
CLIENT ADVISORY – REPEAL OF THE FEDERAL ESTATE TAX
March 4, 2010

As many of you have likely heard, the federal estate and generation-skipping transfer (“GST”) taxes have been repealed as of January 1, 2010. The repeal is the result of legislation passed in 2001, which provided for a gradual increase in the exemption amount to a maximum of \$3.5 million in 2009 and culminating in the complete elimination of the estate and GST taxes for 2010. While it was widely expected that Congress would take action before the end of 2009 to resolve the fate of the estate tax, it failed to do so. As the law stands now, there is no federal estate tax for individuals dying in 2010 and no GST tax on generation-skipping transfers made this year.

Meanwhile, the Massachusetts estate tax remains unchanged with an exemption amount of \$1 million. In addition, the federal gift tax is still in effect. The lifetime exemption against gift tax continues to be \$1 million. However, the maximum rate for 2010 is reduced from 45% to 35%.

In addition to the elimination of the federal estate and GST taxes, the rules governing income tax basis of assets in a decedent’s estate have now changed. Prior to January 1, 2010, inherited assets received a “step-up” in basis, meaning an asset’s basis was increased to its value at the decedent’s death. The law now provides for inherited assets to receive a “carry-over” basis, meaning the new owner takes the decedent’s basis (generally, the value he or she originally paid for such asset). The replacement of step-up in basis with carry-over basis comes with two caveats: (1) the decedent’s estate can allocate up to \$1.3 million to increase the basis of inherited assets generally, and (2) the decedent’s estate can allocate up to \$3 million to increase the basis of assets passing to a spouse. Even with the limited basis step-up, the decision to sell appreciated assets in a decedent’s estate could be complicated. Moreover, determining the decedent’s original basis for each estate asset could be challenging and time-consuming.

If Congress does not take action this year, the 2001 legislation sunsets and the federal estate and GST taxes will return in 2011 at the 2001 exemption amounts and rates. The estate tax exemption amount will be \$1 million (decreased from the 2009 exemption amount of \$3.5 million) and the highest marginal rate will be 55% (increased from 45% in 2009). The GST tax exemption, indexed for inflation, will likely be \$1.3 million. Along with the federal estate and GST taxes, the step-up in basis rules return on January 1, 2011 and the maximum gift tax rate returns to 45%.

Most experts and commentators now believe that Congress will act this year to reinstate the federal estate and GST taxes – most likely reinstating such taxes retroactively to January 1, 2010. Some have questioned the constitutionality of a retroactive reinstatement; however, most agree that retroactive legislation would be upheld if challenged. What is certain is that any such challenge would involve protracted litigation and would not likely be resolved for several years. Therefore, in our opinion it is doubtful the repeal will benefit the estate of a decedent who dies in 2010. Nor do we believe aggressive gifting will be worthwhile, due to the substantial uncertainty. Unfortunately, we are not now in a position to accurately predict when Congress will act and what the results will be.

Due to the current uncertainty surrounding the resolution of the estate tax, we do not recommend making any changes to your estate plan. However, if you have any questions about the specific impact of the federal repeal on your individual estate plan, please do not hesitate to contact us. In addition, if there have been any changes in your family or circumstances that would necessitate re-evaluating your estate plan, please be sure to let us know. Once Congress acts with respect to the future of the estate tax, we will promptly issue a client advisory to inform you what, if anything, needs to be done to your estate plan.

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