



THE LAW FIRM OF
BOVE & LANGA, P.C.

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On June 7, 2001 President Bush signed into law The Economic Growth and Tax Relief Reconciliation Act of 2001 (the "Act"). This Memorandum will provide you with a brief summary of the Act, and end with a statement of our firm's privacy policy.

THE ACT

The Act encompasses over 400 changes to the Internal Revenue Code impacting income taxation, retirement savings, the alternative minimum tax, and the three transfer taxes: the estate tax, the gift tax, and the generation-skipping transfer tax. Our focus here will be on the transfer taxes, but if you would like to discuss any of the other changes, please call any one of us.

Overview: The changes to the estate, gift, and generation-skipping transfer ("GST") tax phase in over a nine year period, ending in repeal of the estate and GST tax for deaths occurring in 2010. Thereafter, these two taxes re-surface in 2011 in the same format as they exist today. Of course, future congressional action is impossible to predict.

Applicable Exclusion (Tax-Free) Amount and Tax Rate: The amount an individual may transfer free of estate and gift tax raises from \$675,000 to \$1 million next January. Thereafter, the amount that may be transferred free of estate tax increases to \$1.5 million in 2004, \$2 million in 2006, and \$3.5 million in 2009. However, the gift tax exclusion remains at \$1 million. The top marginal estate tax rate gradually decreases from a present 55% to 45% in 2009. The rates then jump back to 55% in 2011. The increase in the applicable exclusion amount ("AEA") will impact the funding at death of trusts presently in existence. Many of you have revocable trusts which breakdown at death into a "Marital Trust" and a "Family Trust." Often these subtrusts have different dispositive terms. One effect of the increase in the AEA is to shift funds away from the Marital Trust towards the Family Trust.

Repeal of "Step-Up" in Tax Basis: As many of you may know, one of the greatest benefits of the current law is that at death, the income tax basis of assets included in the decedent's estate is "stepped-up" to the date of death value. For example, assume George owns stock with a tax basis (often the cost of the asset) of \$10 and a fair market value of \$200. Upon a lifetime sale by George, he realizes taxable gain of \$190 (\$200 minus \$10). Assuming a combined federal and state capital gains rate of 25%, George pays \$47.50 in income tax and puts \$152.50 in his pocket. However, if George dies holding this asset, the income tax basis is stepped-up to \$200 (its date of death value) and the subsequent sale by his child for \$200 does not result in any taxable gain, so \$200 goes into the child's pocket (assuming no estate tax).

Under the new basis rules which become effective in 2010, at George's death the child 'inherits' the \$10 tax basis, with the resultant income tax liability. Additionally, the Act provides a limited amount of extra "bonus basis" which an executor may apportion to specific assets, with assets going to a surviving spouse receiving greater amount of allocable bonus basis than other heirs. As may be seen, meticulous record-keeping will be important as your heirs sift through the estate's assets and the executor

(or trustee) attempts to allocate the “bonus” basis. Further, advance planning will be necessary to attempt to apportion the bonus basis in a fair manner between all heirs.

State Transfer Taxes: Presently, the Commonwealth does not have its own estate tax. Instead it picks-up a portion of the federal tax. This is often referred to as a “sponge tax” and is based upon a credit available on the federal estate tax return for state taxes paid. The Act gradually reduces this credit and repeals it in total in 2005. This will effect state revenues, and it is uncertain how the legislature will act when faced with this revenue loss.