

WSGR ALERT

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FEDERAL ESTATE TAX REPEALED FOR 2010; FUTURE OF FEDERAL TRANSFER TAX SYSTEM UNCERTAIN

Although we have awaited legislation clarifying the future of the federal estate and gift tax system for the year 2010 and thereafter, Congress has yet to take any action. As a result, for a one-year period beginning January 1, 2010, the federal estate and generation-skipping transfer (GST) taxes are repealed, to be reinstated in 2011 under the pre-2001 rules. The following table summarizes the rules in effect for 2010 and 2011:

	2010	2011 and Thereafter
Estate tax and GST tax:	Not in effect	Reinstated, with a \$1 million exemption and a maximum rate of 55%
Gift tax:	In effect, with a \$1 million exemption and a maximum rate of 35% (reduced from 45% in 2009)	In effect, with a \$1 million exemption; maximum gift tax rate returns to 55%
Income tax basis of assets inherited at death:	Assets retain their carry-over basis (instead of receiving a step up in basis to date-of-death value), but up to \$1.3 million of basis may be stepped up, plus an additional \$3 million of basis may be stepped up for assets passing to a surviving spouse	Assets receive a step up in basis to date-of-death value

It is anticipated that Congress may act this year to restore the federal estate and GST taxes for 2010, with or without changes from the prior law, either prospectively (effective as of the date of enactment) or retroactively (retroactive to January 1, 2010). It is uncertain, however, when and how Congress may act.

The currently lower gift tax rates and the one-year repeal of the federal estate and GST taxes appear to create some planning opportunities. However, the prospect of a retroactive change to the transfer tax system creates numerous uncertainties in the tax treatment of such planning. Anyone considering transferring wealth in reliance on the 2010 rules should consult with a legal advisor before taking any action, in order to fully understand the risks associated with such planning.

Impact of 2010 Estate Tax Rules on Current Estate Plans

Although the 2010 estate tax laws may create some planning opportunities, most current estate planning documents may be affected in ways that would be less than optimal. This is because most documents have been prepared contemplating the existence of the estate tax and use formulas designed to minimize estate tax. The result is that every estate plan must be reviewed to ensure that it achieves the intended result.

Following are general guidelines to help you determine whether your revocable trust or will must be reviewed in light of the 2010 rules. (Note that these guidelines are applicable for revocable trusts or wills prepared by Wilson Sonsini Goodrich & Rosati. If your revocable trust or will was prepared by another law firm or attorney, there may be other issues in addition to those outlined below that must be addressed.)

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Federal Estate Tax Repealed For 2010 . . .

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Types of Estate Plans That Must Be Reviewed in Light of 2010 Rules

The following types of estate plans should be reviewed to ensure that they achieve the intended result:

- An estate plan that makes a gift in reference to “the gross estate” or “the taxable estate”
- An estate plan that makes a gift in reference to “applicable exclusion amount” or “the maximum amount that can pass free of estate tax,” or that makes a gift of a portion or all of the Exemption Trust (or Residual Trust)
- An estate plan with GST tax planning that makes a gift in reference to “the available GST exemption” or “the maximum amount that can pass free of GST tax”

The following types of married person’s estate plans should be reviewed and amended to optimize the income tax basis adjustment under the 2010 rules:

- An estate plan in which the Exemption Trust or Disclaimer Trust (or Residual Trust) does not require that all income must be distributed to the surviving spouse
- An estate plan in which the surviving spouse is not the sole lifetime beneficiary of the Exemption Trust or Disclaimer Trust (or Residual Trust)

It is anticipated that Congress may act sometime this year to reinstate the pre-2010 rules. Therefore, absent exigent health circumstances or other reasons, most people may wish to wait before changing their estate plan in light of the 2010 rules.

In addition, until there is further clarification to the law, in 2010 you should not make annual exclusion gifts to a trust for grandchildren (or more remote descendants). In 2010 since there is no GST tax in effect, such gifts will not receive an allocation of the GST tax exemption, and a subsequent distribution from or termination of such trust in a year when the GST tax is in effect may incur GST tax. Annual exclusion gifts to custodial accounts for grandchildren may still be made in 2010.

For further information or any questions about the estate planning considerations discussed above, please contact Peter LaBoskey, Diane Fong, Richard Schachtli, Laurie Look, Darin Donovan, or Christina Hwang in the wealth management practice at Wilson Sonsini Goodrich & Rosati.

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