Steve Leimberg's Estate Planning Email Newsletter - Archive Message #1570

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From: Steve Leimberg's Estate Planning Newsletter (http://www.leimbergservices.com)

Subject: **FLASH - Problems for Married Persons Who Die in 2010 in States with Independent Death Taxes**

In their important and timely commentary, **Jonathan Blattmachr, Michael Graham** and **Mitchell Gans** provide **LISI** members with insights into a most extraordinary side effect to next year's repeal of the Federal estate tax and the adoption of a carryover basis regime for inherited property: namely, their impact on state death tax systems, as well as their impact on the estates of married persons. This commentary is a "must read" for anyone who practices in a state with an independent state death tax system.

Jonathan G. Blattmachr and **Michael L. Graham** are co-authors and developers of Wealth Transfer Planning, a software system that provides specific client advice about estate planning matters and automatically prepares client documents, such as wills, revocable trusts, GRATs and much more. Many of the suggestions for coping with the extraordinary circumstances of 2010 repeal of estate and generation skipping transfer (GST) tax, along with the probable attempt by Congress to retroactively reinstate those taxes and the certain return of estate and GST tax in 2011, are derived from their work and strategy embodied in Wealth Transfer Planning. You can learn about Wealth Transfer Planning at www.interactivelegal.com.

Jonathan G. Blattmachr is the author of five books and hundreds of articles. Michael L. Graham is the founder of the Graham Law Firm of Dallas, Texas and a frequent national speaker and writer on various estate planning matters.

Professor Mitchell M. Gans teaches at **Hofstra Law School** in Hempstead, New York, co-authors a book with Jonathan and is author or co-author of dozens upon dozens of articles.

Here is their commentary:

EXECUTIVE SUMMARY:

For the first time since 1915, the United States has no Federal estate tax. This amazing situation is scheduled to last only for 2010.

After that year, the Federal estate, gift and GST tax system will revert to previous law, as set forth in the Internal Revenue Code prior to the enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). Estate planners and their clients need to take the current no estate tax/no GST tax situation into account.

A further complication for practitioners and their clients is that, during the period that the estate tax is repealed, the income tax bases of assets acquired from or passing from a decedent, including most but not all assets included in the decedent's gross estate will not be made to be equal to their estate tax values. Rather, the decedent's basis in those assets will "carry over."

For those who represent married individuals domiciled in states with independent state death tax systems, complications compound. Without careful planning, an inadvertent state death tax may well be imposed upon the death of the first to die of the spouses. To put this issue into context, it is first necessary to consider the Federal estate tax regime for 2010.

COMMENT:

Complications for Word Formula Dispositions.

As is widely known, many dispositions under wills and trusts are phrased in terms of tax concepts. For example, many married people have directed the division of their estates into two broad portions: one portion equal to the unused estate tax exemption (typically passing into a non-marital deduction trust, often called the "credit shelter trust," for the benefit of the surviving spouse and descendants) and the other portion, equal to the "optimum" marital deduction amount, often expressed as the "minimum amount necessary as the Federal estate tax marital deduction to reduce my Federal estate tax to its minimum."

Additionally, or alternatively, it is sometimes true that an individual, whether or not married, will have a portion of his or her estate equal to his or her "unused GST exemption" pass in a way different (such as to a trust for the benefit of his or her grandchildren and more remote descendants) than the balance of his or her estate.

These word formulas are used because they produce what has been the optimal division or disposition of a decedent's property. But do these formulas have

meaning, and what is that meaning, if the concepts used to define the formula clauses are repealed.

An imperfect, but somewhat similar analogy is as if a man said in his will, "I give to my daughter Laura an amount equal to the property tax exemption provided at the time of my death under the law of the Soviet Union." At the date of his death, there is no Soviet Union and, therefore, no exemption under that law.

Perhaps, in that case, the amount passing to the daughter is zero. Would the result would be different if the bequest were phrased as "the largest amount of my estate that can pass to my daughter without generating any property tax under the laws of the Soviet Union in effect at my death"?

