

## 'Death tax' expires

### Planners wait for Congress to act as estate tax lapses

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When President George W. Bush signed into law the Economic Growth and Tax Relief Reconciliation Act of 2001, much of the buzz was about tax rebates.

Pundits and politicians fiercely debated whether the rebate checks would stimulate the economy or drain the government of valuable dollars.

Somewhat lost in the shuffle was the provision in the act that gradually adjusted the estate tax over an eight-year period, phasing it out for one year in 2010 (see chart).

Throughout 2009, speculation in the legal and estate-planning communities centered around how and when Congress would rewrite the act to close what some saw as a tax loophole. But 2009 came and went and Congress failed to address the estate tax, allowing it to lapse as of midnight Dec. 31.

Nearly a month into the new year, where do taxpayers stand? Will Congress allow 2010 to be an estate tax-free year or will it amend the act, as most expect?

#### 'Shocked it wasn't amended'

Count Linda Stravalaci Grear, who chairs the estate-planning department at the HoganWillig PLLC law firm in Amherst, among those who were surprised that Congress didn't act to adjust the 2001 act before the first of the year.

"The House of Representatives in December voted to permanently extend the estate-tax rates that were in effect in 2009, which were at \$3.5 million, and the highest tax bracket was 45 percent," she said. "However, when it got to the Senate, there were debates over the tax rates and the threshold, and to this point in time there has been no legal change."

Although there is no estate tax in place now, that doesn't mean wealthy Americans will avoid paying the tax man altogether.

"There is a consensus among legal professionals that we do expect (Congress) to change it, and most people expect that whatever change they make, they will probably make retroactive to Jan. 1," Grear said. With the passing of some notably wealthy Americans in 2010, including soul singer Teddy Pendergrass and Taco Bell founder Glen Bell, the legal grounds of a retroactive tax are likely to be challenged.

"I think it is a very slippery slope to get into, and that is going to be a problem," Grear said. "You will have all of these people who died during the period when there was no tax, and if you retroactively put one in place, are they going to be challenging the constitutionality of that in court? If you get into people with larger estates and there are significant tax consequences, I would think they will certainly sue."

## Lost revenue to be replaced?

John Spitzmiller handles family wealth and estate planning as a partner at Phillips Lytle LLP. He says many people don't realize that a rule within the 2001 tax act creates a secondary tax in 2010 that not only will cost estates money, but may apply to those individuals who would have been exempt under the 2009 estate-tax rules.

That is because of the elimination of a provision that steps up the value of appreciating assets such as real estate and stocks from the value that was paid for them to the current value for purposes of taxation. This step-up rule was abolished for 2010, offsetting the lack of any estate tax on the books and potentially catching many more Americans off guard - and on the hook for estate taxes.

"Pretend that your father died yesterday with \$2.5 million in Microsoft stock that he paid \$500,000 for," Spitzmiller said. "If he had died less than a month ago (in 2009), he would have paid no federal estate tax," assuming his estate was valued at less than \$3.5 million.

"The basis of his stock that he paid \$500,000 for," Spitzmiller continued, "would have been stepped up to current market value of \$2.5 million. You are the sole beneficiary and immediately after Dad's death you sell the stock for \$2.5 million. Is there an estate tax? No, because you are under the \$3.5 million. Is there a capital-gains tax? No, because for the sale, we look not at the purchase price of \$500,000, we look to its value as of date of death, and it was sold for what it was worth. That's the way it was in 2009." That same estate, Spitzmiller said, could face significant capital-gains taxes in 2010.

"(Say) your father died yesterday, but with the exact same scenario. Is there an estate tax? No, because there is no estate tax," he explained. "But we are now in a regime with what is called carry-over basis. No longer do we get the step up. Therefore, if his basis for the stock was \$500,000 and you sell it for the market value of \$2.5 million, you have a \$2 million gain." Spitzmiller said there is an exemption of \$1.3 million dollars added to the \$500,000 purchase price of the stock in the scenario, leaving the heirs liable for capital-gains tax on the \$700,000 profit.

"For a guy at that level who would have paid no tax under the old law, there is now a cost to dying," he said. "That's why there are those out there saying Congress has got to change this, because there are a lot more estates out there that are going to be subject to a tax at the time of death."

## What to say

Given the uncertainty over the state of the estate tax, how do financial advisers, tax attorneys and CPAs address the issue with their clients seeking answers?

In the first month of 2010, Dale Demyanick, a CPA and partner with Lumsden & McCormick, says he has yet to have any clients asking to rework their estate-planning documents as a result of the tax-law limbo.

"(For) most of the clients I work with that have significant assets, things don't get changed overnight; it is a long process," he said. "By the time we get through that process, things will likely change."

In the unlikely event that Congress leaves the current laws in place, the taxable threshold for the estate tax will be \$1 million in 2011, and many more people would face the estate tax.

"At that point, we would be talking to our clients and saying, 'Do you want to review your documents?' and start changing them," he said.

Until then, like most of his peers, Demyanick is taking a wait-and-see approach. While he believes Congress will take action, he was also confident it would have done so in 2009.

Referring to the elimination of the estate tax as of Jan. 1, he said this: "I don't know any professional adviser I've talked to over the last nine years that really expected this date to happen."