

A year without federal estate tax?

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

Good news? Not altogether.

This is the first time in nearly a century that rich Americans can die without being taxed for it. But it's safe to say nobody hopes for that type of windfall. And there's a significant downside: heirs who would previously have been exempted from estate taxes – up to 70,000 by current estimations – now face paying capital gains taxes when they sell inherited assets.

When the estate tax disappeared, so did the IRS's provision for date-of-death valuations, which valued assets at their price on the owners date of death. Depending on that value, the estate might have been exempted from all taxes (in 2009, the threshold was \$3.5 million per person). Now, heirs will be responsible for capital gains taxes on any appreciation of the properties since they were purchased.

The good news is that capital gains taxes are considerably lower than

estate taxes. Also, Congress has authorized the IRS to provide a stopgap exemption for the first \$1.3 million in capital gains and an additional \$3 million for a spouse. The downside is that this could require the executor to go over decades of brokerage statements to trace the history and growth of a given property or investment. Given the new tax considerations it is more important than ever to have an experienced professional handle this critical job.

What's next for estate taxes?

The tax is gone for 2010, but if Congress does nothing it will come back in 2011 – at a higher rate, and with lower exemptions. Or Congress could reinstate the estate tax this year and make it retroactive to January 1. Retroactive taxes raise constitutional questions, but were allowed by the courts during the Clinton administration. If estate tax reforms are made retroactive, court challenges almost certainly will follow.

This uncertainty raises serious questions for estate planners, who often write provisions into wills based on formulas that assume no changes in tax laws from year to year. And with no minimum, upper-middle-class families who would previously have been exempt may find themselves paying capital gains taxes on their inheritance, even with Congress' stopgap measure in place.

Other taxes are affected, too.

The other two provisions, eliminating the generating-skipping tax and changing the gift tax rate, also raise important questions for short-term tax planning. Until the rules are changed again, a wealthy grandparent can give a substantial gift to a grandchild and only pay the 35 percent gift tax. Unfortunately, like the estate tax, these taxes could be revived next year, or re-instituted retroactively.



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