Arguably, with such wording, Laura receives her father's entire estate because even if she does receive it all there will be no property tax under Soviet Union law. But uncertainty exists if there is no property tax under Soviet Union law and the bequest is premised on there being such law in effect at the decedent's death.

The uncertainty of what passes pursuant to word formulas under United States tax law would seem to have the same difficulties. For example, what is the "minimum amount necessary as the Federal estate tax marital deduction to reduce my Federal estate tax to its minimum" if there is no Federal estate tax or Federal estate tax marital deduction? It might be argued that nothing passes under such a formula because no marital deduction is needed to reduce the Federal estate tax to zero and all property disposed of under the instrument, therefore, passes into the credit shelter trust.

Similarly, if the bequest of the estate tax exemption is defined as "applicable exclusion within the meaning of section 2010(c) of the Internal Revenue Code," what amount is that if there is no applicable exclusion in effect in 2010? Alternatively, if the amount passing into the credit shelter trust is defined as "the largest taxable estate I can have for Federal estate tax purposes without increasing the Federal estate tax in my estate," how large is that amount if there is no taxable estate and no Federal estate tax in the law for that year? While the initial reaction may be that all property passes to the credit shelter trust, an alternative construction might be that everything passes as part of the marital deduction share if there is no such thing as a "taxable estate."

There are at least two caveats that need to be mentioned. First, all of these

formula clauses are designed to accomplish the same goals: (i) minimize (to zero if possible) the amount of estate tax that will be paid when the first spouse dies, (ii) minimize the amount of estate tax that will be paid when the surviving spouse dies with respect to property passing to or for the surviving spouse from the first spouse to die, and (iii) provide for all of the property to be available to benefit the surviving spouse.

It would be odd, since the goals are the same whether the document defines the credit shelter amount or defines the marital deduction amount, that the result would be different—that is, in one case, the instrument is construed as having all the property pass into the credit shelter trust and another having it all pass into the marital deduction share. We know that the intent of the testator must control, and we know that there will be declaratory judgment actions and expert testimony on many of these matters in an environment that, even as recently as the beginning of December of 2009, no one expected to exist.

The second caveat is that neither the IRS nor the Federal courts will be bound by a local court construction of the instrument under the rational of *Commissioner v. Bosch*, 387 US 456 (2d. Cir. 1967). Hence, even if a local court determines that the entire estate passes into a credit shelter trust, the IRS may take the position that property instead passed to the surviving spouse, if the marital deduction bequest is outright, and that either the surviving spouse made a gift by permitting that to occur and/or the credit shelter trust is included in the gross estate of the surviving spouse, assuming the surviving spouse dies in 2011 or later, when the estate tax is reinstituted.

Further Complication: Carryover Basis Increases.

Under Section 1022, the income tax bases of assets acquired from someone who dies in 2010 will not be equal their estate tax values; rather the bases of his or her assets will "carryover" to those who inherit the property. To complicate matters, the Code provides certain basis increases for carryover basis property. One is that the decedent's executor may allocate up to $1,300,000 to increase the basis of property. This allocation, however, may not increase the basis of an asset above its fair market value as of the decedent's date of death.

Note that the allocation of increased basis provision is not to increase the basis of property worth $1,300,000 to $1,300,000 but rather to increase basis by $1,300,000. For example, a child of the decedent inherits land worth $5 million in which the decedent's basis at death was $1,500,000.

The executor may elect to increase the basis of the land to $2,800,000. If the land were worth only $2,300,000 when the decedent died, the executor could increase the land's basis from $1,500,000 by $800,000 to $2,300,000 (and no higher) and could allocate the remaining $700,000 of basis increase to other appreciated property (limited, again, to the fair market value of such asset at the decedent's death).

In addition to the $1,300,000 increase in basis, if the decedent is married, the decedent's executor can also allocate up to $3,000,000 to increase the basis of assets that the surviving spouse receives outright or through a QTIP trust (called "Qualified Spousal Property"). A QTIP trust qualifies for the estate tax marital deduction, when there is an estate tax, only to the extent the executor elects under section 2056(b)(7) for it to so qualify. However, no such election is necessary for a trust otherwise described in that section to constitute Qualified Spousal Property to which the $3 million basis increase may be allocated by the executor.

