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Federal Estate, Gift and Generation-Skipping Transfer Taxes Are in Flux

Congress adjourned at the end of 2009 without taking action to either extend the federal estate, gift and generation-skipping transfer tax rules applicable in 2009, or otherwise modify the limited "repeal" scheduled to take effect in 2010. Congress' lack of action means that for calendar year 2010 (and, at this point, only for 2010), unless Congress takes action:

- The federal estate tax will not apply to the estates of people whose deaths occur during 2010;
- The federal generation-skipping transfer tax will not apply to "generation-skipping transfers" made during 2010 to recipients, such as grandchildren, who are two generations or more below the person making the transfer;
- The federal gift tax will apply to gifts made during 2010, but with a top tax rate of 35 percent rather than 45 percent (the lifetime exemption amount remains US\$1 million for lifetime gifts, and the annual exclusion amount per recipient remains US\$13,000); and
- The rules that adjust the income-tax basis of a deceased person's property to fair market value will be restricted.

During December the US House of Representatives passed a bill that would extend the 2009 provisions, with a top tax rate of 45 percent and a US\$3.5 million exemption amount for estate-tax purposes and generation-skipping transfer tax purposes. However, the US Senate failed to act on this bill before adjourning for

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the year.

We anticipate that attempts will be made in early 2010 to pass such legislation, most likely retroactive to January 1. However, the timing of such legislation, and whether it will match the 2009 provisions, tax rates and exemption amounts, remains uncertain.

As the tax laws are now written, if Congress does not act in 2010, pre-2002 tax provisions will return starting in 2011, with a top federal estate and gift tax rate of 55 percent (plus a 5-percent surtax in some cases) and an exemption amount of US\$1 million. If Congress does not act, the federal generation-skipping transfer tax will also return in 2011.

It is important to examine the possible impact of these changes on existing estate plans. In particular, it may be uncertain how the provisions of your estate planning documents will be interpreted if there is no federal estate tax. Many will and trust provisions are phrased based on federal estate-tax concepts or generation-skipping transfer tax concepts, so questions could arise about how certain provisions should be interpreted and property disposed of, if the federal estate tax laws do not apply when those provisions become effective. The result could be that assets intended for a particular person or trust may not be transferred to them as intended, unless a will or trust provision is modified now. There also may be state transfer tax ramifications.

On another note, there may be a window of opportunity available during 2010 (but possibly only a few weeks or months) to make gifts to children and grandchildren at a reduced federal transfer-tax cost.

If Congress acts early in 2010 the time and expense involved in reviewing and, possibly, revising an existing estate plan may prove to have been unnecessary. Likewise, substantial gifts made to take advantage of the more favorable gift-tax rate and temporary absence of a generation-skipping transfer tax may prove costly, if Congress reinstates the 2009 provisions retroactively and that retroactive action is upheld by the courts. On the other hand, timely action taken now may prove beneficial if Congress does not make changes promptly or retroactively.

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