

TheStreet.com

Who can help you earn
more on your **Savings?**

Countrywid
CA

Taxes

Estate Tax in Limbo

By [Tracy Byrnes](#)

TheStreet.com Contributor

6/16/2006 11:48 AM EDT

URL: <http://www.thestreet.com/pf/funds/taxes/10291809.html>

The estate tax is again the talk of the town in D.C., and all I can say is:

Pull the trigger already!

This is turning into a Hollywood saga -- like the never-ending Britney Spears-Kevin Federline drama. Are you in it for the long run or not? Either way, make a call so we can all move on.

Because tons of people are in limbo. And like Britney and Kevin, folks with big fat estates have no idea how to plan for the future.

And even if you don't have a big estate now, you may in the future. Current rules -- though they're very likely to be changed -- say that by 2011, anyone with an estate over \$1 million will be affected by this tax. That's not too hard a number to reach when you include real estate equity and retirement plans. So, this estate tax controversy concerns many of us.

For now, the estate tax is not going away. Last week, the Senate turned down President Bush's bid to permanently repeal the tax. That marked a big disappointment for the GOP, since it was close to a full repeal last summer. But then Hurricane Katrina hit, costing more time and energy than anyone ever imagined. So, the estate tax debate was shelved for a bit.

But Republicans are sure to bring up the issue again, and it needs to be settled. Because unless you consult a Magic 8-ball to determine how the issue will be resolved, there's not much planning you can do.

The Planning Problem

Under the present rules, as a single person, up to \$2 million in assets are estate tax free at your death (\$4 million for a married couple). That number -- or exclusion -- is schedule to jump to \$3.5 million per person (or \$7 million per married couple) in 2009.

In 2010, things get comical. The current dumb rules say that the estate tax will disappear in 2010. That means you can die estate tax free that year. So for all you planners out there, feel free to walk into traffic sometime during 2010.

Ay, there's a rub. (There always is.)

While the estate tax disappears in 2010, so does the step-up in basis on assets over \$1.3 million.

Here's how that affects your wallet. Let's say Great Aunt Milly wants to bequeath shares of stock to you that she bought at \$5. We'll presume that in 2009, the stock will trade at \$30.

If Milly dies in 2009 and leaves you the shares, you'd get them at their fair market value -- or what they're trading at on the day of her death. So your basis (a.k.a. the original cost in the shares) would be "stepped up" to \$30. That means that if you sold the shares, you wouldn't owe any capital gains tax because the difference between your cost

(\$30) and their current value (\$30) is zero. So, there's nothing to tax. Excellent.

But say she dies in 2010 and the stock is still trading at \$30. While there's no estate tax on her assets, you've lost your step-up in basis. You inherit her original cost -- a.k.a. basis -- at \$5. Then, if you sold in 2010, you'd owe capital gains tax on \$25 (\$30 minus \$5).

An even bigger issue would be if poor Great Aunt Milly didn't know her original cost. You'd have to somehow figure out when she bought and then determine her original price. Holy paperwork nightmare.

That's your 2010 headache.

Move on to 2011. The estate tax and the step-up in basis come back, but the estate-tax exclusion is scheduled to drop to \$1 million for a single guy. And having a \$1 million estate is very obtainable. So, we regular folks have to start worrying.

Regardless of whether the estate tax is repealed, most tax experts agree that the \$1 million threshold will be changed, given the political uprising likely to take place if more people are pinched. But while no one is convinced the exclusion will slip to \$1 million, you just never know.

That makes estate planning difficult, says Richard Coppa, president and founder of Wealth Health, a financial planning firm in Roseland, N.J. If we knew for sure that the exclusion was plummeting in 2011, advisers would be recommending that their clients start giving away money now so that their estates are diminished by then.

Really, all you can do is wait.

If the Republicans get their way, though, the exclusion will jump to \$5 million, and then the majority of us can forget this estate tax nonsense.

But again, no one knows.

And there's one more planning glitch: Though federal estate tax exclusions may increase, your state estate tax exclusions won't necessarily follow, reminds Bob Scharin, editor of Warren, Gorham & Lamont/RIA's *Practical Tax Strategies*, a monthly journal written for tax professionals. So pay attention to your state's rules during this monotonous debate.

The Ethics Questions

Of course, there's always the ethical question of whether there should be an estate tax in the first place, says Bill Fleming, director of personal financial services at PricewaterhouseCoopers in Hartford, Conn.

Clearly, the uber-rich will argue that their hard-earned money is being double-taxed. And some of it may be. But there's definitely a fair amount of appreciation that's been brewing and passed on over the years and has never seen a tax hit.

And in actuality, not that many people will be affected by the estate tax before 2011. According to a study by the Joint Committee on Taxation, 7,500 people who die in 2009 will have an estate tax liability. That means they'll have an estate that's greater than the \$3.5 million exclusion scheduled for that year. Arguably, not a ton of people.

In addition, repealing the estate tax will cost the Treasury nearly a \$1 trillion in its first 10 years -- more than the entire shortfall in Social Security, Robert Reich, former secretary of labor in the Clinton administration, said in a recent commentary on Marketplace Public Radio. And they'll need to make up for that loss in other places -- such as your tax return.

Finally, remember that if the estate tax is repealed, then the step-up in basis disappears too. That could hurt the little guy way more than the estate tax hurts the wealthy.

So, while there will be some form of estate tax, no one knows what it will be. Pull out that Magic-8 ball and ask it.

That's pretty much how our lawmakers seem to make decisions these days anyway.

Tracy Byrnes is an award-winning writer specializing in tax and accounting issues. As a freelancer, she has written columns for wsj.com and the New York Post and her work has appeared in SmartMoney and on MarketWatch. Prior to freelancing, she spent four years as a senior writer for TheStreet.com. Before that, she was an accountant with Ernst & Young. She has a B.A. in English and economics from Lehigh University and an M.B.A. in accounting from Rutgers University. Byrnes appreciates your feedback; [click here](#) to send her an email.