Before turning to other matters relating to the carryover basis rules, it is appropriate to go back and explain how they complicate the division of the estate of a married person who dies in 2010.

Married Persons: No Estate Tax Plus Carryover Basis.

For a married person who had directed his or her estate to be divided into two shares if his or her spouse survives, that is, into an amount equal to his or her unused estate tax exemption equivalent and the balance in a form that may qualify for the estate tax marital deduction, it may seem that he or she would want to have his or her estate pass entirely into the estate tax exemption equivalent share, usually, in the form of a credit shelter trust that benefits the surviving spouse and descendants.

Such as person would have provided for a constantly increasing amount to pass into the credit shelter trust: $675,000 before EGTRRA and then $1,000,000, then $1,500,000, then $2,000,000 and then $3,500,000. This suggests that if the exemption were to increase, for example, to $5,000,000, which was proposed several times in Congress in recent times, the married person would want the first $5,000,000 to pass into the credit shelter trust.

And now, of course, without any estate tax, his or her entire estate (whether $5 million or $500 million) may pass estate tax free into the credit shelter trust.

And perhaps that is how an instrument making the credit shelter trust/optimum marital deduction division will be construed—that is, the whole estate passes into the credit shelter trust. Of course, if the surviving spouse cannot benefit from the credit shelter trust (e.g., it is exclusively for the benefit of the decedent's descendants from a prior union), the result seems harsh at least from the view of the widow or widower.

But assuming that it would occur and even assuming it is exactly what all surviving family members want or assuming the estate planning documents are revised to expressly provide for that result, there is a potentially important additional tax issue. Unless the credit shelter trust is in the form of a QTIP type trust (e.g., all income paid at least annually to the surviving spouse with no ability to pay any part of the trust to anyone else during the survivor's lifetime), there may be insufficient Qualified Spousal Property against which the executor may allocate the $3 million basis increase. See, generally, Blattmachr & Graham, "Thinking About the Impossible for 2010," 21 Probate & Property 12 (May/June 2007).

On the other hand, if the instrument is construed so that (or it is revised to provide expressly that) the entire estate is to pass into a QTIP trust if there is no estate tax, then there presumably will be the maximum amount of property to which the executor may allocate the $3 million basis increase. As mentioned above, a QTIP trust is a form of Qualified Spousal Property.

At the same time, using a QTIP trust limits some other planning opportunities such transferring property to children free of gift tax or "splitting" income with the trust and/or descendants which normally would be available if the trustee of the credit shelter trust holds the discretion either to accumulate all income or to pay income or corpus to descendants as well as the spouse. Perhaps, any part of the QTIP trust disclaimed by the spouse under section 2518 would pass over to such a discretionary credit shelter trust. And, even though the gift tax remains in effect in 2010, the spouse can make a qualified disclaimer under section 2518 and remain a beneficiary of any trust to which the disclaimed property passes by reason of the renunciation without being deemed to have made a taxable gift.

Revising Existing Documents for Married Persons.

In a more perfect world, wills and trusts will have taken into account the possibility of there being no estate tax and there being a carryover basis system. But it is known that most such documents do not cover those

possibilities because almost everyone thought it was impossible that it could happen. In any case, it may well be appropriate for practitioners to contact married clients and ask how they want their property disposed of if they die when there is no estate tax.

Although there are many options, two planning options seem essentially likely to be used, at least if the situation is not complicated by a state death tax, which is discussed below. First, the married property owner could leave his or her estate to a QTIP trust, described in section 2056(b)(7), which qualifies for the estate tax marital deduction only to the extent the executor elects.

