

Will The Federal Estate Tax Be Repealed? Stay Tuned for Our Next Episode

DECEMBER 28, 2009

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The season finale of every television drama ends with a cliffhanger to keep its viewers in suspense of what is to come for their favorite characters. Many of us can remember the “Who Shot J.R.” episode of the television show *Dallas* of the 1980s. As 2009 nears to a close, many are experiencing a similar feeling when it comes to Congress and the Federal Estate Tax Law.

Although most commentators had expected that Congress would act by December 31st to avoid the scheduled one-year repeal of the federal estate and GST taxes, it now looks as though Congress will recess without having taken action.

As the estate law stands now, if Congress does not act before December 31, 2009, then on January 1, 2010, the following estate tax areas will be affected:

I. Federal estate tax and generation-skipping tax are repealed for one year

The federal estate tax and generation skipping transfer tax are repealed for one year. This means that there will be no federal estate tax on the estates of individuals who die in 2010 and there will be no generation skipping transfer tax on transfers made that year.

However, individual state laws regarding estate, gift and generation skipping transfer taxes will continue in effect.

II. Estates of decedents dying after January 1, 2010 are subject to the complicated carry-over basis rules

Along with the repeal of the estate and GST taxes, there will be an elimination of the current “step-up” in basis rule as to assets in a decedent’s estate. Under the current law, all property owned by a decedent receives a basis increase to its value on the decedent’s date of death or alternate six-month valuation date.

As of January 1, 2010, property in a decedent’s estate will retain the decedent’s cost basis, which will “carry-over” to the recipients of the property. Capital gains tax will then be incurred when the property is sold on the difference between the sales price and the decedent’s basis. There are, however, some exceptions to this “carryover” basis regime. Every decedent will be allowed a \$1.3 million step-up in basis to be allocated among their assets. In addition, assets which pass to a surviving spouse are allowed an additional \$3 million increase in basis.

**ACTIONS TAKEN IN
CONGRESS MAY AFFECT
ESTATE TAXES AFTER
JANUARY 1, 2010.**

**Questions or comments?
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III. Gift tax is not repealed

There will still be a federal gift tax at a maximum rate of 35%, with each individual entitled to a \$1 million exemption from the gift tax.

IV. Reinstatement of the Estate Tax is likely during 2010

The 2001 Tax Act, however, also included a "sunset" provision that eliminates all of the changes the 2001 Tax Act made (including the transfer tax changes) at the end of 2010. Unless the Federal Estate Tax Law is changed, beginning in 2011, the Federal Estate Tax Law will revert back to the provisions that were in effect prior to 2001. The estate tax exemption will drop to \$1 million, the top estate, gift and GST tax rate will become 55% as it was before the 2001 Tax Act, the estate and gift tax system will again be "unified" and the state death tax credit will be restored.

It's not as if Congress has been unaware of the problem – since the 2001 Tax Act became law, many bills have been introduced in both the House and the Senate to address the estate tax and at least attempt to make enhanced exclusions and lower rates permanent. Most recently, Congress had attempted to pass legislation which would avoid the repeal and permanently extends the 2009 \$3.5 million estate tax exclusion and 45% rate, as well as the current "basis adjustment" rules. The House passed such a bill early in December. However, the Senate has not acted on the bill. It now appears that Congress will not pass any legislation before December 31, so the estate taxes will be repealed effective January 1, 2010.

It is expected that Congress will act after the new year to reinstate the Federal Estate Tax and that they may attempt to make them retroactive to January 1st. Congress's ability to impose these taxes retroactively is not free from doubt on the premise that the retroactive application of the Federal Estate Tax Law would be an unconstitutional as ex post facto, or "after-the-fact," law.

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Individuals Should Review Their Estate Plans

Congress' inaction leaves taxpayers in a state of uncertainty and confusion as we enter 2010. The lack of consensus in Congress creates doubt about what any new legislation will provide. Some Republicans and conservative Democrats view the one-year repeal as creating leverage to insist on larger exemptions and lower rates (such as the \$5 million exemption and 35% estate tax rate proposal). If the estate and GST taxes are repealed for a full year, their view is that returning to a \$1 million exemption, 55% rate system would be viewed as a massive increase of the unpopular estate tax that would be politically unfavorable, particularly in an election year. However, some Democrats will view the situation as giving them leverage since 60 votes in the Senate will be required to avoid returning to a \$1 million exemption and 55% estate rate system. Key lawmakers expect the fight over the estate tax to intensify next year when the tax is gone.

These developments open tremendous but temporary estate planning opportunities but also may create many unintended distribution of decedents' estates. We encourage you to stay tuned and monitor the news regarding the changes in the Federal Estate Tax Law and invite you to contact us to discuss the impact that these changes in the law may have on your estate plan.

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If you have any questions, please contact the WS+B Tax Services group.



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