



Absence of Estate Tax Legislation: Concerns and Considerations by Irwin S. Love, Esq.



Against all odds, if one had wagered in 2009 that there would be neither a federal estate tax nor a generation skipping transfer tax (GST) in 2010, there would have been few takers. But since Congress has not legislated the continuation of either, these taxes that existed in 2009 with exemptions of \$3.5 million and tax rates of 45% are now history for 2010 only.

Unless Congress passes legislation to reinstitute the federal estate tax, the estate of a decedent dying in 2010, while not being subject to federal estate tax, will instead be encumbered by what is known as "carryover basis." This means, for most purposes, that the institution known as "step up" (to date of death value) is no longer the law, and instead the decedent's historical cost remains the tax basis upon the sale of assets after death. An exception would be a date of death value that is less than historical cost, in which case the date of death value will be treated as cost.

Under this carryover basis, the executor can allocate up to \$1.3 million of gain to be added to the historical cost of selected assets. If there is a surviving spouse, an additional \$3 million of gain can be allocated to assets left to the surviving spouse or in a qualified trust for the spouse's benefit.

This will not be an easy regime for the executor to administer. How will the executor choose assets to be allocated in the event he or she is also a beneficiary?

What protection from legal liability will be afforded the executor in making the choice of assets? While recent legislation requires the brokerage industry to provide accurate cost information, this may be an impossible task for the executor where a decedent has kept poor records or left no records at all. Also note that all assets formerly taxable for federal estate tax purposes will not necessarily be eligible assets for purposes of the \$1.3 million and \$3 million gain allocations.

The elimination of the federal estate tax and GST in 2010 dates to legislation in 2001. Under that legislation, while there is no tax for 2010, beginning January 1, 2011, the taxes are reinstated but at exemptions and rates in existence before 2001. The federal estate tax exemption will be \$1 million with a tax as high as 55%. The exemption for GST purposes, because it is adjusted for inflation, will be \$1.34 million as things stand now. Here, too, the highest rate will be 55%.

Financial advisors are wrestling with how to counsel their clients. Careful and informed consideration is paramount. Under the law as it presently exists for 2010, certain formula clauses may give rise to distribution outcomes that were not intended, possibly leading to unwanted, if not detrimental outcomes. (A number of states have passed legislation intended to circumvent these outcomes, but to date Pennsylvania has not.) On the other hand, the gift tax rate has now been reduced to

35% for 2010. Wealthy individuals willing to take risks that there will be no retroactive legislation might consider making taxable gifts at this reduced rate. Others may wish to make generation skipping transfers to grandchildren or great grandchildren.

One wonders what the future holds. Will Congress pass legislation during 2010 impacting the current state of affairs? Will Congress attempt to make any legislation retroactive to January 1, 2010 and impose federal estate tax and GST for all of 2010? The most reasonable outcome, if a retroactive bill is passed, might well be a choice for an estate to use the retroactive legislation or the law in effect at the time of the death or gift. But many believe any retroactive legislation would be unlawful on constitutional grounds.

Predicting what Congress will do has no better odds than the 2009 predictions that they would not allow the federal estate tax and GST to be repealed in the first place. A busy Congressional calendar and sensitivities toward midterm elections will certainly factor into the ultimate outcome.

As always, Pennsylvania Trust's administrative officers stand ready to address your questions and to discuss how these federal tax issues might affect you and your individual estate goals.

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