Of course, qualification as such for the estate tax marital deduction seems to be of no importance if there is no estate tax. But as explained above, such a QTIP trust is Qualified Spousal Property and, therefore, the executor may allocate the $3 million basis increase to it. And, as also mentioned, above, if the instrument is so structured, the spouse may make a formula disclaimer of the entire QTIP trust above the amount needed to allocate that basis increase and have the disclaimed assets pass into a credit shelter trust which may provide more flexibility than that of a QTIP trust.

Regardless of how much remains in the QTIP trust, no portion should be included in the gross estate of the surviving spouse even if he or she dies when the estate tax is back into effect. Although section 2044 puts a QTIP trust into the gross estate of the spouse for whom the trust was created, the section only applies if the spouse who created the trust avoided estate or gift tax by reason of the gift or estate tax marital deduction.

For the married person who dies in 2010, there will be no estate tax on the trust, not by reason of the marital deduction but because there is no estate tax in effect. Of course, if the estate tax is retroactively reinstated, then presumably the executor of the spouse first to die may elect QTIP treatment under section 2056(b)(7) and avoid estate tax and, to the extent the executor so elects, the QTIP will be included in the gross estate of the surviving spouse when he or she later dies.

The second approach is to provide that, if there is no estate tax, then the entire estate, other than a separate formula bequest to fully use the basis increase for Qualified Spousal Property, should pass into the credit shelter trust. That way, there is no reliance on a disclaimer by the spouse. Professor Jeffrey Pennell has observed, at fn 85 in BNA Tax Mgt. Portfolio No. 843-2nd, that one of the three great lies is "Of course I'll disclaim if it will save taxes." This second

approach avoids any concern about the disclaimer.

Other Drafting Considerations.

Without regard to the marital status of a client, there are other revisions to documents that could be made to take into account the no tax/carryover basis regime of 2010. First, the client's will (and it must be the will because it is the executor who gets to allocate the basis increases) could have language to authorize the executor to allocate the basis increase, in his or her sole and absolute discretion.

Under section 2203, the executor is the person who is the executor or administrator of the decedent but "if there is no executor or administrator appointed, qualified and acting with the United States, then any person in actual or constructive possession of any property of the decedent." There may be many of those persons.

And, if there is no executor, there may be disagreement among these many persons about which one gets to exercise options and elections, such as the allocation of the $1,300,000 and $3,000,000 basis increases under section 1022. Hence, it seems appropriate to make sure there is a will that is admitted to probate so an executor (or administrator) will be acting to make the allocation as the executor determines.

Second, when possible, it may be appropriate to provide expressly in the will that only an executor who is not a beneficiary should be authorized to allocate the basis increase. Otherwise, there may be conflicts of interest and a question of whether an executor who is a beneficiary may allocate basis increase to himself or herself under local law and, if he or she may do so, the potential gift tax consequences of not doing so. See, generally, Gans, Blattmachr & Heilborn, "Gifts By Fiduciaries By Tax Options and Elections", 18 Probate & Property (November/December 2004); republished in Digest of Tax Articles (March 2005).

Third, whether or not an individual is married, some thought should be given to the interpretation of an instrument that makes a bequest or gift equal to the individual's unused GST exemption at death. As mentioned above, there is no GST tax for 2010 and, therefore, the meaning of such a bequest or gift may be uncertain. For example, a wealthy woman makes a bequest in her will equal to "the maximum amount I may transfer free of generation-skipping transfer tax to a skip person" to a perpetual trust for her grandchildren and more remote

descendants, leaving the balance of her estate to or in trust for her children (or, if she is married, to or for her husband).

If she dies in 2010, it may be that the instrument would be construed so nothing passes to or for her children (or her husband). Hence, again, it may be appropriate to contact clients who have instruments containing such dispositions to determine their wishes and, if changes should be made, to implement them soon.

Potential Effects in States with an Independent Estate Tax.

Prior the enactment of EGTRRA, the vast majority of states imposed a state estate tax equal to the amount of Federal credit allowable against Federal estate tax otherwise owed to the Federal government, sometimes called a "sponge tax." That Federal credit for state death taxes was allowable under section 2011 for state death tax paid. EGTRRA eliminated the credit (although it allowed a deduction under section 2058 for such state death tax paid) which meant that a number of states no longer had an estate tax of any kind.

