

June 7, 2001

RE: NEW TRANSFER TAX PROVISIONS

Dear Client:

As you are aware, Congress recently passed the Economic Growth and Tax Relief Reconciliation Act of 2001 (the "Act"). In addition to reducing income tax rates, the Act makes many other changes to current tax law. One area that has been substantially altered is the estate and gift tax law. The Act repeals the estate tax and generation-skipping transfer tax ("GST tax") (the tax on gifts to grandchildren and more remote descendants) in 2010 and makes many changes to the current system both before and after the repeal occurs. The Act does not repeal the gift tax. These changes may require modification of your short- and long-term estate planning, especially as the Act contains a "sunset provision" that essentially re-enacts the current estate and GST tax law in 2011 if Congress does not extend the repeal at that time. Accordingly, the long-term effect of the Act is far from certain.

The major changes in the estate, gift and GST taxes are summarized below:

Phase-Out and Repeal of the Estate and Generation-Skipping Transfer Taxes. Beginning in 2002, the estate tax is gradually phased out by lowering the maximum estate tax rate periodically until full repeal in 2010. At the same time, the exemption from the estate tax is gradually increased from its current level of \$675,000 to \$3.5 million in 2009. The estate tax is repealed in 2010. The same decrease in rates applies for the GST tax and the same increase in exemption occurs for the GST tax beginning in 2004 (the GST exemption until that time will be the same \$1 million indexed for inflation as is currently in place). The GST tax is also repealed in 2010. The following table summarizes these changes:

YEAR	MAXIMUM TAX RATE	AMOUNT OF EXEMPTION
2001	55%	\$ 675,000*
2002	50%	1,000,000**
2003	49%	1,000,000**
2004	48%	1,500,000
2005	47%	1,500,000
2006	46%	2,000,000
2007	45%	2,000,000
2008	45%	2,000,000
2009	45%	3,500,000
2010	TAX IS REPEALED	TAX IS REPEALED

* The GST exemption amount for 2001 is \$1,060,000.

** The GST exemption amount for 2002 and 2003 will be \$1,060,000 indexed for inflation.

Changes to Generation-Skipping Transfer Tax Rules. The Act contains a number of changes to the GST tax rules, including greater ability to use the GST tax exemption.

State Death Taxes. Currently there is a federal credit allowed for taxes paid to states as a result of death. Many states have used this provision to create a simple estate tax regime by taxing estates in the amount of the maximum allowable federal credit. Over the course of the next four years, the state death tax credit is reduced, until its complete repeal in 2005. In its place, there will be a deduction available for estate taxes paid to any state. As the state death tax credit is phased out and the estate tax is repealed, states will lose revenue. As a result, states are likely to implement their own transfer tax regimes and increase taxes on estates, thereby reducing the savings from repeal of the federal tax. This will certainly affect estate planning.

Conservation Easements. The Act expands the availability of conservation easements by eliminating the requirement that the land subject to the conservation easement be located within a certain distance from a metropolitan area, national park, wilderness area, or urban national forest. Thus, if it meets the other requirements, a qualified conservation easement may be claimed with respect to any land that is located in the United States or its possessions.

Availability of Installment Payment Relief. The new law provides for expanded availability of installment payment plans for estate taxes imposed on the transfer of closely held family business interests.

Qualified Family Owned Business Deduction. The qualified family-owned business deduction is repealed for estates of decedents dying after December 31, 2003.

Increase in Gift Tax Credit. Although the gift tax is not repealed, the tax rate on lifetime transfers gradually decreases from the current 55% to the maximum income tax rate (which would be 35% under the Act) over the next nine years. The lifetime exemption from gift tax is also increased to \$1 million (or \$2 million for a married couple) beginning in 2002. The following table summarizes the changes in the gift tax rate and exemption:

YEAR	MAXIMUM TAX RATE	AMOUNT OF EXEMPTION
2001	55%	\$ 675,000
2002	50%	1,000,000
2003	49%	1,000,000
2004	48%	1,000,000
2005	47%	1,000,000
2006	46%	1,000,000
2007	45%	1,000,000
2008	45%	1,000,000
2009	45%	1,000,000
2010	35% (or the maximum income tax rate)	1,000,000

New Carry-Over Basis Rules for Federal Income Tax Purposes. In 2010 when the federal estate tax is repealed, the automatic “step-up” in basis of property received from a decedent for federal income tax purposes is also repealed. Currently, an estate beneficiary receives a basis in inherited property equal to its fair market value at the time of the decedent’s death. The new law will treat such transfers at death in much the same way as it treats gift transfers, with the beneficiary keeping the same basis in the property as the decedent had at the time of death. This

is known as a “carry-over” basis, and a complex set of rules has been enacted governing how the basis should be determined. However, the new law allows a decedent’s estate to increase the basis of appreciated assets by \$1.3 million. Furthermore, the basis of property transferred to a surviving spouse can be stepped-up by an additional \$3 million. Thus, the basis of property transferred to a surviving spouse can be increased by a total of \$4.3 million. In addition, as part of the new basis legislation, estates and beneficiaries can now use the decedent’s \$250,000 exemption from capital gains tax upon the sale of a personal residence.

Estate Planning Implications. It is clear that the new tax law creates a number of changes that will affect estate planning over the course of the next decade and beyond. In the short term, the estate and GST taxes are still in effect. In the long term, repeal of these taxes is far from certain. As mentioned above, there is an automatic repeal of the new tax law in 2011 (*i.e.*, reinstatement of the estate and GST tax) unless it has been re-enacted before then. The uncertainty relating to the future of the estate tax law will continue as the political and economic climates change over the next ten years.

We will be reviewing the tax law changes and developing new estate planning techniques, where appropriate, in response to these changes. Review of your estate plan is important. If you would like to speak to us, please do not hesitate to call or email us at the numbers and addresses listed below.

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