

## The 2010 Repeal of the Federal Estate Tax Brings Uncertainty to Estate Tax Issues

This year has brought great uncertainty to the federal estate tax. As of January 1, 2010, the federal estate tax has been repealed. While this may sound like good, the repeal is only temporary and exists for this year only. Also, the repeal brings with it some very unfortunate consequences for beneficiaries inheriting property.

### **Background and Sunset**

In 2001, Congress passed and President George W. Bush signed the Economic Growth and Tax Relief Reconciliation Act (EGTRRA). Under the EGTRRA, the maximum tax rate for the estate tax was steadily lowered each year from 55% to 45%. It also gradually increased the amount of property exempt from the estate tax each year from \$670,000 to \$3.5 million in 2009. In 2010, as stated above, there is a one-year repeal of the federal estate tax. EGTRRA contained a “sunset” provision, under which the tax rate returns to 55% and the exemption amount returns to \$1 million dollars.

### **Changes to Basis of Inherited Property**

The 2010 repeal also alters how beneficiaries need to calculate the value of inherited property. Prior to January 1, 2010, a beneficiary would receive a “step-up” in basis for inherited property. This means that the beneficiary could value the property at the fair market value as of the date of death, rather than the value that the decedent paid for it. For example, say a decedent owned stock at his or her death in 2009. The beneficiary who inherited the stock received the step up in basis to what it was worth on the decedent’s date of death. When the beneficiary sells the stock, he or she would only pay income tax on the change in value between the sale price and the date of death value.

As of January 1, 2010, this step-up in basis no longer exists. In 2010, a beneficiary who receives property from a decedent receives that property with a basis of equal to the lesser of the decedent’s basis (ie, what the decedent paid for it), or the assets fair market value on the decedent’s date of death. There is, however, a \$3.5 million exemption for property left to spouses and \$1.3 million exemption for other property.

### **Problems Created for Wills and Estate Plans**

Many married couples with assets sufficient to exceed the federal estate tax exemptions divided the decedent’s property into a credit-shelter trust and a marital trust. This division was created so as to maximize the amount that would pass free of the federal estate tax. For many years, it has been common to use a formula to create the division of assets between the two trusts and maximize the tax savings. In 2010, with the repeal of the estate tax, these formulas will not work, and could potentially result in the disinheritance or substantial reduction in property to the surviving spouse.

### **What Will Congress Do Now?**

It was widely predicted that Congress would pass legislation in 2009 that would prevent the year 2010 rules from taking effect. In fact, the United States House of Representatives did pass legislation; but the U.S Senate did not.

At this point, Congress has several options for going forward. First, it could pass legislation that retroactively extends the 2009 EGTRRA provisions for 2010. However, the farther we get into 2009, the less likely this solution is because retroactively laws create problems for estates that are already being administered. Second, it could pass legislation that extends the 2009 EGTRRA prospectively through the end of 2010. This alternative still requires Congress to take further action this year to prevent the sunset provisions from kicking in during 2011. Finally, Congress could use this opportunity to meaningfully reform the federal estate tax code. Because the estate tax is a politically sensitive issue, it is not likely that significant reform will happen quickly.

### **What Should You Do Now?**

Because there is no obvious legislative solution before Congress at this point, having flexibility in your estate plan is extremely important at this point. Now is good time to review your estate plan to ensure that your goals are still being met, while minimizing the tax consequences. For more information regarding this and other tax issues effecting your estate, please do not hesitate to contact me to schedule a consultation at 717-657-7770.

Virginia H. Henning  
Attorney-At-Law  
Scaringi & Scaringi, PC

© Scaringi & Scaringi, PC