

**CHANGES TO THE ESTATE, GIFT, AND INCOME TAX LAWS UNDER
THE ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT
OF 2001.**

by
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The Economic Growth and Tax Relief Reconciliation Act of 2001 (Tax Relief Act) was approved by Congress on May 26, 2001 and signed by President George W. Bush on June 7, 2001.¹

The provisions of the Tax Relief Act fall within three separate time periods:

- Phase down period from calendar year 2002 through 2009;
- Repeal year for the estate tax and generation-skipping transfer tax, 2010 and
- Post-sunset period, 2011 and after.

Because the new law phases in over a period of time, the specific tax law that will apply to an individual will depend on the year the individual dies, the year in which the gift was made, or the year the generation-skipping transfer is made.

The major changes in the estate, gift and generation-skipping law for each year from 2002 to 2011 are summarized in the following table:

Effective Date	Major Changes in Estate and Gift Tax Law
2002	5% surtax repealed. Tax rates above 50% repealed. Unified estate and gift tax exemption increased to \$1 Million. State death tax credit decreased to 75% of its prior-law level.
2003	Tax Rates above 49% repealed. State death tax credit decreased to 50% of its prior-law level.
2004	Tax Rates above 48% repealed. Estate and GST exemption amount increased to \$1.5 Million. Family owned business deduction repealed. State death tax credit decreased to 25% of its prior level.

¹H.R. 1836 P.L. 107-16, 115 Stat. 38.

2005	Tax Rates above 47% repealed. State death tax credit repealed by a deduction for all state death taxes actually paid.
2006	Tax Rates above 46% repealed. Estate and GST exemption increased to \$2 Million.
2007	Tax Rates in excess of 45% repealed.
2008	No additional Changes
2009	Estate and GST exemption increased to \$3.5 Million
2010	Estate and GST tax repealed. Gift tax remains in effect. The maximum gift tax rate is lowered to 35%. The lifetime exemption for gifts remains at \$1 Million. Step-up basis for assets transferred at death is repealed and replaced by modified carryover basis system. A basis increase is permitted for each decedent in the amount of \$1.3 Million plus \$3 Million for assets transferred to a surviving spouse. New reporting requirements are introduced for assets other than cash that are transferred during life or at death.
2011	Unless the new law is reenacted, there is an automatic sunset of all provisions of the Tax Relief Act of 2001, effective December 31, 2010. If law is not reenacted, law returns to law in place prior to June 7, 2001.

Applicable Exclusion Amount

The applicable exclusion amount will increase to \$1,000,000 for gifts made,² and for estates of decedents dying in 2002.³ The applicable exclusion for gifts will stay at \$1,000,000 for gifts made after 2001. However, the applicable exclusion for the estate tax will increase as set forth in the following table:

For Decedents dying in	Applicable Exclusion Amount for Estate Tax
2002	\$1,000,000

²Tax Relief Act Section 521 adding Code Section 2011(b)

³Tax Relief Act Section 521(a) amending Code Section 2011(a).

2003	\$1,000,000
2004	\$1,500,000
2005	\$1,500,000
2006	\$2,000,000
2007	\$2,000,000
2008	\$2,000,000
2009	\$3,500,000

As under prior law, any applicable exclusion amount used against taxable gifts during an individual's lifetime, will reduce the applicable exclusion amount that is available to offset the estate tax at death. For example, if a taxpayer makes cumulative taxable gifts of \$1 Million after 2002 and dies in 2009, the taxpayer would still have a \$2,500,000 applicable exclusion to apply against the estate tax. If the same taxpayer died in 2003, there would be no applicable exclusion available to the taxpayer's estate to apply against the estate tax.

The Generation Skipping Tax (GST) exemption will be the same as the applicable exclusion amount after 2003.⁴ For the years 2002 and 2003, the GST exemption will stay indexed as is under current law. Currently, the GST exemption for 2001 is \$1,060,000.⁵ If the law is not reenacted in 2011, the GST exemption will be the 2003 amount indexed for inflation until 2011.⁶

Gift Tax

⁴Tax Relief Act Section 521 adding Code Section 2011(c).

