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December 31, 2009

FEDERAL ESTATE TAX LEGISLATION UPDATE

The United States Congress adjourned on December 24 without taking any action to address the elimination of the federal estate tax effective for deaths occurring in 2010. When and how Congress will focus on this important tax provision is, at this point, up in the air.

To understand where we currently stand with respect to federal estate tax legislation it will be helpful to remind you how we got here. As you may recall, in 2001 Congress enacted comprehensive tax legislation which, among other things, included the following provisions:

- An increased exemption from the Federal Estate and the Generation Skipping Transfer (GST) taxes over several years. The 2009 exemption is \$3,500,000.
- A reduction in the maximum Federal Estate and GST tax rates. The maximum rate in 2009 is 45%.
- For deaths occurring or transfers made in 2010, there is no Federal Estate tax or GST tax.
- Property inherited in 2010 would have a “carry-over” basis¹ rather than a “stepped-up” basis which has historically been available for inherited property. The 2001 legislation did include a limited “step-up” in inherited property basis of \$1,300,000 plus an additional \$3,000,000 for property inherited by a spouse.
- For deaths occurring or transfers made after 2010, the Federal Estate and the GST taxes would again apply with an exemption of \$1,000,000 and a maximum tax rate of 55%.

¹ The impact of “carry-over” basis is that when the inherited property is sold by the estate or by the recipient of the property a capital gain tax is imposed on the excess of the selling price over the decedent’s cost or other basis in the property. Inherited property with a “stepped-up” basis results in a capital gain only to the extent the sales price exceeds the value of the property on the date of death – any appreciation that occurred while the decedent held the property is untaxed.

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- All property inherited after 2010 would have a “stepped-up” basis.
- Even though Federal Estate and GST taxes are eliminated in 2010, the Federal Gift tax remains for gifts in excess of the lifetime exemption of \$1,000,000. The maximum gift tax rate is reduced to 35% for gifts in 2010. For gifts made after 2010, the gift tax rate is the same as the Federal Estate tax rate (maximum of 55%).

Most estate planners felt that Congress would take the necessary steps to avoid this one year repeal of the Federal Estate and GST taxes and the accompanying carry-over basis rules by either extending the 2009 rules (\$3,500,000 exemption with a 45% tax rate) or enacting new legislation to keep the taxes in place with perhaps a higher exemption and/or a lower rate than 45%. Unfortunately, Congress adjourned without taking any action. When Congress returns to Washington in 2010, legislation may then be enacted to address the estate and GST tax issues, perhaps retroactively to January 1, 2010. However, constitutional challenges to such retroactive legislation will likely be raised and it may be years before that thorny issue is resolved in the courts.

What does this mean for our clients? Until Congress acts, there is no Federal Estate tax on the estate of a family member dying in 2010 but property inherited from that family member will receive no change in the tax basis in excess of a total of \$1,300,000 or \$4,300,000 if a surviving spouse receives the decedent’s property. Maryland and the District of Columbia continue to assess estate taxes on assets in excess of \$1,000,000. Virginia currently has no estate tax. There is no GST tax imposed on lifetime or testamentary transfers that occur in 2010.

We are left with uncertainty until Congress addresses the estate and GST tax issues, hopefully early in the 2010 session. Notwithstanding this uncertainty we recommend that you review the terms of your current estate plan with one of the members of our estate planning group so that any necessary modifications to the existing terms of your plan can be implemented. Please contact us so that we can review your particular situation. You can reach the members of the Estate Planning Group by calling or by e-mail:

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Very truly yours,



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