

# KIRKLAND ALERT

January 2010

## Temporary Repeal of the Federal Estate and Generation-Skipping Taxes for 2010

Based on a law passed in 2001, the federal estate tax and generation-skipping tax (GST) were repealed and the gift tax rate was decreased from 45% to 35% for 2010. Unfortunately, these changes are only temporary. Unless Congress changes the law, the gift, estate and GST tax laws that were in effect back in 2001 will be reinstated on January 1, 2011, at higher rates and reduced exemptions than existed in 2009. Congress may act to reinstate the taxes in 2010 retroactive to January 1, 2010, but no one knows what Congress will do.

### THE REPEAL COULD AFFECT YOUR ESTATE PLAN

If you die in 2010 before new legislation is passed and such legislation is not retroactive, your estate plan may be affected:

(1) Your estate planning documents may contain formulas that reference tax code sections that do not exist in 2010. Thus, you should review your documents to determine whether changes are necessary to avoid an unintended disposition of your assets.

(2) The 2010 tax law also eliminated the basis “step-up” for inherited property. This rule increased the basis of inherited property to its fair market value at death, allowing heirs to sell the property without triggering any capital gains tax. During 2010, only \$1.3 million of unrealized gains can be eliminated under this rule, plus another \$3 million of unrealized gains that pass to a surviving spouse (or a trust meeting certain requirements). It is possible that your estate plan would not be able to fully utilize the additional \$3 million of basis increase without revision.

### PLANNING OPPORTUNITIES

The 2010 tax law also creates opportunities because the gift tax rate decreased from 45% to 35% in 2010 (and will be 55% in 2011 without Congressional action) and the GST tax is repealed in 2010 (but will be 55% in 2011 without Congressional action).

**You can take advantage of both the decrease in the gift tax rate and the repeal of the GST tax.** Examples include the following:

(1) **Gifts to QTIP Marital Trusts:** You could make a gift to take advantage of the 35% gift tax rate. To protect against a possible retroactive increase in the gift tax rate, the gift could be made to a “QTIP Marital Trust” for your spouse’s benefit. If the gift tax rate is retroactively increased, you would elect to qualify the trust for the gift tax marital deduction when the gift tax return is filed in 2011. By doing so, no gift tax would be due. If the rate is not increased, no election would be made, the gift would be subject to the 35% tax and the property would eventually pass free of estate tax to your children.

Moreover, if Congress does not retroactively reinstate the GST tax, your children could “disclaim” their interest in the QTIP Marital Trust, allowing it to pass to your grandchildren. The disclaimers would have to be made by your children within 9 months of the date of the gift.

(2) **Gifts to Grandchildren:** You could make a gift to your grandchildren to take advantage of the repeal of the GST tax. Such a gift would be subject to gift tax except to the extent you have lifetime gift tax exemption remaining. Nevertheless, you will have transferred property down two generations, but only paid one tax (i.e., without the repeal of the GST tax, transfers to grandchildren were subject to *both* gift tax and GST tax). To protect against possible retroactive reinstatement of the GST tax, the gift could be made to a trust for the benefit of your children, and if the GST tax is not retroactively reinstated, your children could “disclaim” their interest in the trust causing the property to pass to your grandchildren. If the GST tax is retroactively reinstated, your children would not disclaim their interest in the trust and no GST tax would be triggered by the transfer.

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**If you would like us to review the impact of the 2010 tax laws** on your current estate plan, or to discuss the potential opportunities, please call one of the attorneys in Kirkland’s Trusts & Estates Practice Group. The Trusts & Estates Practice Group of Kirkland & Ellis LLP is ready to answer your questions concerning this changing situation.

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