



TAX ALERT

FEBRUARY 2010

Repeal of the Federal Estate and Generation-Skipping Transfer Tax for 2010

On January 1, 2010, the repeal of the federal estate tax and the generation-skipping transfer tax went into effect for the remainder of the year. Unless Congress takes further action before December 31, 2010, these taxes will be reinstated, and the federal estate tax and the generation-skipping transfer tax laws will once again be in effect.

This repeal is the product of legislation that was enacted in 2001, which has gradually increased the federal estate tax exemption and generation-skipping transfer exemption from \$1,000,000¹ to \$3,500,000 and has gradually reduced the marginal federal estate tax rate and generation-skipping transfer rate from 55% to 45% over a nine-year period. The federal estate tax exemption is the largest amount that a person may pass upon his or her death without the imposition of a federal estate tax, and the generation-skipping transfer tax exemption is the largest amount that a person may transfer during his or her lifetime or upon death to or for the benefit of individuals who are two or more generations below the donor or testator.

During this same nine-year period, the federal gift tax exemption has remained static at \$1,000,000. The federal gift tax exemption is the largest amount in excess of annual exclusion gifts that an individual may transfer during his or her lifetime to anyone other than a spouse who is a U.S. citizen without the imposition of a federal gift tax. An individual may transfer an unlimited amount of assets to a spouse who is a U.S. citizen during his or her lifetime without the imposition of a federal gift by reason of the unlimited marital deduction.

At the end of 2009, the House of Representatives passed legislation that would have extended the federal estate tax and generation-skipping transfer tax laws that were in effect as of December 31, 2009, for an additional year. However, it failed to pass in the Senate. Max Baucus, the Chairman of the Senate Finance Committee, announced on January 21, 2010, that there is no action pending in the Senate regarding the estate tax; however, he expects to draft estate tax legislation that will retroactively impose the estate tax as of January 1, 2010. A spokesman for Harry Reid, the Senate majority leader, has stated that estate tax legislation is not on the horizon. As a result, there is much uncertainty about the fate of the federal estate tax and generation-skipping transfer tax for the year 2010 and beyond.

The following questions will help you determine if and how the repeal of these taxes may affect your estate planning:

1. Who is impacted by the repeal of the federal estate tax and generation-skipping transfer tax?

There will be no federal estate tax or generation-skipping transfer tax imposed upon the estates of individuals who die during 2010. The beneficiary of an asset of an individual who dies during this time period will receive a basis in the inherited asset equal to the lesser of the decedent's basis in the asset or the asset's current fair market value. In

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addition, the executor of the decedent's estate will have the authority to allocate \$1,300,000 of basis among the decedent's assets, and the executor may allocate an additional \$3,000,000 of basis to assets passing to a surviving spouse. However, the executor may not allocate basis to an asset in excess of the asset's fair market value. Prior to 2010, the basis of each of the decedent's assets would have been increased or decreased to its fair market value as of the decedent's date of death.

2. Does the repeal of the federal estate tax impact the New York estate tax and New Jersey estate tax?

No, the repeal of the federal estate tax does not impact the New York estate tax or the New Jersey estate tax. New York and New Jersey have separate estate taxes that are independent from the federal estate tax. New York imposes a separate estate tax upon the estates of all resident individuals dying with a taxable estate of \$1,000,000 or more and all non-resident individuals owning real or personal property located in New York with a taxable estate of \$1,000,000 or more. New Jersey imposes a separate estate tax upon the estates of all resident individuals dying with a taxable estate of \$675,000 or more.

3. Does this legislation affect annual exclusion gifts?

The federal gift tax is in effect in 2010 and applies at a reduced rate of 35%. To the extent a person makes gifts in excess of the \$1,000,000 gift tax exemption, a gift tax will be imposed. In addition to the federal gift tax exemption, each person is entitled to make gifts in an amount equal to or less than \$13,000 to an unlimited number of individuals without the imposition of a federal gift tax. These gifts are known as annual exclusion gifts and this legislation does not impact them.

4. What steps should I take?

Now is the time to review your current estate planning documents to ensure that these documents still reflect your wishes. Many estate planning documents may contain language which is tied to sections of the Internal Revenue Code, which may not be in effect for 2010. As a result, there may be ambiguities in your estate planning documents that could result in the disposition of your assets in a manner other than which you intended. Finally, changes to your documents may be needed as a result of the basis allocation rules discussed in Question 1 above.

Given the recent changes in the federal estate tax and generation-skipping transfer tax laws, and the uncertainty of the future of these laws, we recommend that you contact Daniel Swick, Paul Herman or Brian Raftery to discuss your documents.

If you have any questions regarding this alert, please contact Daniel Swick at (212) 592-5908, (973) 274-2010 or dswick@herrick.com.

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¹The GST Exemption of \$1,000,000 is indexed for inflation beginning in 1998.