

A year without federal estate tax?

Estate planners were stunned in December when Congress failed to act on fixing the federal estate tax. As of January 1, 2010, both the federal estate tax and the federal generation-skipping transfer tax have disappeared. What's more, the federal gift tax rate, imposed upon lifetime gifts in excess of \$1 million, has fallen from 45% to 35%.

It's not all good news for wealthy families, however. The absence of the federal estate tax also means the loss of basis step-ups for inherited assets. They could owe substantial capital gains taxes when those assets are sold. Still, capital gain tax rates are far below estate tax rates. What's more, every estate will be entitled to \$1.3 million in basis adjustments, with another \$3 million in adjustments for property passing to a surviving spouse. Basis adjustments will be handled by the estate's executor—just one more reason for giving this important job to an experienced professional, such as us.

At the 2009 estate tax exemption of \$3.5 million, an estimated 5,500 estates owed federal estate tax. Press reports indicate that, even with the basis adjustments in place, more than ten times that number of families, perhaps 70,000, could be affected by the new capital gains taxes on assets inherited in 2010.

What's next? As in 2009, either Congress will act, or it won't. If Congress does nothing, the federal estate tax strikes back in 2011 with a \$1 million exemption and a top marginal tax rate of 60% on some estates. If Congress acts, the 2009 rules may simply be extended, or additional reform measures may be included.

Should wealthy families try to take advantage of the year without federal estate taxes? Some will do so, if only because we cannot know the date of our death. But some Congressional leaders have stated that they will try to make any Congressional action on the estate tax retroactive to January 1. Retroactive taxes raise constitutional questions, but retroactive increases in estate tax rates were allowed by the courts during the Clinton administration. If the estate tax reforms are made retroactive, court challenges almost certainly will follow.

(January 2010)

© 2010 M.A. Co. All rights reserved.