Many states, however, have retained state death tax systems which were either in lieu of, or in addition to, the state's so called sponge tax. These include Connecticut, Illinois, Indiana, Iowa, Kentucky, Maine, Maryland, Massachusetts, Minnesota, New Jersey, New York, Ohio, Oregon, Pennsylvania, Rhode Island, Tennessee and Washington (state).

It does not appear that the independent death tax systems of states have automatically been repealed by the repeal of the Federal estate tax for 2010. Hence, there may still be a state death tax and it may present a significant issue for individuals who die domiciled in or who own real or tangible person property in such states. As a general rule, a decedent's domicile state may impose a death tax on all of the decedent's property at death other than real or tangible personal property actually situated in another state, which other state may impose its death tax on the real or tangible personal property actually situated there.

For example, suppose a married New Yorker died with a $25,000,000 estate in 2009 and her estate planning documents provided for an amount equal to her Federal estate tax exemption (which we will assume is $3,500,000) to pass into a credit shelter trust for the benefit of her husband and descendants and for the balance of her estate to pass in a form that qualifies for the Federal and New York marital deduction. The tax will be equal to the amount of credit that

would have been allowable under section 2011.

Her taxable estate is $3,500,000, and her estate would owe $229,200 of New York estate tax. This represents an effective New York estate tax rate of about 6.5%--that is, a $229,200 tax on $3.5 million. And a New Yorker might well decide that paying that tax when he or she dies is very worthwhile because it removed an "extra" $2.5 million from the gross estate of the surviving spouse. New York, in effect, only permits a $1 million estate tax exemption.

But the result in 2010 could be very different. For example, if the married New Yorker died in 2010 with an estate (after estate tax deductible expenses and debts) of $25,000,000, all of which passed into a credit shelter trust, then her estate would owe $3,466,800 in New York estate tax, which represents an effective New York estate tax rate of nearly 14%.

Both the amount of tax due and the effective rate of tax are much higher than for the smaller estate. Although it should mean that $24,000,000 (plus its growth or minus its decline in value) will be excluded from the gross estate of the surviving spouse when he later dies (assuming there is an estate tax in effect at that time) and, at a 45% bracket, would avoid $10,800,000 in Federal estate tax, which is more than three times the amount that had to be paid to New York to achieve that result, some married New Yorkers might well decide it is just too high a price to be paid when they die.

Further Complications Without a State-Only QTIP Election.

And this "awkward" situation may arise even if the instrument is construed (or is revised to state expressly) so that the entire estate passes into a QTIP trust, if the individual resides in a state (or owns real or tangible personal property actually situated in a state) that does not permit a state-only QTIP election. Some jurisdictions, such as New York, New Jersey, Minnesota, Vermont, Iowa, and North Carolina, do not permit state only QTIP elections.

In other words, in those states, the marital deduction for a QTIP trust is permitted for state death tax purposes only if the QTIP election is made for Federal purposes. For someone dying in 2010, it seems no such Federal QTIP election may be made as there is no Federal estate tax and no Federal QTIP election, therefore, is available. Hence, for those individuals domiciled in or owning real or tangible personal property actually situated in a state that does not permit a state-only QTIP election, the form of marital deduction essentially would need to be changed to some other qualifying form, such as an outright

disposition, a general power of appointment trust described in section 2056(b)(5) or an estate trust (where the trust terminates in favor of the surviving spouse's own probate estate).

It is certain that the outright bequest will constitute Qualified Spousal Property but it is not certain a general power of appointment marital deduction trust or estate trust would. Hence, if the married person decides to use a general power of appointment marital deduction trust or estate trust, he or she probably should have a formula bequest outright to the surviving spouse to ensure full use of the $3 million additional basis increase for Qualified Spousal Property. Although as mentioned above, a QTIP trust is treated as Qualified Spousal Property, it will not qualify for the marital deduction for state death tax purposes, unless the state permits state only QTIP elections.

