
Repeal of the Estate and GST Taxes Brings Major Changes in 2010 for Estate Planning and Estate Administration

Legal Alert

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The New Year comes with significant changes to the federal transfer taxes, which include the estate, gift and generation skipping transfer (GST) taxes. There are three major changes that occur this year and without further legislative action, will again significantly change in 2011. First, the estate and GST taxes are repealed during 2010. Second, the gift tax remains, with a lifetime applicable exemption amount of \$1,000,000 but a reduced maximum tax rate of 35 percent. Third, the basis of each asset of a decedent's estate is no longer entitled to an unlimited step-up, but is still subject to a step-down. The executor is permitted to allocate up to \$1.3 million to increase the basis of assets in the decedent's estate and \$3 million to increase the basis of assets passing to the decedent's surviving spouse or to a qualifying trust for the surviving spouse. These dramatic changes are part of the 2001 Tax Act known as EGTRRA, which gradually increased the applicable exemption amount from \$1,000,000 to \$3.5 million in 2009 and decreased the maximum tax rate from 55 percent to 45 percent.

It was anticipated that Congress would enact legislation during 2009 to prevent the repeal of the estate and GST taxes. However, attention to other legislative matters and disagreement among the House and the Senate as to the nature of the legislation prevented Congress from passing such legislation. It is still anticipated that there will be Congressional action this year that will reinstate the federal estate tax and GST taxes, but the timing is unknown. There has also been discussion that such legislation could be retroactive, and if so, such retroactivity will likely raise constitutional challenges. If Congress does not act, then in 2011, the estate and GST taxes will again apply, the applicable exemption amount will revert to \$1,000,000 for both estate and gift tax and a maximum tax rate of 55 percent for each tax will apply.

HOW THESE CHANGES MAY AFFECT YOUR ESTATE PLAN:

Many estate plans include a distribution that is based upon the applicable exemption amount, creating two or more trusts designed to minimize exposure to the federal estate and GST taxes. During this period in 2010 when the estate and GST taxes are repealed, estate plans with this structure may yield an overly restrictive result and/or may foreclose opportunities that exist under repeal. You may wish to consult us to review your plan and determine if changes are necessary.

WHAT PLANNING OPPORTUNITIES EXIST?

Outright Gifts: If you have not used your lifetime applicable exemption amount (\$1,000,000) and are inclined to make gifts to grandchildren, the absence of the GST tax makes such gifts appealing because it eliminates a layer of tax that would otherwise be imposed. There is a risk that if the GST tax is reinstated retroactively, the transfer would be subject to tax (or require the use of your GST exemption amount through an allocation).

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If you have already used your lifetime gift tax exemption amount, and are inclined to make further lifetime gifts, the maximum tax rate is currently 35 percent, which is significantly lower than the 2009 rate, and the anticipated 2011 rate. When coupled with transfers to grandchildren and exemption from the GST tax, significant tax savings can be achieved. Again, the risk is that Congress may retroactively reinstate a higher gift tax rate as well as the GST tax and/or impose a system that would charge a higher estate tax later for gifts made at a lower gift tax rate now.

The annual exclusion amount remains unchanged at \$13,000 for gifts to individuals.

GRATs: With the repeal of the GST tax, there are opportunities to create continuing trusts for descendants at the end of grantor retained annuity trusts (GRATs) created in 2010. Prior to 2010, retroactively allocating GST exemption to a GRAT had to be delayed until the end of the GRAT term (ETIP rules). As those rules do not apply in 2010, there is an opportunity to create trusts at the termination of GRATs for the benefit of future generations without the imposition of any gift, estate and/or GST tax. If the GST and estate tax are reinstated, the trust instrument can provide for an alternate distribution at the conclusion of the GRAT term to avoid the GST tax.

GST Trusts: This is a prime opportunity to fund trusts for future generations as the trusts may be exempt from GST tax. If the GST tax is reinstated retroactively, a retroactive GST allocation may be able to be made, or trust provisions may be able to provide for distributions not subject to the tax. Transfers to GST trusts would still be subject to the gift tax to the extent they exceed your exemption amount at the time of the gift.

Spousal Trusts: You may wish to create a qualifying trust for the benefit of your spouse (QTIP), which benefits future generations upon your spouse's death and avoids the gift tax. If the GST tax is ultimately reinstated, but is not retroactive, the assets could pass to future generations GST tax free. If the GST tax is reinstated retroactively, the trust instrument can provide for an alternate distribution at the conclusion of the QTIP trust in the event the QTIP trust is subject to GST tax.

If you would like more information about the changes discussed in this alert, please contact a member of the Trusts and Estates Law Practice Group at Flaster Greenberg PC.

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