



TAX & ESTATES DEPARTMENT

ALERT

UNCERTAINTY ON EXISTING ESTATE PLANS AND GIFTING STRATEGIES DUE TO REPEAL OF THE FEDERAL ESTATE TAX

Tax Law Repeal

The Federal Estate Tax, as well as the related Generation-Skipping Transfer Tax (GSTT),* expired on December 31, 2009, but only for one (1) year. Since Congress failed to halt the repeal, it occurred automatically based on the tax law enacted in 2001. The Gift Tax was not repealed. In summary, due to failure by Congress to enact new tax legislation by the end of 2009, the following changes and consequences regarding the transmission of wealth went into effect on January 1, 2010:

- Although the Federal Estate Tax and the related GSTT are repealed for one year (2010), it is possible that Congress will try to enact new tax legislation retroactive to January 1, 2010. However, such retroactivity is subject to possible constitutional limitations.
- In 2009, the amount exempted from the Federal Estate Tax and from the GSTT was \$3,500,000 per person. If Congress does not act during 2010, these exemptions will revert to the 2001 exemption levels (\$1,000,000**) with a maximum tax rate of 55 percent on estates over that exemption amount. The maximum tax rate in 2009 was 45 percent.
- The Gift Tax is not repealed and the Gift Tax rate is now set at 35 percent subject to a lifetime

exemption amount of \$1,000,000 plus a Gift Tax exclusion for annual gifts of up to \$13,000 per recipient. The Gift Tax rate is also set to revert to 55 percent in 2011.

- Under the tax law in effect before 2010, the untaxed appreciation occurring prior to death on assets still held at death was not subject to income tax. This process (called “stepped-up basis”) was also repealed on January 1, 2010, so that the historic basis (usually cost) of an asset is now carried over after death and the appreciation is taxable when a sale or other tax recognition event occurs. Special exemptions, however, apply so as to provide a basis step up of up to \$3,000,000 for marital transfers and a general exemption of \$1,300,000.

Estate Planning Issues

- Impact of Federal Estate Tax Repeal on Existing Wills and Trust Documents. Many estate plans of married couples were designed to defer the impact of the Federal Estate Tax until the death of the survivor through the use of an unlimited “marital deduction,” generally using a formula structure. Thus, for example, if a married person had \$10,000,000 of assets includible in his or her estate, and in 2009 the maximum exemption amount (now repealed) was \$3,500,000, the formula would

* The Generation-Skipping Transfer Tax was imposed on transfers of wealth that “skip” more than one generation. For example, transfers from grandparents to grandchildren or great-grandchildren.

** The reverted GSTT exemption amount is also adjusted for inflation.

operate to pass to the surviving spouse \$6,500,000, either outright or in a qualifying marital trust, after setting aside the \$3,500,000 covered by the exemption amount. Under this planning approach, the marital deduction effectively reduced the Federal Estate Tax to zero. Question: Now that there is no Federal Estate Tax, should the estate plan pass on a greater share of the estate to children or grandchildren? Moreover, in the context of Federal Estate Tax repeal, some wills use technical language that may have the effect of reducing the surviving spouse's actual share of the decedent's estate to zero. This result may be completely unintended. In that instance, the estate plan should be revised to pass on the same amount of wealth to a surviving spouse as would have occurred before the repeal or to adopt another approach.

- Impact on Transfers to Grandchildren and Great-Grandchildren. As with marital deduction formula transfers, the repeal of the GSTT requires examination of formula GSTT transfers that assumed a \$3,500,000 GSTT exemption amount. Question: Would the repeal of the GSTT cause someone to immediately make large gifts to grandchildren or great-grandchildren and pay the Gift Tax but seek to avoid the GSTT?
- Impact on Gifts to Public Charities, Private Foundations. With the repeal of the Federal Estate Tax, it has been presumed that there is less incentive for individuals to make transfers at death to public charities or private foundations. Many such bequests were designed to maximize Federal Estate Tax savings through the form of charitable trusts. Question: With repeal of the Federal Estate Tax, will some individuals want to reduce or eliminate charitable transfers in their estate planning documents?

- Disincentives To Make Current Gifts to Children. Question: With the retention of the Gift Tax but the repeal of the Federal Estate Tax, should current lifetime gifting strategies be revised? If the tax incentive was to avoid Federal Estate Tax on anticipated asset appreciation by making lifetime gifts of those assets, such gifting strategies might now be put on hold because there is no Federal Estate Tax.

Reinstatement of the Federal Estate Tax and Generation-Skipping Transfer Taxes

In the next few days or weeks ahead there will undoubtedly be calls for "fixing" the one-year repeal of the Federal Estate Tax and GSTT. We will be monitoring news out of Washington daily as well as maintaining our contacts in Congress for when, and in what form, a solution to the current uncertainty will be enacted. As a result of this uncertainty, existing estate plans need to be reassessed both for transfers occurring in 2010 as well as in subsequent years when the one-year repeal is eliminated.

Conclusion

It should be noted that the repeal, even if temporary, will have varying impacts on each individual's estate plan. From our standpoint, to avoid unintended consequences, it is advisable to revisit existing estate plans in light of this muddled tax landscape with particular focus on formula type clauses for funding marital, charitable or Generation-Skipping bequests. It is particularly important to review those estate plans that use a formula to allocate the estate between the surviving spouse and persons other than the surviving spouse.

For more information, contact any member of our [Tax & Estates Department](#), or visit us on the web at www.foxrothschild.com.



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