

Federal estate and GST tax remain uncertain for 2010 as Congress weighs renewal

As a result of Congressional inaction, the estate and generation-skipping transfer (GST) taxes were allowed to expire at the end of 2009. Democratic leaders' attempts to extend 2009 estate and GST tax law were stymied by the year-end Senate focus on passing health care reform legislation and disagreements among Democratic lawmakers over estate tax policy and other issues. Key lawmakers have suggested the estate and GST taxes may be reinstated retroactively; however, a retroactive tax increase may be politically difficult, especially in an election year. In addition, constitutional challenges are possible. As a result, there is considerable uncertainty about 2010 estate, gift and GST tax law.

Current Law

Under tax law changes enacted in 2001, the estate and GST taxes are repealed for decedents dying and generation skipping transfers made during 2010. The gift tax remains in effect during 2010, with a \$1 million exemption amount and a

gift tax rate of 35 percent (down from 45 percent in 2009). Also in 2010, "stepped-up" basis in property acquired from a decedent are repealed, and a modified carryover basis regime takes effect. Under these rules, each decedent's estate generally is permitted to increase the basis of assets transferred by \$1.3 million. In addition, the basis of property transferred to a surviving spouse may be increased by an additional \$3 million. When property acquired from a decedent is sold, it generally will be subject to capital gains tax rates.

The 2001 tax law changes are scheduled to "sunset" after 2010 and will be replaced by pre-2001 estate, gift, and GST tax law, unless Congress passes legislation to the contrary. Thus, a single graduated rate schedule with a top rate of 55 percent and a single effective exemption amount of \$1 million will apply for purposes of determining the tax on cumulative taxable transfers made by a taxpayer through lifetime gift or bequest. Also after 2010, the modified carryover basis regime would be repealed and stepped-up basis would return.

2009 Legislation

Last year, President Barack Obama proposed making 2009 estate, gift, and GST tax law permanent for

2010 and beyond. Consistent with this Administration proposal, the US House of Representatives on December 3, 2009, passed H.R. 4154, the Permanent Estate Tax Relief for Families, Farmers and Small Businesses Act of 2009. The bill provides for a top federal estate tax rate of 45 percent with a \$3.5 million per-person exemption. The House bill also makes permanent 2009 gift and GST tax law.

The House bill was projected to reduce federal revenues by approximately \$234 billion over 10 years; however, the estimated cost is not offset and therefore would increase federal budget deficits. To address some House lawmakers' concerns about increasing budget deficits, Democratic leaders included a statutory "pay-as-you-go" (PAYGO) budget requirement to fully offset most new tax cuts or spending. The provision is opposed in the US Senate because it would not apply to permanent extension of 2009 estate tax law and certain other individual tax relief scheduled to expire after 2010.

In addition, the House bill faced opposition from Senate Republicans and some Democratic Senators, who favored either repeal or a lower rate and higher exemption. In particular, Senator Blanche Lincoln (D-AR) last year proposed a 35-percent maximum estate tax rate and \$5 million per-person exemption amount. Given the lack of consensus on a permanent solution, the Senate Democratic leaders, in the waning

days of the 2009 legislative session, tried unsuccessfully to pass a short-term extension of 2009 estate tax law to give Congress additional time to work on a longer-term solution. Because of time constraints and procedural rules, the consent of all Senators was required to pass a short-term extension and Senate Republican leaders objected.

Outlook

The chairmen of the House and Senate tax-writing committees have said they intend to pass legislation to extend 2009 estate, gift and GST tax law for 2010, possibly on a retroactive basis. However, the timing and outlook for passage of such legislation is unclear. Congress currently is focused on completing health care reform legislation. The longer the estate and GST taxes remain expired, it may be more difficult politically for lawmakers to support retroactivity, especially Members of Congress up for re-election this year. If Congress extends the estate and GST taxes retroactively, it is widely anticipated that there will be legal action challenging the constitutionality. Some observers point to a 1994 Supreme Court decision permitting a retroactive estate tax law change.

Congress could end up passing legislation that represents a middle ground between complete repeal and retroactive renewal. In addition, any 2010 compromise may be combined with legislation to prevent a return to pre-2001 estate, gift, and GST tax policy in 2011 and beyond.