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Inheritance 2010 Style - The Year Uncommon To Any Other

With the provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), 2010 has become the year in which there is no estate tax. While at first thought this may sound generous, we read on to find the kicker is that the heirs receive no step-up in basis. This has the potential to cost heirs thousands upon thousands of dollars in capital gains tax.

Through the years of 2001 to 2009, estates were taxed at a gradually declining rate, ending at 45%, for estates valued over a regularly rising amount, ending through that period at a value of \$3.5 million. In addition, heirs received the inherited property at its value as of the date of death of their relative (a step-up in basis). This would allow the heir to sell the property within a short period of time with no capital gains tax due. For example, the deceased bought property for \$90,000 in 1950 and holds it until the time of his death in 2009. His daughter inherits the property at the value of the property on the date of his death which is \$2 million. She sells the property three months later for \$2 million and owes no capital gains tax on the sale since her basis in the property was \$2 million.

Forward to 2010. (1) The estate tax disappears; (2) Heirs receive inherited property at the value their relative originally paid for the property; (3) The estate can exempt the first \$1.3 million in capital gains, and an additional \$3 million in capital gains for assets that go to a surviving spouse. Using the above example, the deceased's daughter will pay capital gains tax on \$610,000 from the sale of the property. (This amount may be higher if there was other property in the deceased's estate to which the \$1.3 million exemption applied.) A 1031 tax-deferred exchange would benefit his daughter allowing her to defer the capital gains tax if investment goals can be met through the purchase of like-kind investment properties.

Looking ahead to 2011, the tax code reverts to pre-2001 rates. The exemption will be \$1 million with estate tax at 55%, and a return of the step-up in basis.

Although the hope had been that Congress would act in 2009 to extend the provisions through 2010, there is now expectation that Congress will act on these issues with the ruling retroactive to January 1, 2010. President Obama's budget proposal would make the 2001 tax cuts permanent for lower income levels. The House and Senate have both presented proposals that continue in debate.

Given the current tax situation, taxpayers are advised to provide clear documentation regarding the value of assets in their estate. Remember that some states also have estate tax regulations with exemptions that differ from federal exemptions. Time spent with tax counsel is crucial through these changing times.

"Ninety percent of all millionaires become so through owning real estate"

-- Andrew Carnegie



Capital Gains Tax Rates

Unless Congress extends the provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), capital gains tax rates will revert to pre-2003 levels in 2011. Long-term capital gains rates for 2010 for taxpayers in the 10 and 15% income tax brackets is "-0-", but starting in 2011 the rate will go to 10%. For taxpayers with income tax rates above 15%, the 2010 long-term capital gains tax rate is 15%, and will revert to 20% in 2011. Congressional action may be taken which would leave the capital gains rate at 15% or could provide a rate above 20%.