

Gresham Partners, LLC

Wealth Transfer Brief

Death to the Estate and GST Tax in 2010?

Summary

Happy New Year! Congress took no action at the end of 2009 to prevent the changes to the federal transfer tax summarized below. Congress' inaction leaves taxpayers in a state of uncertainty regarding (1) the operation of their testamentary plans and (2) potential new lifetime wealth transfer opportunities.

Most estate planners are advising a wait and see approach, as Congressional leaders may act in early 2010 to address the current uncertainty. Many believe that the 2009 tax law will be reinstated retroactive to January 1, 2010. However, there is the possibility that Congress will not agree, will agree on a different set of rules, or that any changes are not retroactive. Moreover, any legislation that changes rates or re-enacts taxes on a retroactive basis may give rise to protracted legal challenges, although there is precedent for retroactive application.

We will watch the legislative developments carefully and report again to our community of clients and friends when there are significant developments. In the meantime, clients who are contemplating moving aggressively, hoping to take advantage of the current confused state of the law, should proceed with caution.

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Starting in 2010 (subject to Congressional change)

- Estate tax – Repealed.
- Generation-skipping tax (GST) – Repealed.
- Gift tax – still applies, but rate drops to 35% (or highest marginal income tax rate). The lifetime gift tax exclusion remains at \$1 million. The annual gift tax exclusion remains at \$13,000 per donee.
- Carryover cost basis – beneficiaries take the decedent's income tax basis so that an appreciated asset, while not subject to estate tax, will not have the cost basis reset at the decedent's death. Each estate will be allowed up to \$1.3 million of additional basis, plus an extra \$3 million of basis for qualified bequests to a spouse.

Starting in 2011 (if Congress takes no action to change this)

- Estate tax and GST – Both are reinstated.
- Estate and Gift tax – Exemptions for both at \$1 million (equals 2009 gift tax exemption, but lower than \$3.5 million estate tax exemption for 2009). Highest marginal rate for both at 55% plus a 5% surcharge on estates in excess of \$10 million to phase out the exemption (compared to 45% rate in 2009).
- GST – Exemption of approximately \$1.3 million, indexed to inflation (compared to \$3.5 million in 2009). Rate is a flat 55% (compared to 45% in 2009).
- Full cost basis step-up – beneficiaries have the cost basis reset at the decedent's death, avoiding decedent's unrealized capital gains.
- State death tax credit of 16% on federal estate tax returns (a pre-2001 benefit on federal returns).

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Possible Legislation in 2010

We cannot predict what Congress will do with federal transfer taxes. Based upon Congressional action to date, the easiest outcome is a retroactive extension of the 2009 rules (perhaps permanently), which is a 45% rate for gift tax, estate tax and GST and \$3.5 million estate tax and GST exemptions. However, Congressional agreement, especially in the current Senate, can be challenging.

The Obama administration has also sought to (1) eliminate the availability of valuation discounts on transfers to family members and (2) make it more difficult to transfer assets with no gift tax using grantor retained annuity trusts (GRATs). There have been additional proposals, such as the elimination of "Crummey" withdrawal powers. The Treasury Department may use its regulatory authority to restrict valuation discounts in lieu of Congressional action.

Planning in the Interim

There are numerous planning ideas being discussed in the estate planning community designed to take advantage of the 2010 repeal of the estate tax and GST: most have downside risk under some legislative scenario. What we can say is that if it begins to look as if the estate tax and GST will be eliminated for a significant period of time, our clients' wills and revocable trusts should be examined to make sure they accomplish objectives (as most plans are built around pre-2010 funding formulas), and more aggressive lifetime transfers of wealth during a GST hiatus may be possible.

We do not know if or when Congress will act to resolve the current uncertainty. If Congress acts early in 2010, the time and expense incurred in reviewing or revising wealth transfer plans may prove to have been unnecessary. Because of this possibility, individuals who are in good health may decide simply to take no action and incur no fees until the transfer tax landscape becomes more certain.

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