

Stokes Lawrence, P.S.

2010 Estate Planning Alert

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) was enacted to reduce taxes and thereby stimulate the economy following 9/11. Among other things, EGTRRA included a one-year repeal of the federal estate and generation-skipping transfer taxes. Due to Congressional inaction at the end of 2009, the “promises” of EGTRAA have come to pass:

- The federal estate tax has been repealed for individuals dying in 2010.
- The federal generation-skipping transfer tax will not apply to transfers made in 2010.
- The federal gift tax rate has dropped to 35% for taxable gifts made in 2010.
- Individuals inheriting property in 2010 will no longer receive a “step-up” in property basis for federal income tax purposes.

Estate Tax Planning: What Should You Do?

The current tax situation makes it important for you to review your estate planning documents to ensure that they still carry out your intentions. For example:

- *If your Will (or Trust Agreement) leaves an amount to your spouse, to your children, or to a trust for your spouse’s or children’s benefit and the amount is defined by the “marital deduction,” “unified credit,” “available exemption,” “available credit,” . . .*
- *If your Will (or Trust Agreement) includes a “Credit Trust,” a “Marital Trust,” an “Exempt Trust” or a “Non-Exempt Trust” for the benefit of your spouse or children . . .*

. . . then you should review your Will (or Trust Agreement) to ensure that the amount that will pass to your spouse or your children (and to any trusts for their benefit) is the “right” amount as determined under the federal tax laws that now exist in 2010. Keep in mind that in 2010

Washington state still has an estate tax with a \$2 million exemption.

Income Tax Effects

The **loss of a step-up in basis for inherited assets** is the change with the potential to impact the most individuals. In past years, when you inherited an asset, your basis in the asset for income tax purposes was “stepped up” to the asset’s fair market value as of the date of death. Now, when you inherit an asset, your tax basis in the asset will be the ***lower*** of the decedent’s cost basis or the fair market value as of the date of death. For example,

Bob dies owning a parcel of real estate with a fair market value of \$5,000,000 as of the date of his death. Bob’s basis in the real estate is \$1,000,000. Before 2010, Bob’s beneficiaries would have received the parcel of real estate with a “stepped-up” basis of \$5,000,000. Now, Bob’s beneficiaries take Bob’s basis of \$1,000,000. When the property is sold there will be a taxable gain of \$4,000,000.

There are some **exceptions** to this general rule. **The Personal Representative of a decedent's estate may increase the basis of inherited assets up to \$1.3 million.** For example,

Sally dies owns a parcel of real estate worth \$1,000,000 at her death. Sally's basis in the real estate is \$250,000. The Personal Representative of Sally's estate may increase the basis in the real estate from \$250,000 to \$1,000,000. If the Personal Representative makes such an allocation, the beneficiary receiving this asset will inherit the asset with a basis of \$1,000,000. Assuming that the value of Sally's entire estate does not exceed \$1.3 million, then all of Sally's beneficiaries can receive a step up in basis.

If the decedent is survived by a spouse, an additional \$3 million of "basis increase" is available to allocate to assets passing directly to the surviving spouse or to a qualified trust created for the surviving spouse's benefit (a "QTIP" trust). Unused capital loss carryovers and certain other losses unused by the decedent at death also may result in adjustments to basis.

Income Tax Planning: What Should You Do?

You should locate and maintain all records that may be used to determine the basis of each of your capital assets, particularly records related to the purchase price paid for an asset. Your Personal Representative, Trustee and beneficiaries may need these records to determine the amount of taxable gain when an asset is sold.

What About Next Year?

EGTRRA is scheduled to "sunset" at the end of this year. So unless Congress acts before the end of 2010, on January 1, 2011:

- The federal estate tax will return for individuals dying on or after January 1, 2011.
- The federal generation-skipping transfer tax will apply to transfers made on or after January 1, 2011.
- The maximum estate and gift tax rates will increase to 55%.
- The estate and generation-skipping transfer tax exemptions will decrease to \$1,000,000 (indexed for inflation).
- The basis rules for inherited property will revert back to the "step-up" rule.

Some members of Congress have indicated that they would like to re-impose the federal estate and generation-skipping transfer taxes, perhaps even retroactively to January 1, 2010, a move that likely will be challenged on constitutional grounds. There also are other possible Congressional outcomes, including the potential that due to political gridlock, EGTRRA will be allowed to sunset. **As a result, we still face a great deal of uncertainty at this time.**

If you have questions or concerns about your estate plan, please contact a member of the Stokes Lawrence, P.S. estate planning team at (206) 626-6000 in Seattle or (509) 853-3000 in Yakima.