



## **Never Say Never - The Estate Tax Will Be Repealed! Well, Only for One Year...And Unless There Is Retroactive Tax Legislation**

**December 23, 2009**

The estate tax has been a hot topic in Washington, D.C. for many years. Since passing the 2001 Tax Act, Congress has been negotiating a resolution to universally recognized problems with the Act. The Act repeals the estate tax for 2010, replaces it with a carry-over basis system and then sunsets at the end of 2010, thereby bringing back the estate tax law in effect prior to the 2001 Tax Act. Not only does this make planning for 2010 extremely complex, it will lead to the prior estate tax laws (which will have a low estate tax exclusion amount of \$1 million and a high estate tax rate of 55 percent) coming back to life in 2011 unless Congress acts. These dramatic changes to the estate tax system are not only bad for the taxpayer, the IRS will have its own administration and enforcement challenges as well.

It seemed that everyone who followed the estate tax negotiations in Washington believed strongly that Congress would not allow these problematic changes to occur. The more relevant question appeared to be whether Congress would pass a short term patch to cover the 2010 problem or whether they would be able to reach an agreement on permanent estate tax legislation. Considering that Congress had been, and likely would be for some time, consumed with the health care debate and also considering the high cost of permanent estate tax legislation, it seemed likely that Congress would settle on a short term fix to cover the 2010 problem. Unfortunately, Congress has become dysfunctional and the last legislative opportunity to solve this problem has come and gone; therefore, we will see the one-year repeal of the estate tax in 2010 and the replacement of the step-up in basis regime with a new carry-over basis system.

The matter of estate tax repeal is far from over, however, as Congress will consider enacting estate tax legislation that is retroactive to January 1, 2010. This only compounds the quandary for taxpayers doing estate planning. Do they incur the additional expense of planning for a carry-over basis system that will at best last for one year when Congress may retroactively repeal the legislation? Do they make lifetime gifts because the gift tax rates drop to 35% (which looks much more attractive than the current 45% rate or the possible 55% rate in 2011)? Do they make generation-skipping transfers because the GST tax is also repealed in 2010? The answer to these questions are made significantly more difficult because of the possibility of retroactive legislation and the almost certain constitutional challenge to any such retroactive changes. Perhaps the greatest concern for most people is whether Congress can reach an agreement regarding the estate tax before it reverts back to prior law under which the exemption is only \$1 million and the rates reach 55% (and up to 60% for estates in excess of \$10 million).

Even if you do not wish to plan for estate tax repeal in 2010, there are certain basic measures which should be put into place. For instance, if your estate planning documents include one or more formula gifts based on the estate tax exemption (or the exemption from the generation-skipping transfer tax), the plan should provide for what happens if death occurs when there are no such exemptions. Further, the carry-over basis system provides for an increase in tax basis of \$1.3 million that can be allocated by the executor to assets included in the decedent's gross estate, and also for a \$3 million basis increase for property passing to a spouse (or a QTIP Trust for a spouse). Wills should provide the executor with the authority to allocate such basis increase in his or her discretion to maximize the benefit of these limited basis adjustments.

We have been dealing with these issues and incorporating such planning into our clients' estate plans for many years, but if you have not seen your attorney in some time, you should have your documents reviewed to ensure that your plan can function properly if the current estate tax law is not in effect.

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Dean Mead's **Estate and Succession Planning Team** specializes in estate and trust administration matters and the development of estate plans which help our clients achieve maximum savings in income, estate, gift, and generation-skipping transfer taxes.

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