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## WEALTH PRESERVATION AND TAX PLANNING ALERT

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### Changes to the Transfer Tax System

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As you may have seen in recent media coverage, Congress did not enact legislation in 2009 to address the status of the U.S. transfer tax system (consisting of the gift tax, the estate tax, and the generation-skipping transfer tax ("GST")). Many people were expecting Congress to pass legislation before yearend in order to address then-pending transfer tax changes which became effective on January 1, 2010, and also to address further changes which will become effective on January 1, 2011, absent prior legislative action.

All three components of the transfer tax system remained in effect throughout 2009. The gift tax applied at progressive rates up to a maximum rate of 45% subject to an exemption amount of up to \$1 million per-person. The estate tax applied at progressive rates up to a maximum rate of 45% subject to an exemption amount of up to \$3.5 million per-person. And, to supplement the gift and estate tax regime, the GST applied at a flat rate of 45% subject to an exemption amount of up to \$3.5 million per-person.

This transfer tax system changed dramatically this year. Effective as of January 1, 2010, the gift tax remains in effect at a reduced rate of 35% subject to

a gift tax exemption amount of up to \$1 million per-person. Depending on future legislation, this reduced rate may enhance the value of estate planning strategies implemented during lifetime as opposed to testamentary transfers.

More significantly, for 2010 (and only 2010), current law repeals both the estate tax and the GST. This marks the first time in nearly 100 years that the Federal government has not imposed an estate tax. To reflect the lack of an estate tax for 2010, only a limited "step-up" or increase in the income tax basis of inherited assets will apply.

If Congress does not enact legislation to amend the current system, both the estate tax and the GST will be reinstated in 2011 at the respective rates and exemptions which were in effect as of the beginning of 2002. This result would be regressive in terms of total transfer tax cost. Under the 2002 framework, the estate tax and GST each applied at progressive rates up to a maximum rate of 55% subject to an exemption amount of up to only \$1 million per-person.

Although it is possible that Congress will enact legislation this year which seeks to

impose the estate tax and GST on transfers made in 2010 on a retroactive basis, the ultimate scope and effectiveness of any such legislation remains to be determined. That said, current law literally provides for no estate tax or GST on transfers made in 2010; it remains possible that this law will prevail for the current year.

The current structure of the U.S. transfer tax system without an estate tax or GST may raise material issues within any given estate plan. By way of example, many clauses in wills and trusts are formula-based and tie the amount of a disposition to an applicable estate tax exemption amount or GST exemption amount. With no actual estate tax or GST, and thus no applicable estate tax exemption amount or GST exemption amount, the literal application of certain formula clauses may be problematic and could cause results substantially different from that which was intended. This, however, is but one example, and other issues or problems may exist as a result of the current law.

For these reasons, the commencement of 2010 has brought an unprecedented U.S. transfer tax structure, and, in certain cases, a need to conform estate documents to the current law. ■

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