

# Clients & Friends Memo

## U.S. Federal Estate, Gift and Generation Skipping Transfer (“GST”) Taxes

January 29, 2010

Contrary to expectations, Congress did not pass legislation in 2009 to address the repeal of the U.S. Federal estate and GST taxes for transfers of property in 2010. Therefore, unless Congress passes legislation, the following applies to transfers of property in 2010:

- There is no U.S. Federal estate tax.
- There is no U.S. Federal GST tax.
- The U.S. Federal gift tax and \$1,000,000 exemption remain in effect, but the highest gift tax rate is 35% (reduced from 45%).
- The automatic step-up in basis for inherited assets is changed significantly.

While Congress may attempt to adopt legislation that is effective retroactively to January 1, 2010 or effective as of the date of enactment, it is unclear whether Congress will do so or whether it would be constitutional to pass such legislation retroactively.

Further, if Congress does not amend the U.S. Federal estate, gift and GST tax laws, the pre-2001 U.S. Federal tax laws will apply to transfers of property after 2010. In such case, the top U.S. Federal estate, gift and GST tax rate will be 55%, the U.S. Federal estate and gift tax exemption amount will be \$1,000,000, and the GST exemption will be \$1,000,000 indexed for inflation.

Many wills and revocable trusts for married persons utilize a formula to allocate assets that are exempt from the U.S. Federal estate tax (which exemption was \$3,500,000 for persons dying in 2009) to a "credit shelter trust", with the balance passing to the surviving spouse, either outright or in a marital deduction trust. The reason for this allocation was to shelter the assets in the credit shelter trust from U.S. Federal estate taxation at the death of the surviving spouse. Under current law, there is no U.S. Federal estate tax exemption because there is no U.S. Federal estate tax. Thus, depending upon the instrument, a question could arise as to how property should be allocated under the formula clause between the credit shelter trust and the disposition for the

surviving spouse. The formula clause could be construed as having the entire estate or trust pass to the credit shelter trust, thereby depriving the spouse of a share of the balance of the estate or trust. Similar issues arise with regard to formula GST exemption clauses that take advantage of the GST exemption (which was \$3,500,000 in 2009), and bequests to charity that require the disposition to be deductible for U.S. Federal estate tax purposes.

The existence of such uncertainty makes it difficult to plan. While we are not suggesting that you die in 2010 in order to avoid the U.S. Federal estate and GST taxes, we believe it is prudent and important for you to reconsider your succession planning to determine what changes might be appropriate and whether you wish to make taxable gifts because of the reduced rate.

The changes discussed above will not affect state estate taxes, which will continue to apply. New York has a top estate rate of 16% and other states have similarly high estate tax rates.

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