

The Economic Growth and Tax Relief Reconciliation Act of 2001

In June 2001, the Economic Growth and Tax Relief Reconciliation Act of 2001 (the “Act”) was enacted by Congress. Among the changes that occurred as a result of the Act was an increase of the exemption amount for Federal estate taxes due for taxable estates of those dying in 2002 and later years. Prior to the enactment, the first \$675,000 of a taxable estate was exempt from Federal estate taxation. The Act incrementally increased the exemption amount from \$1 million for deaths occurring in calendar years 2002-2003 to \$2 million for deaths occurring in years 2006-2008 and \$3.5 million for those occurring in 2009. In 2010 there will be no Federal estate tax due for deaths occurring in that year. While the thought of the elimination of the Federal estate tax in 2010 is appealing, it will only affect estates of decedents dying in 2010. For estates of those deaths occurring after 2010, the estate tax exemption will revert to its pre-Act level.

In enacting this law, Congress did not repeal the Federal Gift tax but instead chose to increase the lifetime tax exemption requirement. Effective in 2002, an individual may gift up to \$1 million during his or her lifetime without incurring a transfer tax. Gifts over \$1 million will be taxed, regardless of their exemption for transfers at death. Beginning in 2010, the gift tax rate will equal the highest individual income tax bracket rate, which is currently 35%.

Another provision of the Act which affects the tax planning analysis is the “step-up” in basis concept that will continue until December 31, 2009, but will change to a “carryover” basis for year 2010. Generally, the “basis” of property in the hands of the holder is the cost of acquisition. This figure is used to calculate taxable gain or loss for Federal income tax purposes upon the sale or other disposition of the asset. However, currently when someone inherits property, they receive a “step-up” in basis, whereby their “basis” in the property is its fair market value at the time of the death of the decedent. This law is very beneficial to lessen the federal income tax consequences upon the inheritor’s sale or other disposition of the asset. But, for deaths occurring in the year 2010 (and only for year 2010), the inheritor will receive a “carryover” basis, which means

that the “basis” in the property inherited is the lesser of the decedent’s basis or the fair market value of the property at the time of death. The result is that if the property is sold by the inheritor and the property has increased in value from the cost to the decedent, the inheritor will have a higher Federal income tax liability. After 2010, the “step-up” in basis resumes as it was before the enactment of the Act.

One major aspect of the Act is the “sunset” provision that is attached to the legislation. This provision states that in 2011, every provision of the Act, including the estate tax repeal, will be discarded and the laws will revert back to their original position before the enactment. While there has been discussion in the media regarding the “sunset” provision and groups have urged Congress to revise the law before the Act expires under the sunset provision, the position that Congress will take on the issue is not predictable. The outcome will likely depend upon what political party is in power after the forthcoming elections, and the outlook for the U.S. economy at the time the issue is debated. Suffice it to say that the uncertainty makes it very difficult to craft an estate plan “for all seasons;” your estate plan must be developed with maximum flexibility.

For more information about the effects of the Economic Growth and Tax Relief Reconciliation Act of 2001, or for help with your estate planning needs, contact Brown & Ruprecht, PC:

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