Arguably, the best course of action for a married person domiciled in New York and who might die in 2010 is to change his or her domicile to a state without an estate tax or at least a state that permits state only QTIP elections. That, of course, may be life altering in some ways. But the additional price of dying in a state that has an independent estate tax and that does not permit state-only QTIP elections may be more than enough incentive.

And although, as mentioned above, the individual may bequeath his or her entire estate, above the state estate tax exemption, to a general power of appointment trust or outright to his or her spouse, that property will be included in the gross estate of the surviving spouse, assuming he or she dies when the estate tax is back in effect. In addition to that unpalatable result, the individual may not wish his or her spouse to have the power to control the disposition of the individual's wealth which would be granted with an outright bequest or general power of appointment.

More Complications for States with Death Taxes.

There may be additional hurdle for those who die in 2010 domiciled, or owning real or tangible person property, in a state with an independent state death tax, and especially in those states not permitting a state-only QTIP election. That complication arises where property is already in an irrevocable trust which provides for the creation of a QTIP trust for the surviving spouse if the trust is included in the estate of the spouse first to die.

For example, a woman created a grantor retained annuity trust (GRAT) in June 2008 which is to terminate in June 2010. If she dies before the annuity term

ends, all or a portion of the trust may be included in her gross estate under section 2036(a).

On account of that possibility, the trust agreement provides that, if the grantor of the GRAT dies before the annuity term ends, the trust property, other than any annuity due the grantor or the grantor's estate is to pass into a QTIP trust for the grantor's spouse if then living. If she dies in 2010 and before the GRAT ends, there would have been estate tax inclusion and that will trigger state death tax if the grantor was domiciled in a state with a state death tax. If there is a state only QTIP permitted, then the estate can make that election and avoid the state death tax. But in those states that do not seem to permit that election, there will be state death tax.

In fact, there could be a tax in a state that does permit a state only QTIP trust with respect to such a GRAT because of the way the disposition in favor of the QTIP trust is sometimes designed. Amazingly, there could even be a state death tax if the grantor provides for the trust to be paid outright to his or her surviving spouse, a disposition which would otherwise qualify for the marital deduction, unless the surviving spouse is not a US citizen and the state allows a marital deduction only if the transfer is to a QDOT.

The marital deduction may be lost if the GRAT provides that the amount passing into the QTIP is limited to a portion of the trust "to the extent included in the grantor's gross estate for Federal estate tax purposes." Because in 2010 there is no estate tax, there would be nothing included in the grantor's gross estate for Federal estate tax purposes and, therefore, nothing would pass into the QTIP or outright to the surviving spouse.

A similar result could arise with respect to irrevocable life insurance trusts, which often have such "contingent" marital deduction provisions in the event part or all of the proceeds under the policy or policies owned by the trust are included in the insured's gross estate.

And the same result may arise if one spouse has created a lifetime QTIP trust for his or her spouse. Although if the beneficiary spouse dies in 2010, the QTIP will not be included in his or her Federal gross estate (as there is no estate tax), a state death tax could apply.

Not infrequently, a lifetime QTIP trust will "automatically" provide that, if the grantor spouse survives the beneficiary spouse, the trust property will be put in a QTIP trust for the grantor spouse. If so, a state only QTIP election, if

permitted, could be made to avoid state death tax on the amount in the trust. But if a state only QTIP election is not permitted, the property presumably would be subject to state death tax.

It may be that the best course of action for such cases is to have the trust reformed by a court or, if permitted, "decanted" which is the act of paying the trust assets to a "new trust." See Zeydel & Blattmachr, "Tax Effects of Decanting—Obtaining and Preserving the Benefits," 111 Jl of Taxn 288 (Nov. 2009). About a dozen states have statutes that permit decanting. But many of the states that have independent state death tax systems do not have decanting statutes.

In that event, one option is to use the Alaska decanting statute. AS 13.36.157 provides, in part, that if an Alaska resident or Alaska bank or trust company is appointed a co-trustee and the trustees agree that Alaska will be the primary place of trust administration, the trustees will have the Alaska decanting powers.

