



CLIENT TALK

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ESTATE PLANNING AND TAX REFORM -2001

ESTATE TAX CHANGES

The election of George W. Bush as President, combined with the promise by the Republican Congress to “eliminate death taxes” and the Democrat promise to fight this issue, results in confusing times for citizens concerned about their estates and businesses. The promised reduction and elimination of Federal Estate Taxes will be somewhat beneficial for most people. Nevertheless, there are significant tax traps and complications if the new scheme is passed.

LOSS OF THE STEP-UP IN BASIS

Presently, upon death, all assets are “stepped up” to their fair market value. For example, if an investment property were purchased for \$100,000 and had a fair market value of \$500,000, the basis would be “stepped up” to the \$500,000 rather than the \$100,000. Even though there would be estate tax on the value of the property, *the heirs do not have to pay capital gains tax on the lifetime appreciation of the Decedent.*

TAXES AFTER “REFORM”

The proposed reforms would eliminate the step-up in basis on the death of the owner. This means two significant areas of concern for the heirs. First is obtaining the correct records showing the actual basis of the property. (This is particularly difficult with items of personal property such as jewelry, furniture, antiques, and collections.) The second issue is the sale of property would result in an

immediate capital gains tax for the all of the depreciation during the decedent’s ownership. For depreciated commercial real estate, there can be a substantial tax cost including possible depreciation recapture. The ultimate area of concern in analyzing any upcoming proposals is doubt that Congress will indefinitely permit estates to be untaxed.

200 YEARS OF DEATH TAXES

Death taxes in the U.S. were first imposed by Congress in 1797 (“Stamp Taxes”). The Stamp Taxes were eliminated after five years and reimposed during the Civil War. In the 1890s, Congress passed an Inheritance Tax to fund the war with Spain. In 1916, an Estate Tax was enacted to fund World War I. This was an Estate Tax only - gifts were excluded - until 1926. Franklin Roosevelt and Congress raised the rates again to a peak of 77%. In 1981, President Reagan pushed for a significant exemption of most estates from estate taxes (up to \$600,000) and lower rates (55%)

ESTATE TAXES WILL BE REINSTITUTED

History demonstrates that Congress is used to getting easy money from Estate Tax and will probably reenact it under some “emergency.” *Due to the elimination of the stepped up basis heirs would be immediately taxed for both Income Tax and Estate Tax on the same funds. An Estate Tax plan is now more crucial than ever to small business owners and investors.*