

ESTATE TAXES AND CAPITAL GAIN TAXES

"TAX CONSEQUENCES COULD BE DIFFERENT IN 2010"



Compliments of

As the result of tax legislation enacted in 2001, the estate tax previously applicable to estates over \$1 million for individuals and \$2 million for married couples has been eliminated in 2010. Unfortunately, if Congress does not enact new legislation to modify or extend the current rules, portions of the 2001 relating to the elimination of the estate tax will expire at the end of 2010. In that event, the estate tax rules applicable to estates before the 2001 legislation will be reinstated in 2011.

NO ESTATE TAXES IN 2010 BUT LIMITED CAPITAL GAINS TAX FORGIVENESS

The Economic Growth and Tax Relief Reconciliation Act of 2001 ("2001 Act") temporarily repealed the estate tax and generation-skipping transfer tax for estates of individuals dying in 2010. Along with the elimination of the estate tax in 2010, the familiar unlimited "step-up" in basis on property owned by a decedent at death is now limited to \$1.3 million for non-spouse heirs and \$4.3 million for property passing to the decedent's spouse. The new limited basis-step amounts may be allocated among the assets of the decedent's estate. Thus, the heirs of a decedent dying in 2010 might inherit some of the gain associated with the decedent's appreciated assets. If so, the heir must maintain (or obtain) records and other evidence establishing the decedent's basis in the assets received. If, for some reason, an heir cannot provide such evidence, then long-standing tax rules dictate that heir's basis in such property is zero. Establishing basis may be particularly challenging for securities subject to splits or tax free mergers that occurred during the decedent's life.

The 2001 Act also changed the unified system so that the gift tax exemption amount remained at \$1 million for all years after 2001 and the gift tax is not being repealed during 2010 as is the estate tax. Under the so called "sunset rule," the exemption will be limited to \$1 million for both estate and gift tax purposes in 2011.

POSSIBLE WINNERS IN 2010

The heirs of individuals dying in 2010 with very large estates will save a substantial amount of transfer tax. While they may also be exposed to some income tax under the modified carryover basis regime, the transfer tax savings would more than offset the increased income tax costs.

POSSIBLE LOSERS IN 2010

Heirs of many smaller estates could come out worse as the step-up in basis is removed. While these individuals won't face transfer tax costs, they could face significantly higher income and capital gain tax costs. According to the Reuters article, Estate Tax Seen Bringing Chaos, up to 70,000 heirs could face higher taxes in 2010 as the result of the temporary elimination of estate taxes.

Whether a winner or a loser as discussed above, the potential to defer capital gain taxes with a 1031 exchange remains a viable option for heirs inheriting appreciated property under the current transfer tax regime.



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