The Alaska statute is consistent with the law that a trustee derives its fiduciary powers from the place of administration. See Uniform Trust Code sec. 108 and Scott on Trusts sec. 615. In any case, the decanted trust would provide the appropriate provision such as an outright payment to the surviving spouse if the deceased spouse dies domiciled in a state with an independent state death tax and no state only QTIP and it would not otherwise qualify for the state death tax marital deduction.

Suggestions for Action Steps.

Looking forward, the first step for practitioners, who do not wish to continue to put faith in Congress' ability to solve this issue (and it has now been unable to do so for nine years), is to contact clients about the 2010 law changes. A "generic" memorandum or an individually addressed letter or memo to each client might be used.

It may be appropriate to invite clients to contact the firm to make an appointment to determine what, if any, steps should be taken. As mentioned above, for clients using word formulas, it seems appropriate to determine explicitly how they want their property to be disposed of if they die when there is no Federal estate tax and no GST tax and there is carryover basis. For those living in state death tax states, other factors probably also should be discussed including the possibility of changing domicile.

It may be appropriate for lawyers to prepare documents to effect any changes the client may wish implemented. For example, married clients could explicitly state how their estates are to pass if they die when there is no estate tax.

As mentioned above, this might be a direction for the entire estate to pass into a credit shelter trust, except for a bequest to take full advantage of the $3 million increase in basis permitted for Qualified Spousal Property. Moreover, any married client living in a state with an independent estate tax likely should consider whether he or she wishes:

To have state death tax paid at his or her death and avoid both Federal and state estate tax when the surviving spouse dies; or

To avoid both Federal and state death tax when the first spouse dies even if it means considerably more tax when the surviving spouse dies.

That will be easier if the state permits a state only QTIP election and the "optimum" marital deduction share passes into a QTIP trust. In that event, the decision of whether to pay state death tax if the first spouse dies when there is no Federal estate tax may be postponed until the state death tax return is filed and the election may be made or not.

For those living in a state with an independent state death tax, a decision likely should be made now as to whether state death tax will or will not be paid if the first spouse to die passes on when there is no estate tax. But there is a strategy in which this decision also can be postponed until after the first spouse dies. If the estate planning documents provide for the amount passing to the credit shelter trust to be equal to the state death tax exemption and for the marital deduction share to pass either outright to the surviving spouse or to a general power of appointment marital deduction trust, there will be no state death tax due but the surviving spouse may change that outcome by making a qualified disclaimer within nine months of the death of the first spouse to die.

For those who prefer for the marital deduction share to pass into a QTIP trust but who live in a state with an independent state death tax and no state only QTIP, the following language might be used in such person's will or revocable trust used as a will substitute:

"If there is no Federal estate tax in effect at my death (including no retroactive

reenactment of such tax) and if the state of my domicile imposes a state death tax at my death but does not permit my estate to make an election to treat any property that would be described in section 2056(b)(7) of the Internal Revenue Code of 1986, as amended, to qualify for the marital deduction for purposes of the state death tax, I hereby grant my husband/wife a power to appoint at his/her death by his/her Will by specific reference to this general power of appointment the property in any trust that is so described to his/her estate so that the trust will be described in section 2056(b)(5)."

Conclusion.

The elimination of the estate and GST taxes and introduction of carryover basis for those dying in 2010 represents an extraordinary event for estate planners and their clients. In many ways, it opens tremendous planning opportunities. But as explained, it also poses dangers.

Practitioners can find a sample letter to clients about this at the home page of www.interactivelegal.com which can be downloaded in word format and modified. As that letter indicates, married clients need to decide on the disposition of their wealth if they die this year. That decision is complex, and will be more complex if they live in a state with an independent death tax system.

Action needs to be taken. The real dangers are inaction by practitioners and political risk. Will Congress retroactively reintroduce these taxes? What will happen in 2011? While it is impossible to be at all certain about these matters, advice and counsel to clients now is extremely important.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

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