

Impact of Federal Estate Tax Repeal Effective in 2010

Currently there is uncertainty regarding application of the federal estate and gift tax laws as of January 1, 2010. Legislation originally passed by Congress in 2001 made sweeping modifications to the rules that apply to estate and gift taxes. Among those changes were gradual increases in the amount of property that may be passed free of estate tax as well as reductions in the maximum tax rate. In 2009, the amount that each individual could leave tax-free to heirs had increased to \$3,500,000 (or a total of \$7,000,000 for both spouses with proper estate planning). The 2001 law also repealed the federal estate and generation-skipping transfer (GST) taxes, effective January 1, 2010. However, that repeal is scheduled to last only one year. Without congressional action, beginning in 2011, the law as it existed prior to the 2001 legislation will be reinstated. As a result, among other effects, the federal estate exemption equivalent will be *reduced* to \$1,000,000 and a top tax rate of 55% will apply.

It was anticipated that Congress would eventually agree to extend the federal estate tax in some form beyond 2009, so that repeal would not become effective. However, this did not occur prior to its adjournment for the year. Some prominent members of the House and Senate have expressed a desire to reinstitute the tax, perhaps retroactively back to January 1, but the timetable and the prospects for doing so remain unclear. State death taxes, if applicable, are not affected by repeal and remain in effect in 2010 and beyond.

As a result of these changes, it is possible that estate planning documents which contain formula provisions refer to tax law concepts that do not exist in 2010, and may result in unintended consequences in funding an estate plan. Although flexibility in some estate plans and the availability of various planning options that can be undertaken following death may preserve the intended results of an estate plan, a careful review of all existing documents may be advisable to assure estate planning.

We expect the Congressional climate concerning federal estate and GST taxes will be fluid in the coming months. In the interim, if you would like us to review your existing estate planning documents to discuss possible modifications to take into account the possibility of a death occurring in 2010 while federal estate and GST taxes are effectively repealed, please contact us. We would be pleased to assist you with a review of the possible impact of repeal on your estate plan.

Other Changes Taking Effect in 2010

1. Gift Tax

Despite the repeal of the federal estate tax for 2010, the gift tax remains in force. In 2010, gifts in excess of a lifetime \$1 million exemption will be subject to a gift tax equal to a reduced 35 percent. Also be aware that the annual gift tax exclusion amount for 2010 will remain at \$13,000.

2. Carryover Basis

With the repeal of the federal estate tax comes a change in the income tax treatment of inherited property when it is sold by heirs. Under pre-2010 law, the basis of assets received from a decedent is "stepped up" to the fair market value of the property on the date of the decedent's death. This means that your heirs would not pay capital gains on the amount of appreciation in the property that occurred before death. As of January 1, 2010, however, a "modified carryover basis" rule went into effect. Under that rule, basis will be the same as it was in the hands of the decedent. Therefore, when heirs dispose of the property they have inherited, they will pay income tax on the difference between the sale price and the basis the decedent had in the property, often the price you pay for it, adjusted for depreciation taken or improvements made.

There are two major exceptions to the carryover basis rule. **First**, a basis increase of up to \$1.3 million can be added to the basis of property going to any recipient. **Second**, an additional \$3 million can be added to the basis of assets transferred to a surviving spouse. Both of the basis step-up exceptions can apply – with the result \$4.3 million of stepped-up basis is available to property passing to heirs. Careful planning will be required to ensure that your estate is able to take advantage of these allowances. Reporting and other requirements are imposed as well. There are numerous other rules applicable to the new carryover basis rules in effect for 2010 that are beyond this summary.

If you have any questions or would like further information, please contact [Christopher Was](#) in our Nashville office at (615) 744-8527 or at cwas@millermartin.com; [Don Morton](#) in our Chattanooga office at (423) 785-8294 or at dmorton@millermartin.com; or [Jim Tramonte](#) in our Atlanta office at (404) 962-6415 or at jtramonte@millermartin.com

Federal Tax Advice Requirements

The IRS has issued requirements governing the rendering of written tax advice concerning federal tax issues. In compliance with those requirements, the advice concerning federal tax matters set forth herein **(1)** is not intended or written to be used, and cannot be used, for the purpose of avoiding penalties under federal tax law, or **(2)** promoting, marketing or recommending to another person any matter or transaction discussed herein.

The opinions expressed in this bulletin are intended for general guidance only. They are not intended as recommendations for specific situations. As always, readers should consult a qualified attorney for specific legal guidance. Should you need assistance from a Miller & Martin attorney, please call 1-800-275-7303.

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