

The Federal Estate Tax in 2010: It's Complicated

The first article of the U.S. Constitution prohibits Congress from making “ex post facto laws” – laws that apply to a time before the law was adopted. But that’s exactly what Senate Finance Committee Chairman Max Baucus (D-MT) is said to be considering with regard to the estate tax: pass legislation which would work retroactively so that there would be no gap in collecting the tax.

Congress made an unusual political compromise in 2001 when it adopted legislation reforming the estate tax and numerous other taxes. The law phased the estate tax down over a period of several years, taking it to zero in 2010.

But, Congress also specified an expiration date for the tax cuts, bringing the estate tax back in 2011 with only a \$1 million exemption and a 55-percent rate. The idea was that a future Congress would act before 2010 to create permanency in the tax law, but that never happened.

The House of Representatives tried, right before Christmas. It passed H.R. 4154, which would make the 2009 estate tax level permanent. That’s a \$3.5 million per-person exemption with a 45-percent rate. The Senate, tied up with health care reform, ran out of time to take up the legislation. With no bill sent to the President’s desk before Jan. 1, the federal estate tax no longer exists.

But, that 2001 law also provided that the estate tax be replaced by a 15-percent capital gains tax on the increased value of capital assets that exceed \$5.6 million per couple (\$1.3 million per person plus \$3 million for spousal transfers) if or when those assets are sold by heirs. The law takes away the stepped-up basis (which factors in inflation) and replaces it with a modified carry-over basis. This could impact the amount of capital gains taxes paid by those who inherit those capital assets.

Federal Estate Tax

2009

\$3.5 million per-person exemption,
45% tax rate

2010

No estate tax – but it’s replaced
with a 15% capital gains tax on
increased value of capital assets
above \$5.6 million per couple

2011

\$1 million per-person exemption,
55% tax rate, unless Congress
changes the law

Baucus planned to get the Senate moving on estate tax reform soon after it returned to work this month, Jordan Dux, Farm Bureau national affairs coordinator, said Jan. 14. “Baucus has said he plans to pass legislation which would work retroactively so that there would be no gap in collecting the tax. Look for a number of lawsuits to follow if the President signs a bill retroactively collecting estate taxes.”

It’s not yet clear whether the legislative vehicle used in the Senate will be Baucus’ proposal to make the 2009 levels permanent or another proposal which includes a higher exemption indexed to inflation and a lower rate, Dux said. Farm Bureau continues to push for the latter.

“However, with Congressional leaders now pledging to tackle the deficit in 2010, it will be very difficult to achieve real estate tax relief. As tax revenue forecasts continue to look bleak, the House and Senate leadership will be very hard-pressed to reduce the amount of tax revenue they will be able to take in,” Dux said.

And with a possible health care reform bill to pay for as well, Dux said it will be interesting to see how much if any estate tax relief will come out of Congress this year.