⁵Rev. Proc. 2001-13, 2001-03, I.R.B. 337.

⁶The Tax Relief Act does not specifically address the issue of whether the GST exemption will increase by the index amount from 2003 to 2011.

The gift tax will have a top marginal bracket in 2010 equal to 35%. Although Section 511(d) of the Tax Relief Act states that the maximum gift tax rate will equal the maximum individual tax rate, Code Section 2502 just references the maximum rate of 35% for gifts more than \$500,000 in 2010.

Gift Tax Rate Schedule for 2002-2011

Over	But Not Over	2002	2003	2004	2005	2006	2007-2009	2010	2011 & after unless new law is reenacted
\$0	\$10,000	18	18	18	18	18	18	18	18
10,000	20,000	20	20	20	20	20	20	20	20
20,000	40,000	22	22	22	22	22	22	22	22
40,000	60,000	24	24	24	24	24	24	24	24
60,000	80,000	26	26	26	26	26	26	26	26
80,000	100,000	28	28	28	28	28	28	28	28
100,000	150,000	30	30	30	30	30	30	30	30
150,000	250,000	32	32	32	32	32	32	32	32
250,000	500,000	34	34	34	34	34	34	34	34
500,000	750,000	37	37	37	37	37	37	35	37
750,000	1,000,000	39	39	39	39	39	39	35	35
1,000,000	1,250,000	41	41	41	41	41	41	35	41
1,250,000	1,500,000	43	43	43	43	43	43	35	43
1,500,000	2,000,000	45	45	45	45	45	45	35	45
2,000,000	2,500,000	49	49	49	49	49	49	35	49
2,500,000	3,000,000	50	49	48	47	46	45	35	53
3,000,000		50	49	48	47	46	45	35	55

The Tax Relief Act did not change the \$10,000 per year per donee gift tax exclusion as indexed for inflation. The gift tax exclusion for qualified payments for tuition or medical expenses was also unchanged by the new law. The current carryover basis system will continue to apply to gifts made under the new Tax Relief Act.

The applicable exclusion amount for gifts was maintained at \$1 Million to discourage gifts of appreciated assets to persons in lower income tax brackets. Under Section 2511(c), any transfer to a trust made after December 31, 2009 will be a taxable gift unless the trust is treated as wholly owned by the donor or the donor’s spouse under the grantor tax rules of Section 671-679 of the Code.

Estate Tax

The estate tax rate will follow the gift tax rate except the estate tax will be repealed after December 31, 2009⁷ and then will spring back into place unless the law is reenacted. The following table illustrates the estate tax rates for each year:⁸

Estate Tax Rate Schedule for 2002-2011

Over	But Not Over	2002	2003	2004	2005	2006	2007-2009	2010	2011 & after unless new law is reenacted
\$0	\$10,000	18	18	18	18	18	18	N/A	18
10,000	20,000	20	20	20	20	20	20	N/A	20
20,000	40,000	22	22	22	22	22	22	N/A	22
40,000	60,000	24	24	24	24	24	24	N/A	24
60,000	80,000	26	26	26	26	26	26	N/A	26
80,000	100,000	28	28	28	28	28	28	N/A	28

⁷Code Section 2210(a).

⁸Tax Relief Act Section 511(c) amending Code Section 2001(c).
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100,000	150,000	30	30	30	30	30	30	N/A	30
150,000	250,000	32	32	32	32	32	32	N/A	32
250,000	500,000	34	34	34	34	34	34	N/A	34
500,000	750,000	37	37	37	37	37	37	N/A	37
750,000	1,000,000	39	39	39	39	39	39	N/A	35
1,000,000	1,250,000	41	41	41	41	41	41	N/A	41
1,250,000	1,500,000	43	43	43	43	43	43	N/A	43
1,500,000	2,000,000	45	45	45	45	45	45	N/A	45
2,000,000	2,500,000	49	49	49	49	49	49	N/A	49
2,500,000	3,000,000	50	49	48	47	46	45	N/A	53
3,000,000		50	49	48	47	46	45	N/A	55

Estate Tax Repealed in 2010

The estate and generation skipping tax will be repealed effective December 31, 2009. However, the repeal will last only one year and all provisions of the Tax Relief Act will sunset and will not apply to a decedent dying, a gift made after or generation-skipping transfer made after December 31, 2010. Unless the Tax Relief Act is reenacted, the provisions of the Internal Revenue Code of 1986 will then come back in to place as if the amendments made to the law by the Tax Relief Act never happened.

