

ALERT - 2010 ESTATE TAX REPEAL CAN AFFECT US ALL

Happy New Year?

With Congress tied up in health care and other issues, it has not had time to resolve the impact of the changes in estate tax law that came into effect this year. While few of us expected the repeal would not be reversed and the estate tax imposed at some level for 2010, we are here.

If Bill Gates or Alex Rodriguez were to die this year, their estates would not pay any estate tax. **HOWEVER, ALL OF US HAVE LOST STEPPED UP BASIS** for this year! And modified carryover basis rules apply. That can have very serious **income tax** consequences for us all.

Prior to this year, whenever a person died, the value of his or her assets received a "step-up" in basis. That is, the basis of the property owned by the decedent was automatically increased to its date of death value. No one had to look back to determine how much was originally paid for an item asset. The date of death value controlled.

An example: John owns property he received from his father in 1950. Dad paid \$5,000 for it. John dies in 2010 and leaves the property, now worth \$200,000, to his children. His children decide to sell it and get an offer for \$200,000. Last year, they would pay no capital gains tax on the property. This year, they have \$195,000 in capital gains (assuming no improvements were made to the property). The tax rate this year on capital gains is 15% (so far, but watch what comes out of the health care legislation). The beneficiaries of the property pay this tax.

Suppose, Congress decides to take action, and changes the law to apply retroactively to the first of the year. The children have already sold their property. Do they still owe the capital gains tax? Should they wait to see what happens to the law before they sell it? Should John's estate make distributions to the family before the law is changed? How will the executor get the money back if he or she has to pay taxes?

On the estate planning side, you may have an older will that provides for two trusts on your death. One trust is designed to hold the tax exempt amount (\$600,000 many years ago, and \$3.5M last year). The second trust holds the balance. If the second trust was to be the trust for your spouse, and the first trust was to be the trust for your family – or the children from a second marriage – your spouse could get nothing under the will! Again, what happens if the law is changed or you've had to begin a proceeding in probate court for the spouse to get her elective share (1/3 of the estate)?

The inaction of Congress – and the longer it takes to get around to reviewing this inaction – will make for potentially disastrous and expensive estate administration and planning – not to mention creating an income tax nightmare for individuals selling property.

There are some exclusions from the basis issues. Just be cautious about the steps you take, and review your estate plan to see that your intent will still be carried out.

-Anne & Charles H. Moses, III

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