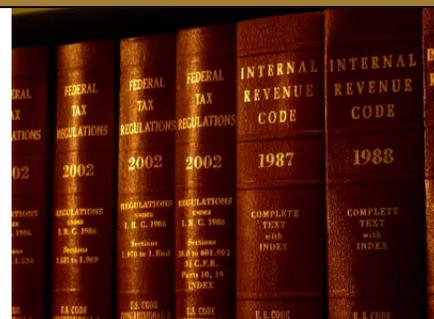


January 2009

ESTATE AND GIFT TAX UPDATE – Temporary Repeal of Federal Estate Tax and Generation Skipping Tax



James H. Henry II
Attorney at Law



John R. LaBar
Attorney at Law

As of January 1, 2010, the future of the Federal Estate Tax, Generation-Skipping Transfer Tax (“GST”) and gift tax remains up in the air. As part of the Economic Growth and Tax Relief Reconciliation Act of 2001 (“EGTRRA”):

- (i) The Federal Estate Tax and GST have been repealed for One (1) year, beginning January 1, 2010;
- (ii) The Federal Gift Tax is not repealed, but remains in effect during 2010 at a lower Thirty-Five (35%) Percent rate;
- (iii) There continues to be a \$1 million lifetime gift tax exemption and an annual gift tax exclusion of \$13,000 per donee; and
- (iv) For individuals dying during 2010, the former “*step-up*” in cost basis at death for assets acquired from a decedent has been repealed, and replaced with a modified “*carryover basis*” system.

Reinstatement of the estate tax is possible during 2010, but the timing of any such legislation is very uncertain. In addition, Constitutional issues (as to the retroactive application of any legislation) or possible Congressional opposition may prevent retroactivity to January 1, 2010.

If Congress does not pass legislation that alters the current tax regime, a “sunset provision” contained in EGTRRA will kick-in effective January 1, 2011. Such “sunset provision” will eliminate all of the exemption increases, rate decreases and other changes originally implemented by EGTRRA. As such, the Federal Estate Tax and GST are scheduled to be reinstated in 2011, with a \$1 million exemption and a maximum effective rate of Fifty-Five (55%) Percent. The Federal Gift Tax also rises in 2011 to a maximum marginal rate of Fifty-Five (55%) Percent. In addition to

This publication is a service to our clients and friends. It is designed to give only general information on the topic actually covered and is not intended to be a comprehensive summary of recent developments in the law, to treat exhaustively the subjects covered, to provide legal advice, or to render a legal opinion.



JANUARY 2010

ESTATE AND GIFT TAX UPDATE – Temporary Repeal of the Federal Estate Tax and Generation Skipping Tax



these Federal taxes, throughout this period, many states, including Tennessee, that impose a separate estate or inheritance tax will continue to do so.

From a capital gains tax perspective, the tax treatment of inherited assets also has changed. For individuals who pass away during 2010, the former “*step-up*” in basis at death for assets acquired from a decedent has been repealed, and replaced with a modified “*carryover basis*” system. In years prior to 2010, the basis for assets held by a decedent would realize a “*step-up*” to the fair market value of the asset(s) on the decedent’s date of death (or according to the alternate valuation date for some assets pursuant to I.R.C. § 2032). The effect of these rules was an elimination of a capital gains tax on any pre-death appreciation with respect to such assets of a decedent.

Under the “*carryover basis*” system, assets will receive a basis equal to the basis of the property in the hands of the decedent. This new “*carryover basis*” regime will, however, permit a personal representative to make an allocation of up to \$1.3 million of increased basis to the decedent’s assets in general, and an additional allocation of up to \$3 million for assets passing to a surviving spouse, if any.

Pursuant to current law, the prior “*step-up*” in basis at death regime will be reinstated on January 1, 2011.

Does the current uncertainty mean that you should generally ignore the current state of the law and wait until these taxes are restored by possible Congressional action (most likely at the 2009 rates and exemptions)?

The answer is a resounding “no”. Efforts are underway to enact a law in the State of Tennessee which would require wills with formula type bequests relating to Federal Estate Tax exemptions, to be deemed to refer to the status of Federal Estate Tax laws on December 31, 2009. However, such proposed legislation may not receive legislative approval and even if implemented, may, or may not, properly implement your estate plan. As such, failure to take corrective action could leave you with a less than optimum estate plan in that many estate plans allocate assets among trusts or beneficiaries based upon the existence of a Federal Estate Tax. However, the current “state of flux” with respect to the ambiguities created by the current state of the law makes a review of your estate plan a prudent decision in order to determine whether a corrective amendment is necessary to cover any gap between January 1, 2010 and the effective date of the restored tax law or January 1, 2011.

If you wish to determine how the current repeal/uncertainty of the tax law may affect your estate plan, Henry & McCord would be happy to provide such advice. You may contact James H. Henry II or John R. LaBar at (931) 455-9301 to schedule an appointment.

CIRCULAR 230 DISCLOSURE: Henry & McCord informs you that any tax advice contained in this Client Alert was not intended or written to be used, and cannot be used, for the purpose of avoiding federal tax related penalties, or promoting, marketing or recommending to another party any transaction or matter addressed herein.

