



ESTATE PLANNING TECHNIQUES THAT STILL MAKE SENSE EVEN IF THE ESTATE TAX REMAINS REPEALED

The Economic Growth and Tax Relief Act of 2001 (the “Act”) signed by the President on June 7, 2001, has a substantial impact on transfer taxes (see reverse side). However, unless re-enacted by a future Congress, these changes are merely temporary. These new laws “sunset” on December 31, 2010, and the transfer tax rules in effect in 2001 will be reinstated in 2011.

Accordingly, persons likely to have estates in excess of \$1 million at the time of their deaths should not postpone conventional estate planning. However, estate planning should proceed with an eye towards the possibility that estate taxes may eventually be repealed or that the applicable exclusion amount may be significantly increased in the future. Following is a discussion of ten techniques that will not result in any adverse tax consequences to the donor (or the donor’s spouse) even if transfer taxes are eventually eliminated or substantially reduced.

1. Use The Gift Tax Annual Exclusion. Gifts of \$11,000 (\$22,000 for married couples) can be made annually to as many donees as the donor desires. These gifts not only reduce the donor’s estate by the amount of the gift, but also by the future appreciation on the gifted property.

2. Gift The Applicable Exclusion Amount. Beyond the \$11,000/\$22,000 annual exclusion, donors can also give away their applicable exclusion amount. The advantage to using one’s applicable exclusion amount to make lifetime gifts is that the future appreciation and income from the gifted property is shifted out of the donor’s estate. If married, this planning opportunity doubles to \$2,000,000.

3. Leverage the Generation Skipping Tax Exemption. The \$1,000,000 (double for married couples) GST exemption can be

“leveraged” by allocating it to lifetime gifts. In other words, use a “dynasty trust” in conjunction with the gifts referred to in paragraphs 1 and 2 above.

4. Leverage Lifetime Gifts with Life Insurance. Consider using lifetime gifts to purchase a life insurance policy on the donor’s life, or a survivorship policy on the life of the donor and the donor’s spouse. Typically, an irrevocable life insurance trust (“ILIT”) will be used to own the policy. In many instances, an ILIT will provide an excellent way to leverage the grantor’s gift tax annual exclusion, applicable exclusion amount and GST exemption.

5. Use CRTs While Income Tax Rates Are Higher. CRTs are widely used to avoid paying capital gains taxes when selling highly appreciated assets. If the grantor and the grantor’s spouse are the only non-charitable beneficiaries, a CRT does not create any gift tax. In addition, a current income tax deduction is available equal to the present value of the remainder interest passing to charity. Since the Act also gradually reduces Federal income tax rates through 2006, the value of this charitable income tax deduction will decrease.

6. Use a Private Foundation to Front-End Load Charitable Gifts. With a private foundation, donors can donate now and decide later which charities to benefit. Since the Act also gradually reduces Federal income tax rates through the year 2006, by donating sooner than later, the donor’s charitable income tax deduction will be more valuable.

7. Use a CLAT with the Remainder at the Applicable Exclusion Amount. A charitable lead annuity trust is an excellent way to make a deferred gift to one’s heirs at a deep valuation discount. The present value of the remainder interest passing to the donor’s heirs is based on

the value of the assets contributed to the CLAT, and the amount and term of the payout to the charity. By keeping the remainder valued at or below the applicable exclusion amount, no gift tax will be due. Therefore, if transfer taxes are repealed or reduced, the donor will not be disadvantaged.

8. Use a GRAT with the Remainder at the Applicable Exclusion Amount. A grantor retained annuity trust (“GRAT”) is another way to gift income producing assets (e.g., Subchapter S stock and family limited liability company interests) to one’s heirs with valuation discounts. It is similar to the CLAT, but with the annuity paid to the donor for the set term, rather than to a charity. Again, as long as the remainder interest is valued at or below the applicable exclusion amount, the grantor will not be disadvantaged if transfer taxes are subsequently repealed or reduced.

9. Make sales to Intentionally Defective Grantor Trusts (“IDGT”). In lieu of a GRAT, consider selling income producing assets to a “grantor trust” on an installment basis. Since the property is “sold” to the IDGT, there are no gift tax consequences as such. Moreover, under Rev. Rul. 85-13, a sale of property by the grantor to a grantor trust results in no capital gains tax. However, for estate tax purposes, it is recommended that some “seed” money be gifted to the IDGT prior to the sale. Usually, 10% of the value of the property sold is recommended. Therefore, a \$1,000,000 gift (using the applicable exclusion amount) will support a \$10,000,000 sale (after valuation discounts).

