

Gift tax will hit hard in 2011 unless law changes

The Economic Growth and Tax Relief Reconciliation Act of 2001 provided for phasing out the federal estate tax over a 10-year period, with complete repeal in 2010.

However, the repeal expires Dec. 31 to mask its effect on the federal budget. That means the estate tax will return next year to its 2001 provisions. The most notable result is the unified credit will cover only \$1 million in 2011, compared with \$3.5 million in 2009. Although the Democratic budget proposal for fiscal 2011 proposes to continue the 2009 estate tax law, it does not yet have the effect of law.



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no capital gains tax because their basis was equal to the sale price. No gain, no tax.

Estate tax for 2010 deaths

Under current law, there is no federal estate tax for people who die in 2010, but that doesn't mean there aren't significant tax consequences. In any other year, a death would mean a tax-basis increase in a person's assets to their value when the death occurred. In 2010, those assets don't receive an automatic basis increase. Instead, an executor may increase the decedent's basis up to \$1.3 million. Also, a spouse may increase by \$3 million her basis in assets received from her husband.

Increase in basis

An increase in tax basis upon death is sometimes very valuable because it results in lower taxes when the property is sold. For example, assume someone bought farmland for \$2,000 an acre in 1995 and dies in 2010 when the land is now worth \$4,000 an acre. Without the increase in basis, when the property is sold for \$4,000 per acre, the individual's heirs must pay capital gains taxes on the increase in value of \$2,000 per acre. But if the heirs received a step-up in basis when the person died and sold the land for \$4,000 an acre, there would be

Estate tax return, 2011

For those who die in 2011 or later, the federal estate tax is scheduled to return with a vengeance. That's because the unified federal estate and gift tax credit available to each person will be the tax owed for a \$1 million estate. Someone who had not used the credit would have no estate tax liability because he could shelter his estate using his unified credit. Married couples have an advantage in planning to reduce estate taxes, because each spouse has a credit. The credit is "unified" because it's against federal estate tax and gift tax. The credit is reduced by the amount used.

Computing estate tax

The federal estate tax applies to all property:

- Someone owned or had the right to control when he died.
- Transferred within three years of death.
- Transferred with a retained life estate.
- Transferred upon death.
- Affected by revocable transfer.

Tax is calculated based on fair market

LAW: Gifts tax applies to large cash or property transfers

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value of a person's property when he died or, in some cases, six months later. Special valuation rules apply for certain small businesses and farms that may lower the tax. Items that are subtracted in computing the tax include debt, state death taxes, estate administration expenses, property passing to the decedent's spouse, and charitable bequests.

The maximum estate tax rate is 55 percent.

Computing gift tax

Gift tax applies to gratuitous transfers — made without any of value in return — over someone's lifetime. They include cash; personal property like a car; land; and interest-free loans. Each person can give \$13,000 per year to as many people as he wishes without exceeding the annual exclusion. Spouses can split an annual gift to a particular individual, resulting in a gift of \$26,000 to one person by filing a gift tax return.

Gift tax deductions are available for related expenses paid directly to a medical provider and educational institution, and for gifts to a charity or spouse. Gifts exceeding the annual exclusion that aren't deductible require filing a gift tax return and lower a person's unified credit by the tax amount. Gift tax is computed on the value of the property when transferred.

The maximum gift tax rate is 55 percent.

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