

Estate Tax Repealed for 2010

By CPM Family Wealth & Estate Planning Attorneys

Despite what estate planning practitioners expected, Congress did not enact comprehensive federal estate tax reform or extend 2009 estate tax law into 2010. Thus, on January 1, 2010 the federal estate tax and generation-skipping transfer (“GST”) tax were repealed for 2010 only. In 2011, the estate and GST tax system is scheduled to be reinstated with an exemption of \$1 million (rather than the 2009 exemption of \$3.5 million) and tax rates will return to a maximum rate of 55% (rather than the 2009 maximum rate of 45%).

There is speculation that Congress may reinstate the estate and GST tax law retroactive to January 1, 2010. However, it is unclear if a retroactive reinstatement of the estate and GST tax will occur or if anything will happen soon. A retroactive reinstatement of the estate and GST tax is also likely to be challenged as unconstitutional, although it is unlikely that a challenge would be successful.

Gift Tax in 2010

The federal gift tax system is still in effect. In 2010 the rate on taxable gifts is 35%, instead of the 45% rate applicable in 2009. The cumulative exemption for lifetime gifts continues to be \$1 million and the gift tax annual exclusion remains at \$13,000 per donee. In 2011, gift tax rates are scheduled to return to a maximum rate of 55%.

Carryover Tax Basis

While there is no estate tax, a new “carryover” tax basis system applies to those who die in 2010 only. Prior to 2010 (and beginning again in 2011) assets inherited from a decedent received a new tax basis equal to the value of the assets at the decedent’s death. Assets inherited from a decedent dying in 2010 do not get a new stepped up tax basis. Assets inherited from a decedent who dies in 2010 will have an income tax basis in those assets that is the lower of the decedent’s tax basis or the fair market value of the asset at the decedent’s death.

Luckily, there is fairly significant relief from these onerous carryover basis provisions for all but the larger estates. Every 2010 decedent’s estate is allowed to increase to fair market value the basis of the decedent’s assets by up to \$1,300,000 of basis increase. For assets left to a decedent’s surviving spouse there is an additional \$3,000,000 of permitted basis increase.

What Should You Do?

While it may be tempting to adopt a “wait and see” approach, unfortunately a significant percentage of clients’ estate plans could be dramatically and adversely impacted by a death in 2010. Due to the temporary repeal of the estate tax and GST tax in 2010, we recommend that you review your estate planning documents. Many wills and trusts divide assets among beneficiaries using tax formulas based on the federal estate tax exemption (\$3.5 million in 2009) and GST tax exemption. For example, in order to reduce taxes many married couples have trusts (so called Marital/Family or A/B trusts) which use tax based formulas designed to fully utilize their federal estate tax exemptions and GST tax exemptions.

If the beneficiaries of your Marital/Family, or A/B, trusts differ, the tax-based formulas designed to fully utilize your federal estate and GST tax exemptions could, with a 2010 death, wildly alter the proportion of assets passing to those beneficiaries from your original intent. Further, in 2010, there could be some uncertainty in how tax based formulas should operate if estate and GST taxes are repealed. All this could result in the distribution or allocation of assets to trusts, spouses, descendants and other beneficiaries much differently from what you expected.

Planning Possibilities

There could be an advantage to currently making transfers to grandchildren and lower generations in 2010 while there is no GST tax. However, retroactive reinstatement of the GST tax, if upheld, may result in no benefit for such transfers, and could incur unnecessary taxes.

Unfortunately no one knows when, how, or if Congress will act. Prudence suggests action, not delay. If you would like to discuss the impact of all this on your estate plan, please contact any of the attorneys in our Family Wealth & Estate Planning group or your CPM attorney.