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Estate Tax Update



The federal estate tax is dead--at least for now.

It's 2010, and the temporary, one-year repeal of the federal estate tax is in effect. The failure of Congress to either extend the 2009 estate tax rules into 2010 or enact a permanent estate tax law has created several unfortunate consequences. Here are some things you need to know to protect your family and your assets.

Facts

Both the federal estate tax and the federal generation-skipping transfer tax (a separate tax on property given to grandchildren, great-grandchildren, etc.) are repealed for 2010 (unless Congress enacts legislation to reinstate them, retroactive to January 1, 2010 or otherwise).

Both taxes are scheduled to return in 2011 at levels that applied prior to 2001; that means a \$1 million exemption and a top tax rate of 55% (in 2009, the exemption was \$3.5 million and the top rate was 45%).

The federal gift tax remains in effect with a \$1 million lifetime exemption, and the top tax rate is 35%.

The step-up in basis rule that allowed heirs to inherit property with a fair market value as of the date of death of the decedent has been modified. For 2010, the basis for inherited property is the lesser of the decedent's basis (carryover basis) or its fair market value on the date of death. But, \$1.3 million of estate property is afforded a step-up in basis, and up to \$3 million of property passing to a surviving spouse receives a step-up as well.

What's next?

It's anyone's guess what Congress will do next. Some believe quick action will reinstate the taxes at 2009 levels (see above). Others believe Congress will proceed cautiously in an attempt to enact serious reform. In either case, any reinstated tax may or may not be made retroactive to January 1, 2010. Needless to say, planning under these circumstances is challenging, at best.

The fallout

If your estate plan assumed that an estate tax would be imposed in 2010, it may no longer carry out your intentions; it may not provide adequately for your spouse, and it may not meet your overall tax objectives. Here are some steps you may want to take.

See your estate planning attorney about the possible need to revise your will, trust, and other estate planning documents, especially if they include formula clauses. A formula clause expresses certain bequests in terms of fractions or percentages in order to eliminate or reduce estate taxes. You may also need to see your estate planning attorney about these documents if you live in a state that imposes its own estate and/or inheritance tax, or if your documents include multi-generational planning.

Organize your records and get your parents/grandparents to organize theirs. The modified carryover basis rules impose strict reporting requirements, including supporting documentation and penalties for noncompliance.