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Holiday from Federal Inheritance Tax Ends

It was lucrative to die in 2010. That's if you had money, lots of money and other assets. Heirs paid no federal estate taxes last year, regardless of the amount of the estate.

The yearlong tax hiatus for the wealthy hit home in July when New York Yankees owner George Steinbrenner died at age 80, leaving a fortune estimated at $1.15 billion. Had Steinbrenner died a year earlier, the federal tax on his estate under 2009 laws would have been roughly $600 million, with the 45 percent rate the government would have taken.

As this year drew to a close, financial analysts and attorneys who handle wealthy clients' estates anxiously awaited action on estate tax laws from a lame duck Congress. Would the zero tax be continued, or would it revert to the 2009 level of 45 percent with an exemption of $3.5 million, or rise even higher, to a top rate of 55 percent?

A compromise between Republicans and Democrats was reached, setting the rate for 2011 and 2012 at 35 percent with the first $5 million tax free.

"They really kowtowed to the Republican position by going to $5 million, which is a total of $10 million if you count a couple," said a Tully Rinckey PLLC Estate PLanning attorney. "After the $5 million, the remaining estate is taxed at 35 percent."

A key provision, he said, is the two years at the $5 million credit "which to us is $10 million per couple, and that's important because most of our clients are couples. If a husband has $10 million in his name and his wife had zero, and she dies, he can now use her $5 million exemption." New York has a state estate tax -- 16 percent with a $1 million exemption, distinct from the federal tax.

So, what does this mean for the average guy, who may leave an estate of $100,000, $500,000 or $750,000?

Financial adviser Sanford Family, head of Sanford Family Financial in Latham, said estate taxes affect the country as a whole, even though the number of estates greater than $3.5 million ranges from 1 to 2 percent. Without the burden of a federal tax, "wealthy individuals would be able to do better estate planning," Family said, which could be "good for the economy, because it keeps money from going to the government and the beneficiaries can spend it."

Opponents of the federal tax claim the "government is penalizing death, and they argue the estate tax is double taxing, since the wealth was created during the lifetime and taxed, whether it was taxed as income or some other tax," Family said. If not taxed, inheritances could have used the wealth to possibly create jobs; "instead it went to an unproductive government."

In the case of spouses, if an entire estate was left to a spouse, the spouse would not be subject to federal taxes. However, future generations would be, Family said.

He agreed, saying in large estates, the tax "could skip down to children and lower generations," so it might be best for the spouse to pay it considering the rate and the exemption.