Update on the Expiration of the Federal Estate Tax

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As you may have read in the newspapers or recently heard in the media, as of January 1, 2010 the federal estate tax law expired. What happened is that Congress was unable to agree on either a temporary or permanent replacement for the estate tax law, which was set to expire on its own terms at the end of 2009. Historically, this marks the first time since 1915 that there has been no federal estate tax in the United States. So you can see why this is considered a major tax event.

Ever since the estate tax laws were changed in 2001, estate planning experts have known about the possibility that the law could expire in 2010. Under that change, the 2009 version of the law (a $3.5 Million estate exemption and a 45% top estate tax rate) would expire on December 31, 2009, a one-year repeal of the law would follow in 2010, and then an automatic reinstatement of the law - based on the original 2001 version – would start up again as of January 1, 2011. We know it's complicated but, simply put, if Congress does nothing in 2010, then on January 1, 2011 we will return to an estate tax system that has a $1,000,000 unified gift and estate tax exemption and a top tax rate of 55% (60% for estates between $10,000,000 and $17,000,000).

In hindsight, it appears evident that most estate planning experts didn't believe that Congress would let this happen and still believe that Congress will take some action in 2010 to reinstate the 2009 version of the law (or some other version) and make it permanent. In fact, before the end of 2009, the House of Representatives passed a bill to make permanent the 2009 version of the law, but the Senate took no action. At present, it remains unclear how a reinstatement of an old law would happen, when it would happen, and whether it could be Constitutional to make it retroactive to the beginning of the year.

Because most estate planning experts believed that Congress would act in 2009 and that we would not have to deal with all these issues, most of them (including the IRS) were not prepared for the tremendous upheaval that the expiration of the law has caused. Few scholars have written about it, few lawyers have agreed on how to change client Wills and Trusts, and the IRS has not produced any Rulings about it for anyone to rely on.

Although there are many unknowns, there are also many things we know about the law as it exits today and what actions people should consider taking to protect their families and their wealth on a long term basis.

1. In 2010, consider contacting your estate planning attorney to discuss how the 2010 "repeal" impacts your Will and other estate planning documents.

   Many Wills have important provisions that are "estate tax-driven". A simple example would be a very common will provision that funds a trust for children upon death, but only to the extent that the funding does not result in any additional federal estate tax due. If there is no estate tax law and the

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testator dies, how much should go into that trust? A strict reading suggests the entire estate. This might not be your intention. For this, and for many other reasons too numerous to mention, we think that now would be a good time to review your will and your overall estate planning goals and objectives.

2. In 2010, be careful about making gifts, because the gift tax has NOT been eliminated.

   The $13,000 per person per year gift tax annual exclusion and the $1,000,000 lifetime exemption for gifts still apply in 2010. Gifts in excess of these amounts are subject to a 35% gift tax in 2010 – down from a top rate of 45% in 2009 and possibly a top 55% rate in 2011. Still, don't be fooled, it could cost more to pay gift tax in 2010 because there would be no dollar for dollar credit that offsets any estate tax due - if death occurs when there is no estate tax. This would result in a "real" gift tax cost (as compared to a zero estate tax cost if the transfer is delayed until death and there's no estate tax).

3. In 2010 "Carryover Basis" rules replace "Step Up In Basis" rules at death, which may result in a capital gains tax being levied on inherited assets that are sold.

   From January 1 until December 31, 2010, inherited assets will no longer receive a "step up in basis" to fair market value at death. Instead, heirs will receive the assets with the same cost basis that the decedent had prior to death. Today, capital gains tax rates are low but they could increase in the future when the assets are sold. There are two exceptions to this new rule. First, assets passing to a spouse may receive an allocation of up to $3,000,000 of new basis and second, up to $1,300,000 of basis may be allocated to assets inherited by non-spouse beneficiaries. Practitioners view this system as unworkable because it requires families to keep track of cost basis from generation to generation.

4. In 2010, upon death, individual State Inheritance Taxes still apply to your estate.

   Every state is different, but at a time when states are looking to increase their revenue sources, states will be enforcing (and possibly enacting) state inheritance tax systems. These systems might not be consistent with current or future federal estate tax law and must be considered. The cost of state inheritance taxes can be as high as 16% (such as in New York) and should be taken into account in every person's estate planning.

5. In 2010, we strongly suggest that you plan your estate by taking a long term view.

   To be blunt, it's the estate tax law in effect when you die which counts - not just the law in effect when you plan. One estate planning expert recently commented on the possibility that any future permanent estate tax reform might only be considered "permanent" until such time as a new political party comes to power – and then all bets are off again. It seems to us that the time has come for individuals to stop waiting for Congress to enact "permanent" legislation. The law may never be permanent. Instead, individuals, business owners and their families should take back control of their estate planning by taking the positive actions that need to be taken today to protect their families, businesses, and overall wealth for the long term - regardless which political party in power or which estate tax law is in effect.

Conclusion

There are many risks that families need to deal with in today's economic times. Mortality risk (the risk of dying), Longevity Risk (the risk of living too long), Inflation Risk, Health Risk, Market Risk, and many more. All of these risks can be mitigated with proper planning and proper insurance protection. Not having a permanent estate tax system is a risk like any other risk that can be mitigated with proper planning and insurance protection. You should consider consulting your MetLife Financial Professional to see how proper planning and life insurance can help protect your estate – for the long term.

This material and any estate, gift or generation skipping transfer ("GST") tax (together referred to as "transfer tax") calculations reflects the current law established under the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"). Among other things, EGTRRA provides for a one year estate and GST tax repeal beginning January 1, 2010. Under EGTRRA, the federal estate and GST tax will be reinstated as of January 1, 2011 with the laws that were in effect in 2001 (e.g. as of 2011, there will be a $1,000,000 estate and GST tax exemption equivalent amount). As of the date this material was drafted, Congress had yet to pass any estate, GST or other transfer tax reform. While there has been a great deal of discussion about Congress reinstating the estate and GST tax retroactively for 2010 and/or amending the transfer tax laws for years beyond 2010, it is unclear if or how Congress will address these transfer taxes in the future and how any new law will affect any estate planning implemented in the meantime. Due to this uncertainty, you should consult with and rely on your own independent legal and tax advisers to confirm the current status of these laws, to discuss your current estate plan and to discuss what options are available during the upcoming year.

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