

Federal Estate & Generation-Skipping Transfer Tax Repeal in 2010:  
What it Means to You

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**Repeal of the Federal Estate and Generation-Skipping Transfer Taxes**

Unless Congress acts in 2010, no Federal estate tax will be imposed on the estate of an individual dying in 2010, regardless of the size of the estate and even if the estate does not pass to a spouse. Not since 1915 has there been a period when no Federal estate tax was in existence. In addition, and unless Congress acts, property can pass to grandchildren or more remote descendants in 2010 without incurring a generation-skipping transfer (“GST”) tax.

Legislation enacted in 2001 substantially raised the exemption against the estate and GST taxes from \$1,000,000 in 2002 to \$3,500,000, in 2009, lowered the tax rate from 55% to 45% and provided that there would be no Federal estate or GST tax in 2010. Under that 2001 law, the estate and GST taxes are scheduled to return in 2011 with an exemption of \$1,000,000 and a maximum tax rate of 55% (60% for certain large estates).

The Federal gift tax remains in effect for 2010 with the same \$1,000,000 exemption and a 35% tax rate (down from 45% for 2009). The maximum gift tax rate will increase to 55% in 2011. The amount that qualifies for the annual exemption from the gift tax remains unchanged at \$13,000 per donee.

It had been expected that Congress would act towards the end of 2009 to prevent the Federal estate and GST taxes from expiring in 2010. However, with the contentious fight over health care taking up much time in Congress, no legislation extending the Federal estate and GST taxes for 2010 was passed. It is not clear when, or if, legislation will be enacted to reinstate the repealed taxes and whether such reinstatement will be retroactive to the beginning of 2010.

**Repeal of the Income Tax “Step-Up In Basis” Rules**

At first blush, the expiration of the estate and GST taxes sounds like good news for the heirs of a decedent. However, the repeal of the estate and GST taxes also brings with it a repeal of the income tax “step-up in basis” rules, which provided that upon death, a decedent’s property received a basis equal to its date of death value. For decedents dying in 2010, the basis of appreciated property owned by a decedent will generally now be carried over from the decedent’s income tax basis. The new carry-over basis rules permit an increase of \$1,300,000 to the basis in the decedent’s assets passing to anyone and an additional \$3,000,000 basis increase for assets passing to a spouse outright or in a special spousal trust (in each case such basis increase cannot raise the basis of any property above its date of death value).

When an heir sells inherited property received from the estate of an individual dying in 2010, gain may be realized, which could be very substantial. In addition, the previously automatic

long-term holding period for inherited property is no longer in effect, so that a sale of such property within one year of death will not result in favorable capital gains treatment. Except for very large estates, it is possible that heirs may find that the aggregate income taxes paid are larger than the estate tax that would have been paid had these laws not been repealed.

### **Be Certain Your Estate Planning Documents Reflect Your Intentions**

Many Will and Revocable Trust documents, when taking advantage of the estate tax marital deduction or the exemption from the GST tax, utilize language couched in a formula, making reference to the estate and GST tax laws that were in effect through 2009. As an example, a document may set aside property in a so-called "credit-shelter trust" with a formula which refers to the amount that can pass free of Federal estate tax. That type of clause is intended to maximize the amount of property that can be transferred free of estate tax. Another document may make reference to the maximum available GST exemption in setting aside assets to be held in trust for descendants of multiple generations to avoid the GST tax. It is unclear at the present time how those formula clauses will be interpreted since the estate and GST laws they make reference to no longer exist (*i.e.*, will such clauses be interpreted to pass some or all of a decedent's property or none of the decedent's property?).

### **What Action, If Any, Should Be Taken**

Some members of Congress have indicated an intention to pass temporary or permanent estate and GST tax legislation in the first part of this year, which would retroactively reinstate the taxes. Given the lack of success in passing any legislation on this subject in 2009, it is unclear at this point in time when, or if, such legislation will be passed, and whether any retroactive effect would be constitutional. Given such uncertainty, some situations may require careful review and possible immediate action to revise estate planning documents to make sure that the intended disposition of property is carried out.

Unintended results could occur under the following circumstances, among others:

Your estate plan documents set aside a credit shelter trust or a generation-skipping trust by a formula to children or others but not for your surviving spouse, and leaves the remainder of the estate to your surviving spouse. It is possible that these documents could be interpreted in a manner to pass all of your property to the credit shelter or generation-skipping trust, to the exclusion of your surviving spouse.

Your spouse is the primary or sole beneficiary of a formula credit shelter trust, and your estate plan documents may be interpreted in a manner to pass all of your property to the credit shelter trust for the primary benefit of your spouse; however, if you live in a state with an independent State estate tax, such as New York, New Jersey or Connecticut, such transfer may result in a large and unanticipated State estate tax payable at your death.

Now may be the time to make large gifts to generation-skipping trusts for the benefit of descendants, taking advantage of the lower gift tax rate and the absence of the GST tax. Techniques may be available to protect against a retroactive increase in the gift tax rate and reinstatement of the GST tax.

### **New Rules for Individual Retirement Accounts In 2010**

Commencing in 2010, an individual can convert a traditional IRA to a Roth IRA, regardless of the individual's income level. If the conversion is made in 2010, an election can be made to report the income over calendar years 2011 and 2012. If you have a traditional IRA, you should consult with your financial advisor to determine if a conversion is appropriate for you, and, if so, on what basis.

### **To Contact Us**

If you would like to discuss your specific estate planning situation with us, please call Steven I. Pollack of our firm at (212) 905-3645 to schedule an appointment to meet with him.

**U.S. Treasury Department Regulations require that certain written advice with respect to Federal tax issues be in the form of a complex formal opinion at significant additional cost, unless the following disclaimer is provided to you. Accordingly, you should be aware that any Federal tax advice contained in this letter is not intended or written to be used, and cannot be used, for the purpose of avoiding penalties under the Internal Revenue Code.**

January 8, 2010

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