Step-up in Basis Replaced with Modified Carryover Basis of Inherited Assets in 2010

For a decedent dying after December 31, 2009, the current adjustment to basis rule for property acquired from a decedent will be eliminated and replaced by a modified carryover basis system. In 2010, property acquired from a decedent will be treated the same as property transferred by gift with certain exceptions. After 2009, the recipient of property acquired from a decedent will receive a carryover basis equal to the lesser of the decedent's adjusted basis or the fair market value

of the property as of the date of the decedent's death.⁹ Unlike gifts, however, the Executor can increase the basis of property acquired from a decedent as follows:

1. The Executor can increase basis by a total of \$1,300,000.¹⁰ The \$1,300,000 is increased by any capital loss carryover under Section 1212(b), the amount of any net operating loss carryover under Section 172 which would, but for the decedent's death, be carried from the decedent's last taxable year to a later taxable year plus the sum of any built in losses as determined under Section 165.¹¹

⁹Code Section 1022(a).

¹⁰Code Section 1022(b)(2)(B).

¹¹Code Section 1022(b)(2)(C).

2. In addition to the \$1,300,000 basis increase, the Executor can increase the basis of property transferred to a surviving spouse (“qualified spousal property”) by a total of \$3,000,000.¹² For a surviving spouse to receive the additional \$3,000,000, the property must pass outright to the spouse or pass as qualified terminal interest property (QTIP).¹³ The Tax Relief Act retains the same definition of qualified terminal interest property as property in which the surviving spouse has a qualifying income interest for life. Any property in a marital deduction estate trust will not qualify for the additional \$3,000,000 basis increase.
3. As a result, a surviving spouse can receive a total basis increase of \$4,300,000 or the Executor could allocate all or part of the \$1,300,000 basis increase to persons receiving property other than the surviving spouse. It is important to remember that the basis increase amounts are counted in addition to the decedent’s adjusted cost basis. For example, if the total adjusted basis of a decedent’s assets were \$1 Million, then \$2.3 Million in assets (\$1 Million plus the \$1.3 Million) could be transferred to a beneficiary with a step-up in basis.
4. Any basis increase is allocated by the Executor on an asset by asset basis.¹⁴ The Executor must elect which asset will receive an increase in basis and the amount of the basis increase allocated to the asset. This means that heirs could receive assets with the same fair market value but with a different tax basis and consequently with varying capital gain tax implications when the asset is sold.

¹²Code Section 1022(c).

¹³Code Section 1022(c)(3).

¹⁴Code Section 1022(d)(3).

5. In no event can the basis allocated to the asset exceed the fair market value of the asset as of the decedent's date of death.¹⁵
6. Only a \$60,000 basis increase will be allowed to nonresidents who are not U.S. citizens.¹⁶
7. The \$1,300,000, \$3,000,000 and \$60,000 basis increase amounts will be indexed for inflation after December 31, 2009. The permissible inflation adjustments are rounded down to increments of the nearest \$100,000, \$250,000 and \$5,000 respectively.¹⁷

For property to be eligible to receive a step-up basis, the property must be owned by the decedent at the time of his or her death. Under Section 1022(d), the ownership rules are applied as follows:

1. As with prior law, the decedent will be treated as the owner of one-half of the property that is owned as joint tenants or tenants by the entirety with the surviving spouse. As a result, only 50% of property by a husband and wife as joint tenants or tenants by the entirety is eligible to receive an increase in basis.¹⁸

¹⁵Code Section 1022(d)(2).

¹⁶Code Section 1022(b)(3).

¹⁷Code Section 1022(d)(4).

¹⁸Code Section 1022(d)(1)(B)(i)(I).