10. Use a QPRT with the Remainder at the Applicable Exclusion Amount. A qualified personal residence trust is similar to the GRAT, but the trust is funded with a principal residence or vacation home. By retaining the right to occupy the residence for a term of years, the

value of the remainder interest (and the taxable gift) is reduced. By keeping the value of the remainder interest at or below the applicable exclusion amount, no gift tax will be due.

CONCLUSION

The Act offers little benefit to most taxpayers because of the sunset provision. The noted exception is for those persons who actually die in 2010. Nevertheless, estate planning documents should be drafted with flexibility so that if the estate tax is eventually repealed or substantially reduced, irrevocable transfers can be “undone”.

Perhaps the most effective estate planning tool to accomplish flexibility is a “limited power of appointment”. For example, the grantor of an irrevocable trust can provide in the trust agreement for a person (i.e., a family member, friend or trusted individual) to have the power to appoint trust property to the grantor, the grantor’s spouse and/or the grantor’s descendants (i.e., property can go to anyone other than the powerholder himself or herself). As such, if a future Congress re-enacts estate tax repeal, the powerholder could transfer the trust property back to the grantor. If properly structured, there are no tax consequences to either the powerholder or the grantor upon exercise of the power.

In summary, even for those persons who believe that estate taxes will some day be eliminated or significantly reduced, use of any one or more of the aforementioned techniques, as well as limited powers of appointment when applicable, is not only safe, but a prudent course of action.

This summary of the new Act is intended solely to provide general information and is not intended to constitute legal or tax advice. You should discuss the implications of this information with your legal, tax and other advisors.

SUMMARY OF ESTATE, GIFT AND GST TAX PROVISIONS OF ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT OF 2001

ESTATE AND GST TAXES

Calendar Year	Estate and GST Tax Deathtime Applicable Exclusion Amount	Highest Estate and GST Tax Rate
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	N/A (taxes repealed)	N/A (taxes repealed)

GIFT AND GST TAXES

1. The gift tax is not repealed, and the applicable exclusion amount for gift tax purposes is not the same as for estate tax purposes.
2. The gift tax applicable exclusion amount will increase to \$1,000,000 in 2002 and remain indefinitely at that amount.
3. The top gift tax rates will be the same as the top estate tax rates (see table at left), and after 2009 (when the estate tax is repealed) the top gift tax rate will be the top income tax rate (scheduled to be 35%).
4. The GST tax will end with the estate tax in 2010. However, since gift taxes are not repealed, GST transfers during lifetime will still be subject to gift taxes after 2009, but not any additional GST tax.

SUNSET PROVISION

To ensure compliance with the Congressional Budget Act of 1974, all provisions of the new act generally do not apply for taxable years beginning after December 31, 2010. Therefore, unless re-enacted by Congress in the future, these new provisions are only temporary and the prior estate, gift and GST tax will be reinstated in 2011.

Given the temporary nature of estate tax repeal, prudence would dictate that estate planning proceed as usual. The possible exception might be with regard to young donors making taxable gifts (i.e., gifts in excess of the \$1,000,000 exemption). Accordingly, given the uncertainty surrounding estate tax repeal, existing estate plans should be reviewed and new plans should be designed with a greater view towards flexibility.

STEPPED-UP BASIS

1. After repeal of the estate and GST taxes in 2010, the present stepped-up basis rules will be modified.
2. Starting in 2010, property acquired from a decedent will have a basis equal to the lesser of the decedent's basis or the fair market value of the property on the date of the decedent's death.
3. However, up to a total of \$1.3 million in basis step-up may be allocated to aggregate transfers to any beneficiaries, and an additional \$3 million for transfers to a surviving spouse, for a total of \$4.3 million.

MISCELLANEOUS PROVISIONS

1. In 2004, the Qualified Family Owned Business deduction is repealed.
2. Beginning in 2001, a qualified conservation easement may be claimed for any land located in the United States or its possessions, regardless of how far it is from a metropolitan area, national park, wilderness area or Urban National Forest.
3. The state death tax credit will be reduced by 25% in 2002, 50% in 2003, and 75% in 2004. In 2005 it will be repealed and replaced with a deduction for state death taxes actually paid.