

YOUR ESTATE PLAN – RECENT ESTATE TAX LEGISLATION

Thank Goodness – They Repealed the Estate Tax! Or **did** they? Let's try to understand the "benefit" Congress conferred upon us this year:

Federal Estate Tax Changes:

- Beginning Jan. 1, 2002, amounts which may be transferred free of federal estate tax will increase, and federal estate rates will be reduced. This chart shows the phase-in:

Year in Which Death Occurs	Amount Which Can Be Transferred Free of Federal Estate Tax	Highest Estate and Gift Tax Rates (Gift tax exemption remains at \$1,000,000)
2001	675,000	55%
2002	1,000,000	50%
2003	1,000,000	49%
2004	1,500,000	48%
2005	1,500,000	47%
2006	2,000,000	46%
2007	2,000,000	45%
2008	2,000,000	45%
2009	3,500,000	45%
2010	Federal estate tax and generation skipping tax <u>fully repealed.</u>	Gift tax is the top individual income tax rate.

Notice that, in the year 2010, federal estate tax is actually repealed. **BE AWARE**, though, that under this new legislation, repeal is **ONLY FOR THE YEAR 2010**. As of January 1, 2011, without future legislation to make the repeal permanent or to extend the repeal, THE ENTIRE NEW LAW EXPIRES and we revert to the law existing prior to passage of the Tax Relief Act of 2001.

Why was this new law structured this way? This unusual provision was created because of a legislative rule which requires 60 votes in the Senate to alter revenue beyond a 10 year period. By including the "sunset" provision which causes the legislation to "expire" in less than 10 years, this 60 vote requirement was bypassed, making it easier to pass the new law.

The effect of the potential reversion to the "old" law will be to potentially create federal estate tax on estates exceeding \$1,000,000 in 2011 and beyond, since the 1997 Tax Act would have escalated the exemptions only to that level. Although even if the repeal of the federal estate tax is not made permanent, the \$1,000,000 exclusion will protect the vast majority of people from federal estate tax. *Consider inflation and growth* when deciding whether federal estate tax planning is necessary for you. All assets you own are included for purposes of calculating federal estate tax, including life insurance death benefits, retirement assets, real estate, etc. We have discovered that many people don't realize that they have potential federal estate tax issues, and therefore don't plan for it, creating large amounts of unnecessary tax.

If the total value of your assets and your spouse's assets combined (including death benefits on life insurance that you own) approach the \$675,000 level today, with a 5% inflation/growth factor, you will have an estate exceeding \$1,000,000 allowance for 2011. It is important that federal estate tax planning included in current plans be reviewed with the new law in mind, to be certain that language protects assets as necessary, yet is not now more restrictive than necessary to minimize or eliminate tax.

Basis Adjustments to Forgive Capital Gain on Death:

- For the year 2010 when federal estate tax is repealed (remember: for that year only under the new law), legislature balances that benefit to taxpayers by eliminating a current income tax benefit. Right now, and continuing through 2009, when the owner of appreciated assets dies, all capital gain on that asset is eliminated, so the asset could be sold for the date of death value with no capital gains tax due. For the year 2010, this benefit will be eliminated EXCEPT that capital gain on up to \$1.3 million of assets WILL still be forgiven at death, PLUS an additional \$3 million of capital gain on assets transferred to a surviving spouse will be forgiven. For many estates with capital gain of less than \$1.3 million, this rule will have no effect, but for those with significant amounts of appreciated assets, or who have depreciated assets for income tax purpose during lifetime (investment real estate, for example), this could be a very important change. The manner in which assets are titled is very important in making sure that each person receives all forgiveness of capital gain taxes for which he or she is eligible. Further, with the coming of this so-called "carryover basis" provision, it becomes necessary for all taxpayers to make sure that they keep good records concerning the their cost basis of their assets.

Gift Tax Provisions:

- On January 1, 2002, the exemption amount for gift tax will increase to \$1,000,000 and will remain at that level. Previously, the gift tax exemption was equal to the federal estate tax exemption, but legislators were concerned that taxpayers would gift large amounts of assets to those in lower income tax brackets so that income generated by those assets would be subject to less income tax. Gifts may still be made in the amount of \$10,000 per person per year without gift tax ramification, as long as rules are met in structuring those gifts. Note that the provisions that escalates the \$10,000 per year "annual exclusion" for CPI factors remains in effect, and we should see the annual exclusion amount rise to \$11,000 in 2002 or 2003.

So What Am I Supposed To Do? We have no crystal ball regarding future legislative activity. However, recognize that the repeal of the federal estate tax was approved during a period when public debates centered on the best manner to spend projected budget surpluses. With the recent downturn in the economy and the rapidly escalating federal expenditure in the military arena, most commentators are anticipating the disappearance of the budget surplus, and are forecasting budget deficits. Our common sense tells us that federal estate tax repeal may not be made permanent, and modifications will be brought to the legislative table before long.

One thing is certain: THIS AREA OF THE LAW REMAINS VERY UNSETTLED. We've been advising our clients to continue their planning under the assumption that the federal estate tax will be with us for the foreseeable future (even if nothing happens legislatively, remember the repeal only impacts one year -- 2010). Accordingly, the planning structures that we've put into place with clients over the past years remain sound, and future planning will not look appreciable different. Other pages in this series review the questions of general estate tax applicability.