2. As with prior law, any property owned by the decedent in joint tenancy with a person other than the surviving spouse, the decedent will be considered the owner of the property to the extent the decedent furnished the consideration for the acquisition of the property.¹⁹
3. In the case of property owned by the decedent as joint tenants with a person other than the surviving spouse in which the property was acquired by gift, bequest, devise or inheritance, and the ownership interest in the property is not otherwise specified by the document or by law, the decedent will be treated as the owner of the property by dividing the value of the property by the total number of joint tenants.²⁰
4. The decedent will be considered the owner of any property that the decedent transferred to a qualified revocable trust as defined in Section 645(b)(1).²¹
5. The decedent will not be considered the owner of any property by reason of holding a power of appointment. As a result, property that the decedent possessed a general or special power of appointment will not be eligible for the allocation of a basis increase.²²
6. The decedent will be considered the owner of the surviving spouse's one-half share of community property if at least one-half of the whole of the community property interest is treated as owned by, and acquired from the decedent.²³

¹⁹Code Section 1022(d)(1)(B)(i)(II).

²⁰Code Section 1022(d)(1)(B)(i)(III).

²¹Code Section 1022(d)(1)(B)(ii).

²²Code Section 1022(d)(1)(B)(iii).

²³Code Section 1022(d)(1)(B)(iv).

Under the definition of ownership, it does not appear that property passing in a QTIP trust upon the death of the surviving spouse would be eligible to receive a step-up basis.

Even if the property is considered to be “owned by the decedent,” the following property will not be eligible for an adjustment to basis:

1. Any property that was acquired by the decedent by gift or by inter vivos transfer for less than full consideration during the 3-year period ending on the date of the decedent’s death.²⁴ The 3-year rule will not apply for property acquired by a decedent from his or her spouse unless such spouse received the property in whole or in part by gift or inter vivos transfer for less than full consideration.²⁵
2. Property that constitutes income in respect to a decedent under Section 691.²⁶
3. Stock or securities of a foreign personal holding company, a DISC or former DISC, a foreign investment company, or a passive foreign investment company.²⁷

Special Rules

²⁴Code Section 1022(d)(1)(C)(i).

²⁵Code Section 1022(d)(1)(C)(ii).

²⁶Code Section 1022(f).

²⁷Code Section 1022(d)(1)(D).

1. Effective for decedents dying after December 31, 2009,²⁸ the \$250,000 exclusion from gross income for the sale of a principal residence is extended to estates, heirs and certain revocable trusts. Under new Section 121(d)(9), \$250,000 of gain can be excluded by an estate and heir if the decedent used the property as his or her principal residence for two or more years during the five-year period prior to the sale.²⁹ In addition, if an heir occupies the decedent's home as his or her principal residence, the decedent's period of ownership and occupancy can be added to the heirs subsequent ownership and occupancy in calculating the two out of five years ownership and use test. Under Section 121(d)(9)(C), the \$250,000 exclusion is also extended to property sold by a trust provided that the trust was a qualified revocable trust as defined under Section 645(b)(1) immediately prior to the decedent's death. Any period of occupancy and ownership of the decedent can be extended to an heir's subsequent ownership and use regardless of whether the principal residence was owned by a trust established by the decedent.
2. The heir receiving the property from a decedent will report the same type of gain as if the property had been received by gift. As a result, depreciable property received by an heir will continue to be subject to recapture when sold by the heir.

²⁸Pub. L. 107-16, Section 901, provides that provisions of Section 121(d)(9) will not apply to estates or decedents dying after December 31, 2010.

