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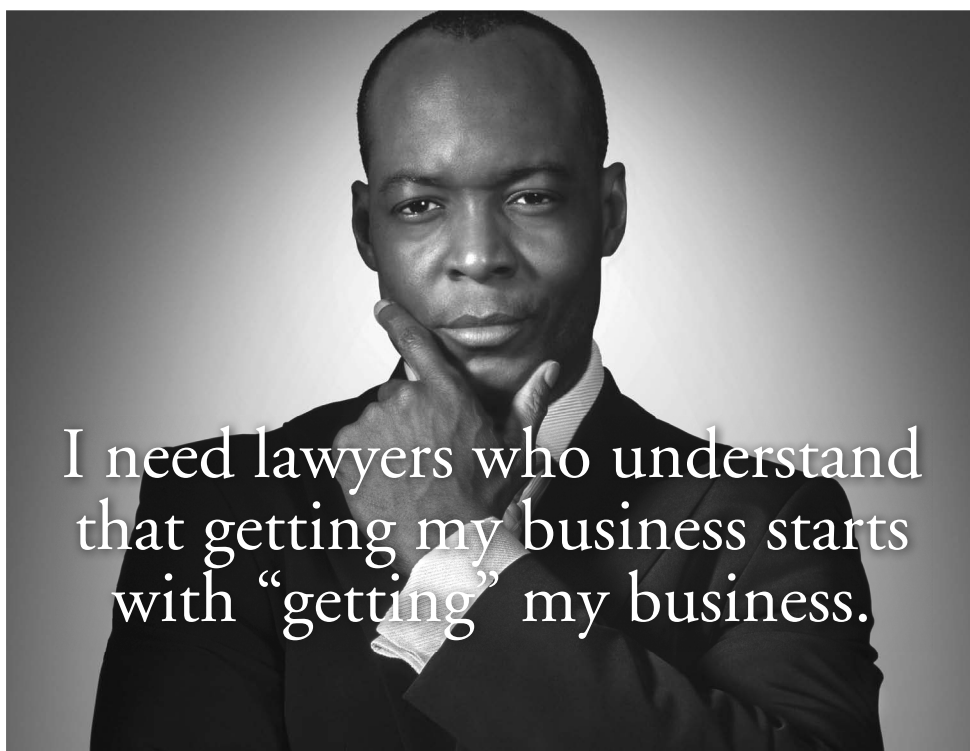
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LAW

The state of the federal estate tax

Congress is getting closer to the law's 2010 sunset date

BY AMY K. KANYUK

When President Bush signed the Economic Growth and Tax Relief Reconciliation Act of 2001 – one of the largest tax bills ever – it instituted significant changes to the federal estate tax. However, due to congressional budget rules, these changes could only last for 10 years and are due to expire (or “sunset”) in 2011.

Way back in 2001, it was inconceivable that Congress would not act again within that 10-year window to make permanent changes to (and perhaps even completely eliminate) the estate tax. But nine years, two wars, two presidential elections, one Category 5 hurricane, and one we-can't-call-it-a-depression economic crisis later, none of the estate tax issues that have been hanging in the balance for nearly a decade has been resolved.

With the new administration, however, there's been a recent flurry of activity to try to break the congressional logjam. The Obama administration and several members of Congress recently proposed permanent changes to the estate tax.

The federal estate tax has been around since 1916, after making brief appearances in the 19th century to raise emergency revenue. In 1976, the gift and estate taxes were unified, and the generation-skipping transfer (GST) tax — which taxes lifetime and at-death transfers to people more than one generation away from you (for example, a grandchild) — was introduced.

Although the tax exemption amounts increased over the next 25 years, it wasn't until President George W. Bush that we saw real momentum for foundational changes to the estate tax.

By 2001, the estate and gift tax exemption amounts had reached \$675,000, with a top rate of 55 percent (and a 5 percent “surtax” that applied to estates of more than \$10 million). The 2001 tax act raised the estate tax exemption amount and gradually decreased the top tax rate for the years 2002 to 2009. Congressional efforts

to permanently repeal the estate tax since 2001 have been unsuccessful, due to economic, political and weather conditions. (Hurricane Katrina abruptly postponed what was anticipated to be a successful vote to eliminate the tax.)

Budget rules

Today, the estate tax (and GST) exemption amounts are each \$3.5 million per person. The gift tax exemption amount has remained at \$1 million since 2002, although the gift tax rate has declined since then. The gift tax annual exclusion — the amount you can give away each year to anyone you choose, without using any of your \$1 million lifetime exemption — currently is \$13,000 per donee, indexed for inflation.

The big payoff comes in 2010, when the estate and GST taxes are slated to disappear entirely. Then those pesky budget rules come back to haunt us in 2011, when the 2001 law sunsets, and we go back to a \$1 million exemption and a 55 percent top tax rate. Of course, this was never supposed to actually happen, and it almost certainly will not. The momentum for estate tax repeal has waned, along with tolerance for a wide-reaching estate tax.

President Obama's budget calls for freezing the estate tax exemption at \$3.5 million, with a 45 percent rate. This would exempt more than 99 percent of all estates from the estate tax. Various proposals in the Senate have suggested even higher exemption amounts (indexed for inflation) and lower rates. Proposals in the House, where tax legislation must originate, have been less generous, calling for only very modest estate tax relief or a reduction in the exemption amount and increase in the rate.

Estate tax reform is almost certain to occur before the end of 2009, to avoid repeal in 2010. These next few months will be critical in determining the future of the tax. In the meantime, individuals with potentially taxable estates should continue to evaluate and implement estate-tax reduction strategies, especially those tied to the current historically-low interest rates. The two certainties in life continue to be death and taxes. **NHR**

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Members of the Bass family join with Robert P. Bass Jr., second from left, the surviving founder of the Concord law firm of Cleveland Waters & Bass in celebrating the firm's 50th anniversary. From left, they are, Kate Bass Root, Sally Bass and Timothy Bass. Among those joining in the celebration at the Capitol Center for the Arts in Concord was Hilary Cleveland, wife of the late Congressman James C. Cleveland, also a founding member of the firm, retired New Hampshire Superior Court Justice George Manias and retired U.S. District Court Judge Joseph DeClerico Jr.

