

Does the Estate Tax Have a Future?



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For the first time since 1915, the federal government has no law in place to tax large estates when they are transferred to heirs.¹ In 2010, individuals can inherit an unlimited amount of wealth without having to give any of it to the IRS. At least, that's the situation so far.

The federal estate tax has been scheduled for repeal for nearly a decade, but few people believed it would ever come to pass. And were it not for the debate over the health-care legislation that dominated the final days of 2009, Congress might have succeeded in throwing the estate tax a lifeline before the repeal took effect. But because of the rules for filing estate tax returns, Congress still has until September to resuscitate the estate tax before anyone is able to take advantage of the repeal.

Why a Temporary Repeal?

A 2001 tax law scheduled a gradual reduction in the federal estate tax, with a full repeal taking effect on January 1, 2010. However, because of congressional budget rules, the law also included a sunset provision stipulating that the repeal could only last for one year. Proponents of repealing the estate tax apparently had no choice but to accept temporary measures until they could rally support for a permanent repeal.

But that hasn't happened, and there's little evidence to suggest it ever will. In fact, the House and the Senate passed competing measures in 2009 to prevent the temporary repeal from taking effect, but the chambers could not settle the differences between their proposals before the year ended. The House legislation called for freezing the estate tax at its 2009 levels: a 45% tax rate on assets in excess of a \$3.5 million exemption. But the Senate never took up the House bill and instead passed a budget

amendment that provided for a \$5 million exemption and a 35% tax rate.²

Why September?

What would happen if Congress can't agree on the future of the estate tax by the end of the year? In 2011, the estate tax would revert to the rates that were in effect prior to the 2001 tax law: a 55% top tax rate on assets in excess of a \$1 million exemption. Fortunately, this doesn't appear likely to happen. Instead, Congress will probably work out a compromise before September and make it retroactive to January 1. Why September? An estate has nine months to file a tax return after the owner's death, so the estate tax returns for people who died in January 2010 would begin to come due in September.

Other Caveats

In addition to the uncertainty surrounding the federal estate tax, there remains the matter of state estate taxes. Several states levy their own estate taxes, and many have taken steps to ensure that their laws would not be affected by the federal estate tax repeal.

Also, federal tax law holds that, in the absence of an estate tax, some assets passed from decedent to heir could be subject to capital gains taxes.

There is still a possibility that people with \$1 million or more in taxable estate assets, who may have never considered themselves wealthy, could nonetheless find that their estates may be subject to the federal estate tax after 2010. This is an improbable outcome, but it's a good idea to stay tuned as long as the possibility remains. The good news is that there may be ways to legally reduce or possibly avoid paying estate taxes, but doing so typically requires help from a qualified tax and/or legal professional.

If you are concerned about whether your estate might be subject to estate taxes, we can work with you and your tax and legal advisors to help you find appropriate solutions. Please call if you have questions about estate taxes or other aspects of estate conservation.

- 1) United States Department of the Treasury
- 2) *The Wall Street Journal*, April 6, 2009

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