²⁹Code Section 121(d)(9)(A) and Section 121(d)(9)(B).
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3. If gain is recognized by an estate as the result of the funding of a pecuniary bequest, the gain will be recognized only to the extent that the fair market value of the property at the time of the transfer exceeds the fair market value of the property on the date of the decedent's death.³⁰ As a result, an Executor will not be forced to allocate basis to property funding a pecuniary bequest just to avoid gain being recognized. Although the Tax Relief Act provides that the same rules will apply to a trust to the extent regulations are promulgated, it may be necessary to make a Section 645 election (an election to treat a qualified revocable trust as estate) if the rules are not clarified by that time.
4. Gain is not recognized if property is received by an estate or heir subject to a liability in excess of the decedent's adjusted basis. In addition, no gain will be recognized by the estate upon the distribution of such property to a beneficiary subject to a liability unless such beneficiary is a tax-exempt beneficiary. A tax-exempt beneficiary is defined to include the United States, a state, a possession, an organization exempt from income tax, a foreign person, entity, government or organization.³¹

Reporting Requirements and Penalties for Failure to Report

Prior law required the Executor of an estate with gross assets in excess of the applicable exclusion amount to file an estate tax return with the Internal Revenue Service. The rules regarding filing an estate tax return will continue to apply during the phase down period (to estates of decedents dying up to December 31, 2009). The prior rules relating to the filing of estate tax returns will be reinstated when the new law sunsets in 2011.

³⁰Section 1040(a).

³¹Code Section 1022(g).

For deaths occurring in 2010, the Executor of the estate (or the trustee of a revocable trust) is required to report to IRS all non-cash assets transferred at death if the gross fair market value of the property (in the aggregate) exceeds \$1.3 million.³² However, the reporting requirements only apply to property that is considered to be property acquired from a decedent.³³ Property that constitutes a right to receive an item of income in respect of a decedent (IRD) under Section 691 is not considered to be property acquired from a decedent for purposes of the carryover basis rules. Consequently, IRD property (including traditional IRAs and 401(k) plans) is not eligible for a step-up in basis, and need not be reported to the IRS on the Section 6018 return relating to large transfers.

The Executor also must report to the IRS any appreciated property received by the decedent within three years of death which was required to be included on a gift tax return.³⁴ The Section 6018 return is to be filed with the decedent's last income tax return, unless a later date is specified in IRS regulations.

The Executor must report the following information for each asset to the IRS:³⁵

- the name and taxpayer identification number (TIN) of the recipient;
- an accurate description of the property;
- the adjusted basis for the property in the hands of the decedent and its fair market value at the time of death;
- the decedent's holding period;

³²Code Section 6018(a).

³³Code Section 6018(d).

³⁴Code Section 6018(b)(2).

³⁵Code Section 6018(c).

- sufficient information to determine whether any gain on the sale of the property would be treated as ordinary income;
- the amount of basis increase (aggregate and spousal) allocated to the property; and
- such other information prescribed by the IRS.

Within 30 days of filing the return with the IRS, the Executor is required to provide the same information in writing to the individuals receiving each property, along with the executor's name, address and phone number.³⁶

The Executor will be subject to penalties for failure to provide the required information to the IRS by the required date. The penalty for each violation is \$10,000 for failure to report on the transfer of noncash assets at death; \$500 for failure to provide the required information to the IRS on appreciated property acquired by the decedent within three years of death; and \$50 for each failure to report the information to a beneficiary.³⁷

For gift transfers made during life, the donor is required to provide the donees with the property's fair market value and tax basis. The donor will be subject to a \$50 penalty for each failure to provide the required information to each donee.³⁸

Although the penalty will be waived on a showing of reasonable cause,³⁹ a 5% penalty on the fair market value of the property at the date of the decedent's death or the time of the gift (for a lifetime gift) will be imposed on an intentional disregard of the rules.⁴⁰

³⁶Code Section 6018(e).

³⁷Code Section 6716(a).

³⁸Code Section 6716(b).

³⁹Code Section 6716(c).

Family-owned Business Deduction Repealed

Prior law provided a special deduction for family-owned business interests under Section 2057. Currently, the family owned business deduction of \$675,000 (maximum), in combination with the applicable exclusion amount (available to all estates), can protect up to \$1.3 million. Since the applicable exclusion amount will be \$1.5 Million as of 2004, the family-owned business deduction would no longer offer any special advantage. As a result, the Tax Relief Act repeals the family owned business deduction as of 2004.

