

Current Status of Federal Estate Tax

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This flyer is intended to provide a short summary of the current status of the federal Estate Tax. Any specific questions as to how federal estate tax laws affect your particular estate should be directed to a qualified estate planning attorney or other qualified professional.

The federal estate tax as we currently think of it was largely enacted by the Economic Recovery Tax Act of 1981. In that tax act, the top estate tax rate bracket was lowered from 70% to 50%, and the estate tax exemption was increased ultimately to \$600,000. The estate tax exemption stayed at this level until the passage of The Taxpayer Relief Act of 1997, which established the following schedule of increases.

<u>Year of Death</u>	<u>Exemption</u>
1986 to 1997	\$600,000
1998	\$625,000
1999	\$650,000
2000 and 2001	\$675,000
2002 and 2003	\$700,000
2004	\$850,000
2005	\$950,000
2006 and after	\$1,000,000

During 2001, President Bush signed tax legislation that will phase out the federal estate tax until January 1, 2010, when the estate tax will be repealed. It will be repealed for only one year, however, because the tax bill also includes a "sunset provision," meaning that the entire tax bill will expire on December 31, 2010. In other words, the old estate tax law (with a \$1,000,000 exemption and a maximum 55% tax rate) will once again be in effect January 1, 2011, and thereafter unless Congress and the President take action to extend the repeal or make other changes. Under the current tax law, the exemption amounts will be increased until 2010 as follows:

<u>Year of Death</u>	<u>Exemption</u>
2002 and 2003	\$1,000,000
2004 and 2005	\$1,500,000
2006 thru 2008	\$2,000,000
2009	\$3,500,000
2010	Repealed
Sunset 2011 and thereafter	\$1,000,000

Although the estate tax is being repealed (at least for one year), the gift tax will not be repealed. A new \$1,000,000 lifetime exclusion from the gift tax will be allowed per person (starting in 2002), and the tax rate will be the same as the highest income tax rate in effect at the time the gift is made. In 2010, assuming that the estate tax is repealed, the gift tax will be 35%.

Also, starting when the estate tax is repealed in 2010, not all appreciated assets may get a new basis at death. Currently, assets owned by a decedent are appraised at death, and the basis is changed to the new appraised value. For example, if someone bought a house for \$50,000 many years ago (and has not made any improvements on it or depreciated it), the basis for capital gains purposes is \$50,000. But if the owner dies, the basis is stepped up to the fair market value of the property as of the date of death. If the appraisal shows that the fair market value is \$2,000,000, for example, that becomes the new basis under current law. Under current law, the decedent's children could inherit the property, sell it for \$2,000,000, and pay no capital gains taxes. This step-up of basis at death to fair market value is currently unlimited, but Congress will now be imposing limits starting in 2010.

As of 2010, that step-up in basis would be eliminated, except that \$1,300,000 in transfers to beneficiaries (other than a spouse) would receive a step-up in basis, and \$4,300,000 in transfers to the decedent's spouse would receive a step-up in basis. Transfers in excess of these amounts would have a carry-over basis. Therefore, is Congress simply trading one tax (the estate tax) for another tax (the capital gain tax)? It sure looks that way to me.

The sunset provisions of the current tax act have made planning for estate taxes very difficult. Of course, my advice will be different in the case of the estate tax being permanently repealed, as opposed to the case where the estate tax is revived. Planning for both contingencies is the best course of action, but such planning can lead to overly complex solutions, some of which are irrevocable. Many people therefore are taking the "wait and see" approach. However, one thing that I believe is that inaction never favors the taxpayer. My fear is that Americans are being lulled into a false sense of security, and when the time comes, Congress will strike and have their payday. Time will tell.

You have the ultimate responsibility of keeping up to date on how your estate is affected by changing estate tax laws. Expertise is available to assist you in understanding the current law and the effect it will have on your estate plan, whether the estate tax is permanently repealed or not. Without seeking out such advice and implementing the recommendations, your final outcome may not be what you or your beneficiaries expected.

Should you wish to discuss in detail with this firm how the estate tax laws affect your particular estate, as well as planning options available to you, please call my office to schedule a consultation. These meetings are billed at our regular hourly rate (currently \$250/hr as of 7/7/08).