



THE KIRWAN LAW FIRM

## **TRANSFER TAX RELIEF UNDER THE NEW LAW**

### **NOW YOU SEE IT, NOW YOU DON'T?**

On Saturday, May 26th, 2001, Congress passed the "Economic Growth and Tax Relief Reconciliation Act of 2001." Although the bill fell short of the 1.6 trillion dollar tax cut initially advanced by President Bush, the President pronounced the 1.35 trillion dollar cut in taxes a bipartisan victory and the single largest tax cut in twenty years. At 9:01 am on Thursday, June 7, 2001, President Bush signed the bill into law.

The Estate, Generation-Skipping, and Gift Tax are all affected by the new legislation, however, the word "Repeal" is grossly misleading. Unfortunately, only people who die in the next ten years will benefit from the new law. In addition, the benefit available to those "fortunate" enough to have a short life expectancy is far less than what is being touted by law makers. What taxpayers **really** get is (i) an acceleration of Unified Credit (which currently shelters \$1,000,000 from Estate and Gift Tax), and (ii) a slight reduction of Estate Tax rates, up to, but NOT beyond December 31, 2010. Below is a summary of the changes to the Estate, Gift, and Generation Skipping Tax laws made by the new Act and what these changes mean to you from a planning prospective.

### **Changes to the Top Rates and Unified Credit**

#### **Benefits Started in 2002**

As stated above, the two principal changes to transfer taxes under the new law are (i) an increase of the Unified Credit over time, and (ii) a slight reduction of the Estate Tax rates, again, over time. Currently, the top Estate Tax rate is 55%. In addition, a 5% surtax is applied to estates over \$10,000,000 to phase out the benefit of the graduated rate structure. Under the new law, this 5% surtax was eliminated in 2002 and the top Estate and Gift Tax rate drops to 50%.

#### **Benefits Increase from 2002 to 2009**

Between now and 2009, the top Estate Tax rate slowly drops to 45% and the Unified Credit increases with most of the increase taking place in the last few years. As explained below, the amount of property you can give away without triggering gift tax does not increase.

## Estate Tax (But Not The Gift Tax) Repealed for 12 Months in 2010

In 2010, the Estate and Generation-Skipping transfer taxes are repealed for twelve months. During this one year period, if you plan properly, \$1.3 million of assets can receive a "Step-Up" in basis. If you are married, an additional \$3 million of assets can receive a "Step-Up" in basis if they are left to the surviving spouse. This is discussed in greater detail below.

## Estate Tax as We Know it **Today** Springs Back in 2011

In 2011, the current Estate, Gift, and Generation-Skipping Tax laws spring back into existence under the new Act. This means that any benefits of an increased Unified Credit or decreased tax rates offered under the new law completely disappear as of January 1, 2011.

The Estate and Gift Tax rates and Unified Credit amount for Estate and Gift Tax purposes are shown in the table below.

Calendar Year	Unified Credit		Highest Estate and Gift Tax Rates
	For Estate Tax	For Gift Tax	
2001	\$675,000	\$675,000	55% (together with the 5% surtax for estates over \$10,000,000)
2002	\$1 million	\$1 million	50%
2003	\$1 million	\$1 million	49%
2004	\$1.5 million	\$1 million	48%
2005	\$1.5 million	\$1 million	47%
2006	\$2 million	\$1 million	46%
2007	\$2 million	\$1 million	45%
2008	\$2 million	\$1 million	45%
2009	\$3.5 million	\$1 million	45%
2010	N/A (repealed)	\$1 million	Gift Tax Only: Top Individual Rate (anticipated to be 35%)
2011	\$1 million	\$1 million	55% (together with the 5% surtax for estates over \$10,000,000)

## **No Repeal of the Gift Tax**

Due to a fear that eliminating the gift tax would allow people to shift income to trusts or family members with lower tax rates or who reside in states that don't impose a state income tax, the gift tax stays in place during the year the Estate and Generation-Skipping Taxes go away. This prevents a parent in New York or California (which states impose a high state income tax) from giving a multi-million dollar stock portfolio to a child in Florida (which has no state income tax), with the unwritten understanding that the child will just give money back to mom or dad whenever they need the money. By keeping the gift tax in place, this type of planning loses its attractiveness.

## **The New Gift Tax Credit**

The reason the estate tax credit we have become accustomed to is called the "Unified" Credit is because it is used to offset both the Estate Tax AND the Gift Tax. In other words, this year you could choose to give away up to \$1,000,000 and pay no gift tax. Likewise, if you died this year you could shelter up to \$1,000,000 from Estate Tax. There are several gifting techniques that allow you to give away assets (thereby removing assets and growth on those assets from your estate) yet still retain indirect control and/or enjoyment of the assets. The new law "Un-unifies" this credit by raising it to \$1,000,000 FOR GIFT TAX PURPOSES and keeping it at \$1,000,000 regardless of how high the credit FOR ESTATE TAX PURPOSES becomes. This being the case, the only way to truly take advantage of the increased Estate Tax credit shown in the above table is to actually die during the specified year. Estate planners are already jokingly referring to the new law as "The Assisted Suicide Promotion Act of 2010."

## **Gift Tax Rates**

The top Gift Tax rate continues to be equal to the top Estate Tax rate (see Table on Page 2) through 2009. In 2010, the Gift Tax rate drops to a rate equal to the top individual income tax rate (currently projected to be 35%).

