

THE CONFUSING FEDERAL ESTATE TAX PICTURE

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The current state of the law with respect to the Federal Estate Tax is complex and at least somewhat confusing. As a result, taxpayers with significant assets are faced with difficult decisions in putting together the optimum estate plan. Adding to the confusion is the possibility that Congress will either repeal the Estate Tax altogether or modify its provisions so that it would apply to only very large estates.

The majority of the confusion relating to the Federal Estate Tax relates to the “Applicable Exclusion Amount” which limits the value of assets which can be transferred on death to persons other than a surviving spouse. Transfers to surviving spouses are protected by the Marital Deduction and are, therefore, less complex. Currently the Applicable Exclusion Amount is \$2 million and this amount is scheduled to increase to \$3.5 million for decedents dying in the year 2009. Thereafter, in the year 2010, the Federal Estate Tax is to be repealed. However, commencing January 1, 2011, the tax is to be reinstated and the Applicable Exclusion Amount set at \$1 million. It is important to note that in the event gifts are made during lifetime, it is possible that a portion of the Applicable Exclusion Amount would be used up by the amount of gifts. The Gift Tax rules are somewhat different from the Estate Tax rules and present additional complications. For example, the Gift Tax rules permit an annual exclusion of up to \$12,000 per donee, and the Gift Tax Applicable Exclusion Amount is set at \$1 million.

Planning decisions are further complicated by rules with respect to income tax basis in inherited property which affect persons who receive such property on the death of the decedent. Until December 31, 2009, the basis for such property is increased or stepped-up to the value at the time of death, so that if this property is later sold, the capital gain resulting from the sale would be limited to the difference between the sales price and the newly established stepped-up basis. However, after December 31, 2009, these rules are replaced with a carryover basis regime which requires the property acquired from a decedent to keep the same basis that the decedent had in such property. There are some variations to this rule allowing a partial increase in basis up to \$1.3 million to any designated beneficiary or \$3 million in the case of property passing to a surviving spouse.

Additional confusion is created by the fact that the State of Kansas has its own Estate Tax rules. All of these issues make planning extremely difficult for a physician or anyone with sufficient assets, and as a result, care should be taken to obtain professional advice from an attorney who is familiar with the law in this area.