

PLANNING FOR YOUR FUTURE

Estate taxes: where do we stand?

By Bernard A. Krooks, Certified Elder Law Attorney

There is no federal estate tax in 2010, so far. However, that could change at any point in time; perhaps, even retroactively. When will we know and what should we do?

Estate planning attorneys have joked (yes, contrary to popular belief attorneys do have a sense of humor) that this is the year to die. Because of a law enacted in 2001, the federal estate tax has long been scheduled to disappear this year, but to return in 2011 with a sort of taxman's vengeance. Although estates of less than \$3.5 million were exempted from the federal estate tax last year, next year the limit is scheduled to drop to \$1 million. The New York State estate tax exemption for 2010 is \$1 million and that is not scheduled to change next year.



For years, we estate planners have all reassured our clients that Congress would not — could not — let the estate tax expire. Many of us even confidently predicted what Congress would do. Most of us agreed that it was likely Congress would leave the estate tax in place, with the \$3.5 million exemption figure or maybe a slightly higher number, and tinker with some of the mechanics. Don't worry, we all said there is no way the estate tax will return to the \$1 million level — nor will it disappear altogether in 2010, even just for a year.

We were all wrong. Congress has been unable to reach any agreement about how to act and we are now half way through 2010 and there is no estate tax.

But there might be. Speculation has swirled for months about whether Congress has the power to reinstate the estate tax now and make it retroactive to the first of the year. Even if it is legal (and it is not completely clear that it is), every passing day makes it politically less palatable. One idea now being discussed: could Congress reinstate the estate tax but let the executor of each estate decide whether to apply the "new" estate tax or the eliminated estate tax rules?

Why would anyone want to be subject to the estate tax? Because of something called "carryover basis." As the rules now stand for the estate of someone dying in 2010, there is no estate tax but accumulated capital gains can be taxable if and when heirs sell the property they inherit — though there is \$1.3 million of capital gains avoidance given to the estate of each decedent (plus an additional \$3 million exemption for surviving spouses).

Let's imagine a scenario: because you are a market genius, you bought \$1 million worth of McDonald's stock in early 2003. It is now worth about \$3.5 million. That is the only thing you own, and you are not feeling very healthy. Now assume Congress adopts a new estate tax for 2010, sets a \$3.5 million exemption amount, and allows your heirs to decide whether to apply it or the current, no-estate-tax system.

Your heirs actually do better with the imaginary new estate tax in place. They could inherit your entire estate with no tax consequences; under the current 2010 rules, they will eventually owe income tax on about \$1.2 million of gain. Need the math? Here it is: your imaginary estate has \$2.5 million of capital gains that would be untaxed under either 2009 or 2011 rules, but do not escape taxation in 2010. You do get a \$1.3 million exemption, which leaves \$1.2 million of gain that your heirs receive along with their McDonald's shares. So if they ever sell their inherited stock, they will owe a significant (but uncertain) income tax on the capital gain. By the way, capital gains taxes are likely to go up in 2011.

So, what are you supposed to do? The best answer for now might be to keep an eye on what Congress is doing, expect to have your estate plan updated before the end of this year, and perhaps next year as well once we know what Congress is going to do (or not do). Depending on your net worth, the types of assets you own and your intended beneficiaries, it might turn out that you don't need the 2011 update — but we won't know until Congress acts.

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