Credit for State Death Taxes Phased Out, Replaced with Deduction

Under prior law, a limited tax credit is allowed against the federal estate tax for death taxes (including estate, inheritance, legacy, or succession taxes) actually paid to any state on any property included in the decedent's gross estate. The maximum amount of the credit is determined based on the size of the decedent's adjusted taxable estate in conjunction with a table of graduated tax rates.

Since the state death tax credit may only be claimed against the federal estate tax liability remaining after subtracting the unified credit from a tentative tax on the estate, the credit only helps those estates with a net taxable value that is larger than the applicable exclusion amount in effect for the year of death (\$675,000 in 2001, corresponding to a unified tax credit of \$220,550).

⁴⁰Code Section 6716(d).

The new law phases out the state death tax credit over four years, beginning in 2002.⁴¹ In 2002, the credit is 75% of its former level; in 2003, 50% of its former level; in 2004, 25% of its former level; and in 2005 the state death tax credit is repealed. Beginning with 2005, the credit will be replaced with a deduction.⁴²

Once the state death tax credit is changed to a state tax deduction in 2005, those states that specifically link their state estate tax to the federal credit will be required to enact a new statute creating an independent state estate tax or inheritance tax. Otherwise, the state will lose all state estate tax revenue because the federal state death tax credit will no longer be in existence. A decedent dying in a state with independent state death taxes still in existence after the repeal of the credit could deduct those taxes in full from the gross estate.

For estates required to pay independent state estate or inheritance taxes in 2005 - 2009, the replacement of the state death credit to a state death tax deduction will cause the combined federal and state tax liability to be higher. The combined federal and state tax liability will increase because the deduction for state taxes paid will reduce federal estate taxes only in proportion to the estate's marginal tax rate. (The maximum estate tax rate is 47% in 2005, 46% in 2006, and 45% in 2007 - 2009.) This offset is lower than the dollar-for-dollar reduction in federal taxes provided by the state death tax credit under prior law, but higher than the 25% credit available in 2004.

The reduction and then change of the state death tax credit to a deduction will have no effect on those estates not subject to the federal estate tax because they are smaller than the exemption amount. Similarly, the deduction for state taxes will be worthless to all estates when the estate tax is

⁴¹Tax Relief Act Section 531, amending Code Section 2011(b).

⁴²Tax Relief Act Section 532, adding Code Section 2058.

repealed in 2010. The credit for state death taxes will be reinstated if the provision of the Tax Relief Act sunset as scheduled in 2011.

Conservation Easements

Prior law required a qualified conservation easement to be in or within 25 miles of a metropolitan area, national park, or wilderness area, or in or within 20 miles of an Urban National Forest (IRC Section 2031(c)(8)(A)). The Tax Relief Act expands the geographic area and now allows a qualified conservation easement to be claimed on any land located in the United States or its possessions.⁴³ The Tax Relief Act clarifies that the values are the values as of the date of the contribution. These amendments are effective after December 31, 2000.

Planning with an Uncertain Law

1. The change to a modified carryover basis system will increase record keeping responsibilities for most taxpayers. Since it is always easier to obtain information regarding the tax basis of property while the owner is alive, clients should be alerted to this new requirement. Changing your client intake sheet to include questions about the client's tax basis may help minimize problems when the client passes away. Remember, an asset received by a decedent within 3 years of death will not receive a step-up basis even if the decedent's estate is less than \$1.3 Million.
2. Most states that tie their estate tax to the federal estate tax credit will be forced to amend their estate tax system or risk losing all tax revenues in this area. Most states will enact an independent estate tax or inheritance tax system. Some states may enact taxpayer friendly systems to compete with neighboring states.

⁴³Code Section 2031(c)(8)(A)(i).

3. Although the applicable exclusion amount is scheduled to increase from \$1 Million in 2002 to \$3.5 Million in 2009, it continues to apply on a per decedent or per person basis. As a result, a married couple must continue to take the necessary tax planning steps of dividing ownership of assets to each spouse and using the estate tax applicable exclusion amount on the death of the first spouse.
4. The transition period will create numerous problems for the planner. While the increase in the applicable exclusion amount will eliminate tax liability for many of our clients, it will create additional planning problems for individuals and couples with assets in excess of \$1 Million. It will be necessary to continually educate our clients and draft their estate plans to take into account the almost limitless scenarios that could occur under the new law. Many of our clients may be unwilling to pay for several revisions to their estate plan as a result of the new law. Others will ignore the matter entirely hoping that they will survive the transition period and that the repeal will be permanent.

