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## New Tax Law Necessitates Review of Estate Plans

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Q. My spouse and I have been procrastinating when it comes to regular reviews of our estate plan. Now, with another new year about to be, and a new tax law just around the corner, we would like to know whether there is any compelling reason to have an attorney review our estate plan now.

A. The Middle Class Tax Relief Act of 2010 (“2010 Tax Act”) was enacted during December 2010. However, contrary to its name, the 2010 Tax Act does not offer much relief at all. In fact, in the area of estate taxation, tax rates increase from 0% in 2010 to 35% in 2011, on that portion of estates which exceed \$5 million. But that is only the tip of the taxation iceberg.

Using the new \$5 million estate tax exclusion, married couples can avoid estate taxes on the first \$10 million of their combined estates. If the first spouse to die does not fully use his or her exclusion, the unused portion can be used by the surviving spouse. However, with an A-B Trust – a type of trust which commonly was used prior to 2011 – the transferability of all or part of a deceased spouse’s \$5 million exclusion may cause problems which reasonably could not have been anticipated when the A-B Trust was created.

The problem arises in the interplay between the “unlimited marital deduction” (“UMD”), on the one hand, and the \$5 million exclusion which was created by the 2010 Tax Act, on the other hand. Many existing estate plans were drafted with an eye toward taking advantage of the UMD, without, of course, any consideration of the newly-enacted 2010 Tax Act.

In most cases, the UMD provides that, regardless of the size of an estate, there are no estate taxes on the first death. Because A-B Trusts typically were drafted to take advantage of the UMD, and did not transfer assets to take advantage of an exclusion that did not exist prior to 2011, continued use of an A-B Trust may result in married couples being subject to estate taxes on that portion of their estate which exceeds \$5 million, rather than on full \$10 million exclusion that they should be able to enjoy.

Thus, beginning on January 1, 2011, A-B Trusts will be obsolete. Accordingly, most, if not all, A-B Trusts should be reviewed and revised to take advantage of the new \$5 million exclusion.

Now, as Paul Harvey might have said, here is the rest of the story: A-B Trusts, in order to take advantage of the UMD, intentionally waived a step-up in basis to avoid estate taxes because, with the exception of 2010, estate tax rates have always been significantly higher than capital gains tax rates. Now, however, use of an A-B Trust may expose the estate of all married couples – regardless of the value of the estate – to a loss of their step-up in basis which, in turn will increase their exposure to capital gains tax, while simultaneously doing nothing to protect against or mitigate estate taxation.

Estate plans should always be reviewed and updated any time there is either a change in the law or in your personal circumstances. So resolve now to put a review of your estate plan (or creation of an estate plan, if you do not already have one) at or toward the top of your 2011 list of “To Do” items.

Earle Law Offices provides trial and appellate litigation, as well as non-litigation, legal services in the areas of

bankruptcy, business law, constitutional and civil rights law, family law, real estate law, tax law, and trusts and estates.

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Mr. Earle received his law degree from the Santa Clara University School of Law, where he served as an Editor of the school's Law Review, and where he received awards for academic excellence. He received his undergraduate degree, with honors, in business administration from the University of La Verne.

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