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Estate Taxes: Where Are We Headed?

What was once unthinkable for estate planners and their clients has actually occurred: no estate tax. At least for now.

As those of you who have updated your estate plans since 2001 may remember, the estate tax reduction plan that was included in the 2001 Tax Act culminated the ten-year period of reductions with a one-year estate tax repeal in 2010. The estate tax has a "sunset" in 2010. But the estate tax repeal law itself has a "sunset" - on January 1, 2011 the estate tax is resurrected.

Virtually all, or perhaps all estate planners, including yours truly, anticipated Congressional action that would have headed off the one-year estate tax repeal. No one truly thought that Congress would ever allow a one-year estate tax gap followed by reinstatement of a harsher estate tax. This one-year gap until the reinstatement of the tax would create a mess for transfers made during that gap, and trusts created during that time.

As it turned out, Congress allowed 2009 to expire without any transfer tax legislation. And so we are in the uncharted waters of not having an estate tax in 2010, and expecting the estate tax to be resurrected in 2011, if not sometime later in 2010. And if Congress reenacts the estate tax in 2010, they may do so retroactively to January 1. Whether you are in favor of this estate tax or not, the result of Congress' failure to act is chaos for taxpayers and estate planners.

What to Do?

Assuming your family has a distaste for tax litigation, and you prefer not to die in 2010, flexibility in planning remains key. Knowledgeable commentators think that Congress will not act this year, but allow 2010 to pass without a Federal Estate Tax, letting the sun rise on 2011 with the much lower exemption of $1 million per taxpayer. Again, a flexible estate plan remains key.

One seldom discussed feature of this temporary estate tax repeal is that taxpayers have lost the "step-up" in income tax basis for their assets that occurred with the estate tax. As a result, surviving family members may have to pay capital gains tax when they sell inherited assets. Under the new rule, the basis for determining gain or loss on the sale of capital assets acquired from a decedent will be the decedent's basis in those assets prior to his or her death. No longer is the new basis of the asset's Fair Market Value (FMV) on the decedent's

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date of death, unless that FMV is lower than the decedent's basis - only then is the date of death FMV used. However, the personal representative of an estate may allocate $1.3 million of basis to appreciated assets plus an additional $3 million to increase the basis of assets passing to a surviving spouse.

If you have specific questions about your personal estate plan or wish to have it revised, please contact your Reinhart attorney or Christine Rew Barden, shareholder in Reinhart's Trusts and Estates Practice.

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