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Changes in Estate Tax — Is Your Will Obsolete?

“The times they are a changing” is the way the Bob Dylan song lyric went. On January 1, 2004 we began a six-year trek to the abolition of the federal estate tax. But the changes already implemented by the 2001 Tax Reform Act have rendered plenty of tax-oriented wills dreadfully obsolete. Those are wills which establish trusts that are funded using formula provisions tied to the amount protected from the federal estate tax. That “exempt amount” was locked in at \$600,000 for many years. On January 1, 2006 that exempt amount moved to \$2.0 million.

Before you stop reading because you know that you are not a millionaire, be aware that all of your life insurance, retirement accounts, stock investments and real estate are counted in calculating your “taxable estate” and imposing the federal estate tax. You can be one of the “filthy rich” and subject to the tax, even if you don’t own a successful business, a family farm or some highly appreciated real estate. That tax starts at 46% and thus cannot be taken lightly.

You might think that the death tax is not going to be a problem for you because you will outlive it. Didn’t we start this piece with a mention of its abolition in 2010? No, Congress is playing a good news/bad news joke on us. On January 1, 2010 the death tax is scheduled to be abolished; only to come back to life on January 1, 2011. The House of Representatives has voted at least three times to make the repeal permanent. As long as there are enough pro-tax Democrats to filibuster in the Senate, the repeal will not occur.

One last increase in the exempt amount to \$3.5 million will occur in 2009. In past years a married couple needed to plan for two uses of the exempt amount. Once by establishing a trust at the “first death” and a second time when the surviving spouse died. Now that the exempt amount is already on the other side of \$2 million, there are a lot of people with formula provisions in their old wills who are going to discover that they created tax-oriented trusts that are unwanted and unnecessary.

All of these changes suggest the need for every family to review the estate tax implications of their wills. Some will discover that they should remove the formula provisions. Others may find that inherited wealth, when combined with retirement accounts and life insurance render them big targets for the IRS. I am especially worried about people who have real estate that was valued as farm land for decades. Now with Atlanta’s growth heading towards the North Georgia mountains, the same real estate may become commercially valuable. The result is someone who is very rich “on paper” and, more importantly, in the eyes of the IRS.

Even assuming the death tax repeal becomes permanent, Congress has also repealed long-standing tax protection for appreciated assets by ending the step-up in basis given to assets of a decedent who dies after 2009. The fair market value on the date of death will no longer be the value used by the heirs in determining any capital gain tax on inherited assets. When the death tax goes away, the capital gains tax will partially replace it. However a surviving spouse will be able to “step-up” \$3 million of assets and non-spouse heirs will similarly have \$1.3 million of such protection.

All of this proves that any set of estate planning documents, whether it consists of a will containing a testamentary trust or a will combined with a “living trust,” needs to be reviewed at least every three to

five years. It highly probable that estate plan documents that are over ten years old have been overtaken by either real world events, such as changes in wealth or with family members, or by changes in the tax laws.

Each person needs a level of complexity in their legal documents that is appropriate to their circumstances. Estate planning is not a one-size fits all deal. It's also not a "once it's done it stays done" deal. We are entering an exciting period of time when economic freedom will be increased. Plan to take advantage of it.

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Patrick J. Gibbs practices law in Roswell, Georgia with a concentration on Wills, Trusts and Estates. This article is intended to be educational. Legal advice should be obtained as to individual needs before taking any action.