

2010 Estate Tax and Related Tax Law Changes

Legal Alert
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Garvey Schubert Barer Legal Update, January 29, 2010.

Is it true that there is no federal estate tax this year?

Yes. Currently, there is no federal estate tax for people who die in 2010, regardless of the size of their estate. In 2009, the federal estate tax applied to estates over \$3.5 million at the rate of 45%, but starting on January 1, 2010, the federal estate tax has been repealed.

Similarly, the generation-skipping transfer tax does not apply to transfers after January 1, 2010. The generation-skipping transfer tax applies when you gift or bequeath assets to someone more than two generations below you (e.g., grandchildren). Until last year, such transfers were subject to a flat tax at the highest estate tax rate after an exemption (45% and \$3.5 million in 2009, respectively).

These changes last for only one year, as discussed below.

What about the gift tax? Is it gone, too?

No, the gift tax still applies. After certain exclusions, deductions, and a \$1 million aggregate exemption over one's lifetime, the gift tax applies at the rate of 35% (down from 45% last year).

Are there other related changes this year?

The trade-off for having no estate tax is that the income tax "step-up in basis" upon death has been severely limited. The income tax basis is the value from which gain or loss is calculated upon the sale or disposition of an asset. Under the old rules, when the owner died, the income tax basis became the value of the asset at the time, so the person who inherited the asset and then sold it for fair market value did not pay capital gains tax on pre-death gain.

Now, except for a limited basis increase allowed under the new law, heirs must determine and keep track of the basis of inherited property for future sales or dispositions of the property (e.g., How much did mom pay for that family cabin back in the 1950s?).

Do we have to keep track of the basis for everything we inherit?

Yes, for deaths in 2010 — unless Congress changes the law. The current law allows a limited basis increase, so you may still inherit assets with the fair market value basis as of the time of death. The executor of the deceased's estate may increase the income tax basis of the estate

assets by up to \$1.3 million in the aggregate. In addition, if the deceased is married, the executor may allocate an additional \$3 million increase to the basis of assets that pass to the surviving spouse.

But all this is only for a year? What happens in 2011?

Unless Congress changes the law this year, the federal estate tax will return in 2011 with a vengeance: the exemption amount will be \$1 million and the tax rate will be 55%, with a surcharge of an additional 5% for larger estates. To further complicate things, according to many commentators, Congress may decide as early as February 2010 to bring back the estate tax.

Exactly what a resurrected tax would look like is unclear, as is the issue of whether the tax would be retroactive to January 1, 2010. Thus, estate tax planning is still critical if your estate (inclusive of life insurance and retirement accounts) exceeds \$1 million.

[View a Summary of Changes in Federal Taxes.](#) [PDF]

This is all federal law. What's happening with the state estate tax?

None of the above changes affect the state estate or inheritance tax.

In Washington State, the state estate tax continues to apply to Washington residents whose gross estates are over \$2 million. The tax is imposed at a sliding tax rate between 10% and 19%. If you have a question about Washington State estate tax planning, please contact [Akane R. Suzuki](#).

In Oregon, the Oregon inheritance tax (OIT) applies to estates of Oregon residents valued over \$1 million. The OIT is imposed on a graduated basis with rates between 0.8% and 16%, with a taxable estate of \$2 million having its highest rate at 8%. If you have a question about Oregon estate tax planning, please contact [Christine P. Brown](#).

In the District of Columbia and Maryland, the state estate tax also applies to their respective residents whose gross estates are over \$1 million. If you have a question about estate tax planning in District of Columbia, Virginia or Maryland, please contact [William D. Simon](#).

Even if no federal estate tax is owed in 2010, an estate may be liable for state estate tax and would benefit from estate tax planning.

[View a Summary of Washington, Oregon, District of Columbia, Maryland and Virginia State Estate Tax Laws.](#) [PDF]

What should we do?

Because of this highly unusual situation, it is difficult to offer generalized advice that applies across the board. Also, we do not know whether Congress will retroactively continue the estate tax at the 2009 level, allow the one-year repeal to take place and revert to the old law, or do something else during this year.

That said, if any of the following conditions are present, consulting an attorney is advisable:

Estate assets in excess of \$1 million

Individuals who are close to death

Estates that are divided among different beneficiaries based on how much can pass free of the estate tax — for example, the tax free amount to the children from a prior marriage and the balance to the surviving spouse

Estates that create trusts for the surviving spouse

Assets that have appreciated significantly since the estate plan was last updated

Estate plans that provide for long-term trusts for descendants or others

Our attorneys can also help you take advantage of unique planning opportunities that the repeal presents in 2010. Opportunities may include transfers to grandchildren free of generation-skipping transfer tax and gifts at a reduced gift tax rate.

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