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It's the Law

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Disappearing Act: The Federal Estate Tax in 2010

If you find the federal income tax rules in this country confusing, you will fare no better with the estate tax rules. The Federal Estate Tax, which until the end of 2009 was only applicable to estates with a gross value of more than \$3.5 million, temporarily disappears on January 1, 2010, but then amazingly, returns in 2011—and with some significant changes. You're not alone if you think this disappearing and reappearing act doesn't make much sense. Efforts to amend the statute to keep the estate tax, and the \$3.5 million exemption, going without interruption through 2010 were derailed by the recent health-care reform debate in the nation's capital and a growing movement to repeal the estate tax altogether. As a result, we are currently stuck with this odd situation, which may have significant implications for estates and beneficiaries.

First, when the federal estate tax returns in 2011, it will apply to all estates with a gross value of more than \$1 million. As mentioned above, in 2009, the federal estate tax only applied to those estates with a gross value of more than \$3.5 million. Although \$3.5 million may still seem well out of reach for many of us, \$1 million is a lot closer, especially when you consider that real estate, retirement accounts, and life insurance proceeds get included in the gross estate.

Another significant implication is that in 2011, the highest estate tax rate will rise to 55% from 45% in 2009. Estates with a gross value above \$1 million could be hit hard as a result.

Last, the one-year repeal of the federal estate tax in 2010 could have unexpected implications to beneficiaries of estates where the decedent's assets have appreciated more than \$1.3 million during the decedent's lifetime. Those beneficiaries could be hit with a greater capital gains tax when they subsequently go to sell property received through the estate.

It is still possible that Congress could pass an amendment extending the estate tax into 2010. There is some question, however, whether they could legally apply the tax retroactively to estates of individuals who passed away prior the adoption of the amendment. At this point only one thing is certain: Until the law is amended, estate planning in this environment will be much more difficult.