## **New Basis "Step-Up" Rules**

During the one year repeal of the Estate Tax in 2010, the present laws allowing an unlimited amount of appreciated property to receive a "stepped-up basis" (i.e., eliminating capital gains liability for appreciated property) are also repealed, thereby substituting an income tax problem for an Estate Tax problem. If you plan properly, you will still be able to receive "stepped-up basis" treatment for up to a total of \$1.3 million. An additional \$3 million can receive this benefit if it passes to a surviving spouse in an acceptable manner. With respect to any property above this amount, the property's recipients will receive a basis equal to the **lesser** of (i) the property's basis in the hands of the decedent prior to his or her death, or (ii) the fair market value of the property on the date of the decedent's death. Therefore, capital gains but NOT capital losses can be passed to the next generation.

## **Summary of "Relief"**

While the Act does provide some "relief," unfortunately, it is not what is being touted by the law makers. What we actually get can be summarized as follows:

1. Repeal of the 5% surtax applicable to estates over \$10,000,000 until December 31, 2010.
2. Decreases in the marginal rates for Estate, Gift, and Generation Skipping Tax, and an immediate increase in the Unified Credit, as listed in the Table on Page 2.
3. Repeal of the Estate Tax for persons dying in 2010 (unfortunately coupled with a repeal of the "Stepped Up Basis" benefit).
4. Some technical changes that will affect a handful of individuals like the expansion of the Estate Tax rule for conservation easements.
5. Reduction of the State Death Tax Credit, which is not a benefit at all but rather a means of shifting some of the cost of the new law to the States.

### **What this Means to You**

In the event you die in 2010, you will escape the Estate Tax. If you die between, now and 2009, you have the potential of saving Estate Taxes depending on the size of your estate, the planning you have in place, and the year in which you die. If you expect to be among the living on January 1, 2011, you will have the same planning concerns that you do today since none of the changes under the Act will survive past that date. There is always the possibility that law makers will again make changes, however, it is hard to say whether they will extend a repeal of the Estate Tax or prevent the repeal from ever taking place in 2010; only time will tell. A lot will depend on which political party controls congress, who is president, and whether the projected \$5.7 trillion dollar budget surplus ever becomes a reality.

### **Proper Planning Remains a Must**

In the mean time, proper tax planning remains a must. Unfortunately, the benefit of repeal is also the Act's worst detriment if it encourages complacency when it comes to properly structuring your estate plan. Now is an excellent time to review your estate plan for several reasons.

1. New planning opportunities are presented by the Act given the increase in the Unified Credit.
2. Your wills and trusts should contain provisions to make sure your current planning functions properly if you do pass away in 2010 or if the repeal is made permanent by future law makers.
3. Recent changes to the rules governing IRAs and qualified plans provide new planning options that have an even better result with an increased Unified Credit.
4. Several powerful planning techniques to reduce Estate Taxes yield the best results if created at a time when interest rates are low. We are enjoying some of the lowest interest rates in years.
5. If you have not taken an "Integrated" approach to your planning in the past, you are missing out on several important benefits.  
Integrated Wealth Planning is customized, complete planning incorporating the following:

- a. **Risk Management.** Managing risk by properly structuring your assets during your life to ensure the assets you worked hard to acquire are not taken by a judgement creditor;
- b. **Tax Planning.** Reducing taxes by structuring assets in the most tax efficient manner to provide you benefits both during life and on your death;
- c. **Customized Planning for Future Generations.** Customized planning for future generations utilizing dynastic trusts (trusts that give beneficiaries the ability to enjoy assets AND keep those assets from being reduced by creditors, divorcing spouses, and/or estate taxation) and incentive trusts (trusts that allow you to provide incentives for children or other beneficiaries to achieve certain goals or lead a productive life style in order to enjoy the trust assets). Trusts are wonderfully flexible planning tools and have almost no limitations when it comes to furthering your planning goals;
- d. **Business Planning.** If you own your own business, it is imperative to incorporate the following goals into your overall plan: (i) managing risk, (ii) ensuring a plan is in place to protect the business in the event of your incapacity, and (iii) ensuring the business passes to the next generation in the manner you desire (i.e., who gets control, splitting value among children in the amount you deem appropriate, planning for liquidity to pay taxes and provide adequate capitalization as the business' management changes hands, etc.);
- e. **Planning for Sickness and Disability.** Proper planning in the event you have a serious medical emergency or are physically or mentally incapacitated. If you don't know what would happen if something happened to you that prevented you from being able to function fully, your planning is inadequate and should be updated as soon as possible;
- f. **Planning for your Minor Children's Well Being.** Proper planning for the care and guardianship for your minor children in the event you die prematurely or become incapacitated. Customized planning can be used to ensure your children continue to grow up in a loving environment and have financial security; and
- g. **Making Sure the Plan Stays Effective.** Implementing a strategy to ensure your plan is properly maintained in the future. This usually involves establishing a clear line of communication between your accountant, financial advisor, and attorney. If you don't have advisors, we can help by referring you to competent experts who are familiar with this team approach. With a strategy in place and all your advisors communicating effectively, you will have peace of mind that what needs to get done to accomplish your objectives is being attended to and that if life throws you a curve ball everyone will be able to react quickly and appropriately.

## **Conclusion**

In summary, Integrated Wealth Planning is creating an effective plan to (i) protect your assets and maximize their benefit to you during your life, (ii) ensure your assets and business are structured in a way that allows you to meet your goals and objectives in the most tax efficient manner, and (iii) pass your assets to your children or other beneficiaries on your death in a manner that maximizes the positive effects of your hard work for years to come. Once the Integrated Wealth Planning process is complete, you have peace of mind that you are on track to accomplishing your personal goals and objectives.

If you have any questions regarding the new tax laws or the planning opportunities mentioned in this memorandum, please call Adam O. Kirwan at (407 ) 210-6622.