

2010 - A Year Without Estate Taxes?

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Most people familiar with estate planning and taxation know 2010 is the year without estate taxes – at least to this point. However, many taxpayers, estate planners, accountants, financial planners and trust departments do not know what to expect for the remainder of the year, in 2011 – or beyond.

As outlined in an Estate Planning e-bulletin sent earlier this year (accessible at www.wnj.com), 2001 legislation substantially changed the estate tax, gift tax and generation-skipping tax systems, which resulted in increased exemptions from estate and generation-skipping transfer taxes and reduced estate, gift and generation-skipping tax rates for the ensuing several years. The 2001 legislation culminated with the following changes for 2010:

- Repeal of the estate and generation-skipping transfer taxes;
- A decrease in the top marginal gift tax rate to 35% (the gift tax exclusion amount for gifts made in 2010 remains at \$1 million); and
- Repeal of the step-up in basis rules. In other words, the assets of a person who dies in 2010 will now generally retain the decedent's basis (also called "carryover" basis) instead of receiving a "step up" in basis to fair market value. However, the ability to step up the basis of a portion of the decedent's assets is still available.

Under the existing law, and unless Congress acts otherwise, the 2010 changes will officially expire on January 1, 2011 and we will revert back to the laws as they existed in 2001. This means:

- The estate tax exclusion amount will be \$1 million;
- The generation-skipping tax exemption amount will be \$1.34 million (which has been adjusted for inflation);
- A top marginal rate of 55 percent for estate taxes, gift taxes and generation-skipping taxes; and
- The step up in income tax basis rules would go back into effect.

So what are the possible next steps? Below are three courses of action that Congress could take:

- **Pass legislation retroactively.** Congress could choose to retroactively reinstate both the estate tax and the generation-skipping tax and modify the gift tax. This reinstatement could be either a continuation of the 2009 laws, or it could be completely different from what we have previously seen. This course of action could result in the filing of a number of lawsuits that would question the constitutionality of the retroactive legislation. In looking at this possible course of action, Congress would have to weigh the constitutionality of the retroactive change and the number of lawsuits it could potentially generate.
- **Pass legislation prospectively.** Congress could choose to pass a law that would only be effective from the date of enactment forward. Making a change prospectively may not warrant quite as many lawsuits; however there is an ethical question as to how a single person who passed away on December 31, 2009 with a \$10 million estate can owe approximately \$3 million in estate taxes, while a person in that same exact situation who died one day later on January 1, 2010 would owe no estate taxes whatsoever. If a prospective change is made, a debate will certainly arise as to the fairness of having a window of time when the estates of persons who die aren't taxed.
- **Do nothing.** Congress could do nothing, which is exactly what it has done to this point. If Congress does nothing in 2010, then on January 1, 2011 we will simply revert back to the law as it existed in 2001. For those acting as a trustee or personal representative for someone who died in 2010, caution and consideration of these possibilities should be contemplated before making distributions.

This is a critical time for people to review their estate planning documents and determine if their current plans are still operating properly. It is also an excellent time to discuss "doing more," such as shifting wealth to younger generations, increasing charitable giving or transferring a business to the next generation.