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Estate, Legacy and Business Planning

ESTATE TAX 2010

Congress Didn't Act... Where Does This Leave Us? BY GARY ALTMAN, ESQ.

The final year of The 2001 Tax Act (EGTRRA 2001) is now upon us, and estate tax repeal, at least temporarily and unless reinstated retroactively, is upon us. Quite frankly, I never expected this to happen. I, along with many of my colleagues, anticipated Congress to act before this. Now, we have to consider that, at least for some part of 2010, all transfers at death will be *estate tax and generation-skipping transfer tax free.*

The Early Byrd Catches the Worm

Due to the Byrd Rule, which limits laws with a negative fiscal impact to 10 years, EGTRAA is set to expire on December 31, 2010. This means that the estate tax law is scheduled to revert back to what it was as of January 1, 2001, as if the changes never occurred. (The federal estate tax exemption will become $1,000,000, the GST exemption will be somewhat greater, and the maximum estate tax rate will return 55% - with a surcharge of 5% for certain estates over $10,000,000).

The looming question is: Will Congress be able to address the massive confusion that is taking place when trying to understand and plan for a year of no estate and GST tax? Complicating the matter, if Congress makes new legislation retroactive to January 1, 2010, numerous lawsuits over the constitutionality of such a move may occur. Such proceedings could end up tied up in the courts, possibly culminating in a Supreme Court decision.

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The Blame Game

It should not be a foregone conclusion that Congress can make the estate tax retroactive to January 1, 2010. Many already feel the reinstituting the estate tax on a retroactive basis would be unconstitutional. And, many say it would be in the best interest of the country to do nothing and let EGTRRA sunset (which means a $1,000,000 estate tax exemption, with a maximum rate of 55%). The Democrats argue that a Republican Congress and President signed the law creating this insanity. Republicans argue that they have steadfastly argued for total repeal of the "death tax" – which resonated with the people, at least back in 2001. Democrats had the opportunity to permanently end the "death tax" and chose not to. Both sides had numerous opportunities to compromise on an exemption number (like 3.5 million or 5 million or even greater) and an estate tax rate (like 45% or 35% or even lower). In addition, this issue will likely be a significant mid-term election discussion. The most likely outcome of all of this will largely depend on the political priorities on Capitol Hill.

Step by Step

Probably the most controversial and confusing aspect of EGTRAA is that it replaced, for 2010, the estate tax and GST with a modified carryover basis. Under the law that was in effect in 2009, subject to some exceptions, assets owned at death received a basis "step-up" to a fair market value at death. For example, if a client were to die owning a stock that he/she purchased many years ago, the beneficiaries could sell that stock at its fair market value of today and pay little or no capital gains tax (though the value of the stock would have been subject to estate taxes at its fair market value on the date of death). The only capital gains tax that would be paid is the difference between the sale price and fair market value at time of death.

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Under the 2010 repeal of the estate tax, a beneficiary receives property with an adjusted basis equal to the lesser of the decedent's basis or the asset's fair market value at the date of death. This means the automatic "step up" is eliminated at death but retains the "step down" for depreciating assets. Many attorneys agree that this modified carryover basis will impact far more decedents than those that would have been impacted by the estate tax. To offset this loss, EGTRRA provides the executor or any other person responsible for the decedent's property with the right to allocate a $1.3 million "aggregate" increase on an asset by asset basis. Assets left outright to a spouse receive an additional $3 million "spousal property basis increase". Assets left to a spouse in a "marital trust" may be eligible for this additional $3 million property basis increase depending on the terms and provisions of the marital trust. In any event, this ability to increase the basis on certain assets will certainly complicate the administration of estates of persons dying in 2010 and could lead to lawsuits if an executor's action in increasing the basis of certain assets benefits the estate's beneficiaries unequally.

The Bottom Line:

I have always advocated that all existing estate plans created more than 4 years or so ago should be reviewed to make certain the client's objectives are still being met. The elimination of the estate tax for 2010 makes it imperative that many estate plans be reviewed and possibly changed immediately. For instance, if someone created their estate plan when the federal exemption was significantly lower, and should the client die in 2010, a client's estate planning documents may include a formula that could shift assets from a spouse to another beneficiary. This may be of particular concern where a client wanted his or her children or other relatives to receive the amount that passed free of estate tax and for the surviving spouse to receive the balance. If all of the assets pass free of estate tax, then the surviving spouse may end up with nothing. This could be a totally unintended consequence and could be particularly ugly for second marriages and children from a prior marriage. It is important to make certain that the will or trust language will ensure assets are available for the surviving spouse.

As all of the above demonstrates, it is important that every person's estate plan be periodically reviewed to provide the necessary flexibility and provisions to take account of current and ever changing tax circumstances.

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