Problem Areas the New Law Creates

Existing documents that contain formulas for funding the marital and nonmarital trusts will need reviewed. This will be an especially sensitive subject for couples with children from multiple marriages, or in situations where one spouse possesses or controls most of the wealth. The following are some of the problems that will occur with formula clauses:

1. A pecuniary marital deduction clause that funds the marital or QTIP trust with the smallest amount to reduce the estate tax to zero will not pass anything to the surviving spouse if the estate tax is no longer applicable, or may cause the nonmarital trust to be funded more than necessary during the transition period. Placing all of the assets in the nonmarital trust with little or nothing to the surviving spouse may not be what your clients intended. The nonmarital trust may impose additional limitations on the surviving spouse that are not necessary and none of the nonmarital trust assets will be eligible for an increase in basis upon the death of the surviving spouse.
2. A formula leaving the nonmarital trust equal to the applicable exclusion amount with a marital residuary bequest may create similar problems. If the estate tax is no longer applicable, all property will pass to the residuary marital trust. If the client dies during the transition phase, the pecuniary nonmarital trust may be funded with more assets than is needed leaving little if anything for the surviving spouse in the marital residuary trust.
3. Standard language used in documents that direct the fiduciary to “not designate any asset to the marital trust that does not qualify for the marital deduction” will create problems if the estate tax is repealed and there is no longer a marital deduction.
4. The Tax Relief Act changed or eliminated a considerable number of Code Sections. If your document reference specific code sections, it will be necessary to reflect the new code sections in your documents.

Drafting for Flexibility

Wills and Revocable trusts need to be drafted to handle situations when the client dies during the phase-in but prior to the repeal, during the repeal, and when the Tax Relief Act sunsets and pre-Tax Relief Act law springs back into existence. This will require the attorney who is doing estate planning for individuals or couples with assets in excess of \$1 Million must learn the new Tax Relief Act now. The following are a few drafting suggestions:

1. Consider drafting documents with two parts. The first part applies if the federal estate tax is not applicable at the date of the client's death.⁴⁴ If the federal estate tax is not applicable, a different funding mechanism that does not reference the marital deduction, or charitable deduction should be used. The funding plan should take into account the \$1,300,000 and \$3,000,000 basis adjustments. The second part of the document would reference a standard funding formula with caps on the amount funded into the nonmarital or marital trust or utilize some of the other methods as suggested below.
2. Have the document pass all property to a QTIP trust. The assets the fiduciary does not make a QTIP election would then pass to another trust for the benefit of the spouse and/or children.
3. The use of disclaimers in lieu of a formula. In this manner, the surviving spouse or independent party could wait until nine months after death to determine the amount to fund into any sub trusts. Disclaimers provisions can create friction among beneficiaries, and will not be successful unless completed within the applicable nine

⁴⁴Avoid language that states if "I die after the federal estate tax is repealed" because it may be repealed in 2010 and come back in 2011.

month time period and all other requirements are satisfied. Appropriate exculpatory language for the fiduciary should be included in the document.

4. With a revocable trust, a client can designate the trustee, special fiduciary, a trust protector or an agent under a durable power of attorney with the authority to change the terms of the trust. This could also be done with an inter vivos irrevocable trust. Appropriate language would need to be included in the trust to make sure the person given the authority to make the changes does not possess a general power of appointment. In addition, any changes given to the individual should be limited by precatory language that it is the settlor's intent to enable the person to make amendments to the trust due to changes in the tax law.
5. It would be important to grant the trustee broad discretion to terminate or continue a trust. It will be critical to limit any power given to a family member who is acting as trustee so the family member will not be deemed to possess a general power of appointment over the trust assets. The use of an independent trustee to make these decisions will be advisable.