

The State of the Estate Tax

Is there really no estate tax in 2010?



The Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") made sweeping changes to many areas of the Internal Revenue Code including the Estate Tax. Not only did EGTRRA provide for a gradual increase in the Unified Credit (the amount an individual can pass at death free of federal estate taxes) until it reached \$3,500,000 for 2009), but it also provided for a gradual decrease in the top estate tax rate until that reached 45% for 2009. Then EGTRRA eliminated the estate tax altogether for 2010.

However, there was an unusual "**Sunset**" provision added to EGTRRA before it passed Congress. Beginning on January 1, 2011 the provisions of EGTRRA will be repealed which means that unless Congress acts, the estate tax rules that were in effect in 2001 come back (i.e., a \$1,000,000 Unified Credit and a top tax rate of 55%).

Although the House did vote in December of 2009 to permanently extend the estate tax rules that were in effect in 2009 (the \$3,500,000 Unified Credit and a top tax rate of 45%), the Senate did not pass the extension. While Senate Democrats wanted to approve the House version, Senate Republicans wanted a higher Unified Credit (\$5,000,000) and a lower tax rate (35%). Then came Health Care Reform and Estate Tax Legislation was nowhere to be seen.

The elimination of the Estate Tax this year also brings about the elimination of most of the "**Step Up**" in cost basis of estate assets (assets passing at death were given a cost basis equal to the date of death value). This may create some unintended consequences because while an estate may not have an estate tax to pay, it may have a significant capital gains tax burden. For example, many estates which would not have had any estate tax liability (because their value is less than \$3,500,000) under prior law, may have to pay capital gains taxes because an estate will only be allowed to exclude up to \$1,300,000 of capital gain (with an additional \$3,000,000 exclusion for assets passing to a surviving spouse). The following tables highlight these issues:

	2009	
<u>Asset</u>		<u>Value</u>
Home		\$500,000
Vacation Home		\$500,000
Rental Property		\$500,000
Stock		\$500,000
Business		<u>\$1,500,000</u>
Total		\$3,500,000

In 2009, this Estate owes no Federal Estate Taxes and heirs receive a Step Up in Cost Basis.

	2010	
<u>Asset</u>	<u>Cost Basis</u>	<u>Value</u>
Home	\$100,000	\$500,000
Vacation Home	\$100,000	\$500,000
Rental Property	\$20,000	\$500,000
Stock	\$300,000	\$500,000
Business	<u>\$20,000</u>	<u>\$1,500,000</u>

Total \$540,000 \$3,500,000

In 2010, the Estate does not have an Estate Tax, but it does have a Capital gains Tax liability of \$332,000 ($\$3,500,000 - \$540,000 = \$2,960,000 - \$1,300,000 = \$1,660,000 \times .20 = \$332,000$).

If Congress does nothing and the Estate Tax rules which were in effect in 2001 return in 2011, the following scenario would apply:

<u>Asset</u>	2011	<u>Value</u>
Home		\$500,000
Vacation Home		\$500,000
Rental Property		\$500,000
Stock		\$500,000
Business		<u>\$1,500,000</u>
Total		\$3,500,000

In 2011, the Estate would have an approximate estate tax of \$1,375,000 ($\$3,500,000 - \$1,000,000 = \$2,500,000 \times .55 = \$1,375,000$).

Most financial and estate tax planners truly believed that Congress would have been able to address and resolve this issue by now. Unfortunately, they could not and now, the longer the uncertainty remains, the closer we are to a higher estate tax rate and a lower Unified Credit. This means more estates will be subject to estate taxes.

Contact us today to find out if and how the Sunset Provision may affect your Estate.