



## What Happens to Trusts in 2010?

There is NO federal or state estate tax in 2010! That's the most important consideration to determine whether or not your trust needs any modifications or amendments. While at first this may sound like a good thing, there are several issues that complicate or cloud your decision.

Most industry professionals expected that Congress would act either at the end of 2009 or early 2010 to define both the amount and structure of 2010 estate tax. However, they did not AND Congress can still enact a law instituting an estate tax at any point during 2010 and make it retroactive to the beginning of 2010! While there would likely be constitutional challenges to a retroactive estate tax, many industry experts conclude that a retroactive tax would stand.

The chart is a synopsis of the Federal estate tax from 2009 through 2011.

Federal	2009	2010	2011
<b>Exemption</b>	\$3.5M/Person	ESTATE TAX REPEALED	\$1M/Person
<b>Tax Rate</b>	Top rate 45%		Top rate 55%
<b>Basis</b>	Full step up in basis to date of death value	\$1.3M of step up in basis can be allocated to assets passing to any beneficiary. \$3M of step up in basis can be allocated to assets passing to a spouse	Full step up in basis to date of death value

### Implications

#### Formula provisions

Many family trusts were written to utilize the estate tax exemption by using a formula provision that was available before 2010 and will again be available in 2011. The result of many formula provisions is that upon on the death of the first spouse, all of that spouse's share of the community property and separate property will be placed in the Decedent's Trust. They were created to utilize the \$3.5 million exemption that existed in 2009 and the \$1 million exemption that will exist in 2011. You will not be able to utilize any of the \$3 million step up in basis for assets passing to a spouse, if you die in 2010, because the assets allocated to a Decedent's Trust are not considered to pass to a spouse.

#### Basis

While larger estates may benefit from the estate tax repeal in 2010, smaller estates - that may have been able to utilize the federal estate tax exemption in previous years to pay zero estate tax - may be negatively impacted. For example, a \$6 million estate with a tax basis of assets of \$1 million in a Trust formed to fully utilize the exemption amount for both spouses, if after the death of both Trustors, this estate passed to a Trust's beneficiaries in 2009, the estate's tax would be zero. The basis of the assets would be a total of \$6 million. If they sold the assets for \$6 million they would pay no tax on the sale. While the estate tax would also be zero if this estate passed to the beneficiaries in 2010, the basis of the estate would only be stepped up by \$1.3

million to \$2.3 million. Thus, if the beneficiaries sold the assets for \$6 million, they would pay tax on \$3.7 million.

Year	Tax Basis	Value of Assets- Date of Death	Stepped up Basis of Assets	Gain on Sale of \$6M
2009	\$1M	\$6M	\$6.0M	\$0
2010 - No surviving spouse	\$1M	\$6M	\$2.3M	\$3.7M
2010 - If surviving spouse	\$1M	\$6M	\$5.3M	\$ .7M

Note: No estate tax in 2009, if married and used both \$3.5M exemptions. In 2010, there is NO estate tax. In 2011, the exemption will be \$1M per person and there will be a taxable estate.

While there is limited ability to prevent the loss of the full step up in basis, it is important to fully utilize the limited step up in basis that is allowed in 2010. Currently, many family trusts - that are joint trusts for both spouses - are written so the surviving spouse may not be able to fully utilize the \$3 million step up of basis for assets passing to them. Additional steps can be taken that will restructure the trust and allow for the step up.

There are additional questions that need to be determined to most effectively use the step up basis in 2010. They include:

- How will the \$1.3 million step up in basis be allocated?
- Who will allocate the allowed step up?
- Does your trust utilize both the \$1.3 million and the \$3.0 million spousal step up in basis effectively?
- What records do you need to determine what the current basis in your property is?

### Recommendations

Depending on your situation and the size of your estate, we may recommend that you amend your trust by a simple amendment that maintains flexibility until the end of 2010 by allowing the surviving spouse to decide how to allocate the assets upon a death in 2010. If you have a high value estate and/or a lot of appreciation in your assets, you may want to have a more detailed discussion with your estate planning professional to make sure that you optimize the basis step up and understand the risks and benefits of various options. In either case, we recommend that you review your existing trust and, if necessary, restructure it so that the spousal step up in basis can be taken and designate who will allocate both the \$1.3 million basis step up and the \$3 million spousal basis step up.

This notice is simply an overview and does not cover the estate laws in their entirety. It is designed to provide you with an overview of some of the issues that may affect you. Please contact Beth Cohn at 602-248-1030 or [bsc@jaburgwilk.com](mailto:bsc@jaburgwilk.com) to discuss the impact of the changes in estate tax law and how they apply to your estate plan.