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## SILICON VALLEY LAW GROUP NEWSLETTER

### ESTATE TAX DEVELOPMENTS

– **Increase in Annual Gift Tax Exclusion.** For calendar year 2002, the annual gift tax exclusion (previously \$10,000 per year per donee) has been adjusted for cost of living so the first \$11,000 of gifts to any person (other than gifts of future interests in property) are not included in the total amount of taxable gift under Section 2503 made during that year.

– **New Estate and Gift Tax Law.** New tax law phases out over the next nine (9) years, and in 2010 repeals Estate and GST Taxes.

The recently enacted *Economic Growth and Tax Relief Reconciliation Act of 2001* (the “2001 Act”) gradually reduces, and eventually repeals the Estate and generation-skipping transfer (“GST”) taxes, but not until 2010. When the repeal takes effect for estates of individuals dying after 2009, assets acquired from a decedent generally will receive a modified “carryover basis” rather than the existing “stepped up” basis.

The gift tax was not repealed. For gifts made after 2009, the top gift tax rate will be the highest individual income tax rate. Beginning in 2002 and through 2009, the estate and gift tax rates will be reduced, and the lifetime exemption amount for estate tax purposes and the GST exemption will be increased.

For individuals dying, and gifts made, between 2002 and 2009, (the “Transition Period”):

- ***Life Time Exemption.*** The lifetime exemption amount for both estate and gift tax purposes will increase from the current year’s \$675,000 to \$1 million in 2002 and 2003. Thereafter, the lifetime exemption for estate tax will steadily increase the individual exemption amount so that it will be \$1.5 million in 2004 and 2005, \$2.0 million in 2006, 2007, and 2008, and \$3.5 million in 2009.
- ***GST Tax.*** The 2001 Act also repeals the GST tax for transfers after December 31, 2009. This tax is imposed on gifts and bequests to grandchildren and more distant generations, and to trusts established for their

benefit. Currently, planning for the GST tax is focused on the effective use of the \$1.0 million GST exemption. This exemption is scheduled to increase in tandem with the lifetime estate tax exemption, so that the GST exemption will be \$3.5 million in 2009, the year before repeal.

- **Tax Rates.** The top estate and gift tax rates of 53% and 55%, and the GST tax rate, will drop to 50%. The top GST tax rate will be further reduced by 1% a year until 2007, when it will be 45%.
- **Gift Tax.** To the surprise of many, **the 2001 Act did not repeal the gift tax.** The gift tax exemption increases to \$1.0 million in 2002, but receives no further increases.

For individuals dying after 2009:

- **The Estate Tax and GST Tax will be eliminated**, *subject to congressional extension.*
- **Tax Basis.** The tax basis of property acquired from a decedent, in the hands of the person receiving it, generally will be the lower of the Fair Market Value on the date of death or the decedent's adjusted tax basis of the property immediately before the decedent's death. Exceptions to the carryover basis rule include the following:
  1. **Spouse.** Estates will be allowed an additional \$3 million of basis, to be allocated among the assets passing to a surviving spouse.
  2. **Others.** Each estate will receive \$1.3 million of basis to be added to the carryover basis of one or more assets held at death.
- **Gift Tax Rate.** In 2010 the maximum gift tax will drop to 35%, equal to the then top income tax rate for individuals.

**Planning Considerations:** Below are some planning comments regarding the 2001 Act:

- **Estate and gift taxes will be with us for the next nine (9) years, and it is highly likely they will affect estates for much longer.** The "sunset" provisions of the legislation make the repeal inapplicable for years beginning after December 31, 2010. ***This requires congressional action for the "repeal" to last more than one year.*** The fact that the gift tax provisions have not been repealed (so as to retain the gift tax on lifetime transfers of assets) increases the skepticism of myself and other practitioners that the estate tax will be completely repealed. By keeping the gift tax in place, the 2001 Act will prevent individuals from transferring most of their assets to heirs during their lifetime in the event that the estate tax provisions are re-implemented.

- **The increases in the GST exemption amount creates greater opportunities to transfer assets directly to grandchildren.**
- **Nontax reasons for estate planning** remain, such as holding assets in trust for younger children (or older children, for that matter), naming of guardians for minors, and asset protection issues.
- **Income tax planning** will become more critical.
- **State inheritance taxes** may become a prominent planning concern as states enact death taxes.
- **Liquidity issues** (i.e. cash for payment of taxes) and the need for life insurance will continue in many instances.
- **Asset Allocation Planning.** More attention than ever before will be given to what assets are allocated to the bypass (aka, credit shelter or exempt trust) and what assets are allocated to the other trusts.
- **Record keeping.** Taxpayers will have to give greater attention to maintaining asset basis records.
- **Bypass or Credit Shelter Trusts could be “over-funded”.** Most of the wills or revocable trusts drafted for married couples, which provide for by-pass or credit shelter trusts, have provisions that automatically track the federal estate tax exclusion or use a “formula clause”. This generally means that there will be allocated to the bypass or credit shelter trust an amount equal to the lifetime exclusion amount (will increase to \$3.5 million each in 2009). For larger estates this may be a desirable course of action. However, for many estates, particularly those estates that are at or near the exclusion levels, it may mean that too much will be allocated to such bypass or credit shelter trusts.

**WARNING:** THIS LETTER IS INTENDED TO GIVE A GENERAL DESCRIPTION OF THE 2001 ACT AND OFFER SOME PLANNING CONSIDERATIONS. IT IS NOT INTENDED, NOR SHOULD A READER CONSIDER IT, TO BE A DESCRIPTION OF ALL OF THE PROVISIONS OF THE 2001 ACT OR PLANNING ADVICE TO THE SPECIFIC READER. ALL READERS OF THIS NEWSLETTER ARE WARNED NOT TO MAKE ANY ESTATE PLANNING DECISIONS OR CHANGES TO THEIR ESTATE PLANNING DOCUMENTS WITHOUT CONSULTING WITH AN ESTATE PLANNING ATTORNEY OR OTHER PROFESSIONAL.

If you are interested in such a consultation or to discuss the 2001 Act, please contact Bernard. J. Vogel, III at (408) 286-6100 or by e-mail at [vogel@svlg.com](mailto:vogel@svlg.com).