

## ESTATE TAX CHANGES REQUIRE CAREFUL PLANNING

Many wealthier taxpayers may be excited that the new tax act eventually eliminates estate taxes, but they may not realize that the law's complexity and uncertainty will require cautious planning, say many CERTIFIED FINANCIAL PLANNERS™ professionals. Here are some of those planning highlights.

**Relief is phased in.** Higher exemption rates and lower tax rates are phased in over eight years. In 2004 and 2005, estates valued at \$1.5 million or less won't face estate taxes. The top tax rate for estate assets above that exemption amount will drop from the current high of 55 percent to 50 percent. The \$1.5 million exemption amount gradually rises to \$3.5 million by 2009, while the top tax rate gradually declines to 45 percent. In 2010, the estate tax is repealed for all estates. The generation-skipping tax, which taxes lifetime gifts above \$1 million made to someone more than a generation below you, such as grandchildren, will also be phased out along the same schedule.

However, the gradual repeal of estate taxes is fraught with uncertainty, say many estate tax experts, because to reach the scheduled complete repeal in 2010 the nation will go through five Congresses and possibly see three presidents. Thus, modifications or a reversal of this schedule could occur at any time. Furthermore, larger estates will continue to be subject to some estate taxes for the next eight years even if all goes as currently scheduled, so traditional estate-tax reduction techniques such as lifetime gifting and the use of trusts could still be warranted.

**Scheduled to end.** Far less known to the public is the fact that legislation is scheduled to "sunset," or expire, in 2011. That is, the estate tax would be reinstated in 2011 at its current rates and exemption amount. In short, someone who dies in December 2010 would pay no estate taxes, whereas if they die a month later they could pay as much as 55 percent. To eliminate or extend this sunset provision, Congress must revisit the act between now and 2011. However, many observers question whether budgetary concerns by 2010 may compel Congress to delay the complete elimination of the tax.

**A new carryover basis.** Currently, heirs receive estate assets remaining after any estate taxes are paid with what's called a "step-up in basis." Say you inherit \$1 million in stock that your parents bought years ago for \$100,000. If you sell the stock immediately, you would pay no taxes on the \$900,000 in capital gains. (If you wait to sell, you'd pay capital gains taxes on any gains between the time of inheritance and sale.)

Under the new tax act, most of this step-up in basis disappears upon the estate tax's elimination in 2010. Property passing to a surviving spouse generally will receive a one-time \$3.4 million step-up in basis, while property passing to other heirs will receive a \$1.3 million step-up. (Some property, such as income-tax deferred assets in retirement plans, won't qualify for this step-up.) Assets above those amounts will retain their original basis, but no capital gains taxes will be paid until the assets are sold ("carryover basis"). Consequently, you should begin keeping good basis records in order to assist your heirs when they eventually sell the assets.

**No elimination of gift taxes.** To further complicate estate planning, although the rate on gift taxes will be reduced, the gift tax, unlike estate taxes, will not be eliminated. Currently, estate and gift taxes are unified. That is, you can give away tax free any combination of lifetime gifts or post-death gifts up to the exemption amount in force in the year of the death. This often made it valuable to gift appreciating assets during lifetime instead of waiting until death. Under the new law, the maximum tax-free lifetime gifting will rise to \$1 million in 2002 and stay there. The maximum gift tax rate will gradually drop to 35 percent in 2010, when the estate tax disappears. This divergence, say tax experts, suggests that it will make more tax sense to wait until death to gift, particularly for younger people. Older people not likely to reach 2010 may still want to gift during lifetime. Also, you may need your wills, trusts and other testamentary documents, along with titling of assets, revised if their language is based on the current unified gift-and-estate-tax system.

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