



By Nancy M. Kiskis



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REPEAL OF THE FEDERAL ESTATE TAX IN 2010— WHAT DOES THIS MEAN FOR YOU?

The federal transfer tax laws (estate, gift, and generation skipping taxes) have seen significant change over the last few years, but none so dramatic as the changes we are seeing in 2010. The federal estate tax has been repealed for persons dying in 2010, and the generation skipping tax also has been eliminated in 2010. The law as it currently stands provides that in 2011 the estate tax will revert back to what it was several years ago, that is a \$1 million exemption with a maximum estate tax rate of 55%.

In addition, federal law provides that in 2010 the beneficiaries of a decedent's estate no longer receive a "step up" in basis in appreciated assets held by a decedent at death. Rather, we now have a modified "carryover" basis that, with certain limited exceptions, provides that the decedent's basis carries over to the beneficiaries of the decedent's estate.

The gift tax laws have changed the least. As in the past, tax free lifetime gifts of \$13,000 per recipient are permitted each year, in addition to a lifetime gift tax exemption of \$1,000,000. The change is that the maximum gift tax rate has dropped from 45% in 2009 to 35% in 2010.

The Minnesota estate tax exemption and tax rates remain unchanged.

A summary of the exemptions and tax rates in 2009, 2010, and 2011 under current law follows:

	2009	2010	2011
Federal Gift Tax Exemption	\$1,000,000	\$1,000,000	\$1,000,000
Maximum Federal Gift Tax Rate	45%	35%	55% with 5% surcharge on gifts between \$10,000,000 and \$17,184,000
Federal Estate Tax Exemption	\$3,500,000	Unlimited	\$1,000,000
Maximum Federal Estate Tax Rate	45%	0%	55% with 5% surcharge on gifts between \$10,000,000 and \$17,184,000
Basis on Death	Step up to fair market value on date of decedent's death	Decedent's basis carries over subject to limited basis adjustments	Step up to fair market value on date of decedent's death
Exemption from GST Tax	\$3,500,000	Unlimited	\$1,000,000 indexed for inflation since 1999
GST Tax Rate	45%	None	55%
Minnesota Estate Tax Exemption	\$1,000,000	\$1,000,000	\$1,000,000

These changes in the transfer tax laws have caused tremendous uncertainty in estate planning. Why? It is difficult to plan when not only is the law changing dramatically, but we have no idea how the law may be changed again and when. In these times of economic turmoil and unprecedented deficits, it had been expected that Congress would pass legislation to make the 2009 law permanent, at least until Congress had a chance to review it in more detail. That did not happen. A brief review of the history may help to understand how we got here.

How We Got Here—History of the Current Transfer Tax Laws.

The Economic Growth and Tax Relief Reconciliation Act of 2001 (commonly called “EGTRRA”) was passed at a time when surpluses in the trillions of dollars were being predicted for the coming decade. Its intent was to return some of the surplus to taxpayers. EGTRRA phased in increases in the federal estate tax exemption from \$675,000 in 2001 to \$3.5 million in 2009. In addition, reductions in the top federal estate tax rate were phased in from 55% in 2001 to 45% in 2009. Similar reductions in the gift and generation skipping transfer taxes were also phased in.

EGTRRA culminated in repeal of the estate and generation skipping tax in 2010. In addition, EGTRRA provided that the step up in basis on death would be replaced with carryover basis effective in 2010 as a kind of revenue replacement for repeal of the estate tax.

All of the changes made by EGTRRA expire or “sunset” on December 31, 2010. An amendment to the Congressional Budget Act makes it out of order in the Senate to include “extraneous” provisions in budget reconciliation. “Extraneous” includes the reduction of tax receipts beyond the period provided for in the Congressional Budget Resolution, in this case ten years. Therefore, the provisions of EGTRRA expire on December 31, 2010, and as of January 1, 2011, we revert back to the laws that were in effect ten years earlier.

After all of this, we are left with a federal law that progressively reduced transfer taxes from 2002 through 2009, repealed the estate and generation skipping taxes completely in 2010, and reinstates these taxes in 2011 at the same level they were at ten years earlier. Although various attempts were made by Congress in 2005, 2006, and lastly in 2009 to change the law to provide certainty in 2010 and future years, Congress was unable to reach agreement, and no new law was passed.

What Does the Future Hold?

In these times of recession and huge deficits, it has been anticipated that Congress will take action to reinstate the estate and generation skipping tax rates and exemptions. This is mere speculation, however, and thus far Congress has done nothing. Following are some of the possibilities:

- Congress could enact legislation that reinstates the 2009 transfer tax rates and exemptions retroactive to January 1, 2010.

- Congress could enact legislation that enacts new transfer tax rates and exemptions retroactive to January 1, 2010.
- Congress could enact legislation that adopts the 2009 transfer tax rates and exemptions or new rates and exemptions effective as of some date in 2010.
- Congress could do nothing, which means that the current law stands.

If any law is enacted retroactively, say to January 1, 2010, there is some question as to whether such a law would be constitutional. If a constitutional challenge is made (and a challenge is likely), it could be years before we know the state of the law with certainty.

Have the Minnesota Estate Tax Laws Changed?

It appears that the Minnesota estate tax laws, including the exemption permitted under state law, have not changed. However, as the Minnesota estate tax laws are very closely tied to federal law, some feel that a question has been raised as to whether the Minnesota estate tax has also been repealed for 2010, although this is unlikely.

What Should You Do?

Above all, exercise caution. We cannot predict what Congress will do, and thus rash moves now may have unintended consequences later. For example, you could make a taxable gift now and pay a reduced gift tax of 35%. However, if Congress changes the law retroactively, are you prepared to pay a 45% gift tax (the gift tax rate in 2009) or higher? Or if you act now to make gifts to grandchildren and take advantage of repeal of the generation skipping tax in 2010, are you prepared for a retroactive reinstatement of the tax and possible assessment of a 45% tax on your gifts?

Review your estate plan with your estate planning attorney to determine how the new law will affect you. Does your plan still meet your objectives? Will the shares for your spouse and children be funded just as you intend? Will your assets be allocated in such a way that your estate will be able to take maximum advantage of the special basis adjustments? Does your estate plan provide the flexibility your personal representative or trustee may need to ensure that your objectives for your family are met while minimizing both federal and state taxes?

We are available to help. Please contact your attorney at Moss & Barnett with any questions you may have.

