current uncertainty regarding estate tax laws as well as actions you should consider taking now. In our next chapter, we will delve deeper into the importance of developing your estate plan.