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**FOLEY LARDNER**  
ATTORNEYS AT LAW*Tax and Estate Planning Alert***The Economic Growth and Tax Relief  
Reconciliation Act of 2001:  
Estate, Gift and GST Tax Provisions***June 2001*

The Economic Growth and Tax Relief Reconciliation Act of 2001 (the "Act"), passed by Congress on May 26 and signed into law by President Bush on June 7, provides meaningful tax relief, including changes to the tax laws that affect estate planning. As part of our commitment to providing you with the highest quality legal services, we have prepared a summary of the principal changes that will have an impact on your estate plan.

**ESTATE, GIFT AND GENERATION SKIPPING TAX  
CHANGES****Repeal of the Estate and Generation-Skipping Transfer Taxes**

The Act repeals the estate tax and the generation-skipping transfer ("GST") tax after 2009. The repeal applies only to taxpayers who die in 2010, due to the inclusion in the legislation of a "sunset" provision. This means that additional legislative action will be necessary to extend the repeal beyond December 31, 2010.

**Reduced Tax Rates and Increased Exemption Amounts**

Of more immediate significance than the eventual repeal of the estate and GST taxes, the top estate tax and GST tax rate is gradually reduced over an eight-year period from the current 55% rate to 45%. Additionally, the estate tax exemption amount (the amount you can give at your death without payment of estate tax) is gradually increased from the current \$675,000 to \$3,500,000 in 2009. The GST exemption (the amount of assets that can pass to or remain in trust for grandchildren and future generations without payment of GST tax) which for 2001 is \$1,060,000, is increased after 2004 according to the same schedule as the estate tax exemption. For 2002 and 2003, the \$1,060,000 will be indexed for inflation.

The top gift tax rate has also been reduced but, unlike the estate and GST taxes, the gift tax has not been repealed. Instead, the top gift tax rate will be identical to the top estate tax rate until 2010, at which time the top gift tax rate will be 35%, equal to the top individual income tax rate. The lifetime gift tax exemption is increased to \$1,000,000 in 2002, and remains at that level. Notably, the current \$10,000 per donee (\$20,000 from a married couple) annual gift tax exclusion, which is indexed for inflation, continues to be available, but has not been increased.

The following table sets forth the exemption amounts and the decreased top tax rates under the Act:

<b>Estate, Gift and GST Tax Exemption Amounts and Highest Estate, Gift and GST Tax Rates</b>					
<b>Year</b>	<b>Estate Tax Exemption Amount</b>	<b>Highest Estate and GST Tax Rate</b>	<b>Gift Tax Exemption Amount</b>	<b>Highest Gift Tax Rate</b>	<b>GST Exemption Amount</b>
2002	\$1,000,000	50%	\$1,000,000	50%	\$1,060,000**
2003	\$1,000,000	49%	\$1,000,000	49%	\$1,060,000**
2004	\$1,500,000	48%	\$1,000,000	48%	\$1,500,000
2005	\$1,500,000	47%	\$1,000,000	47%	\$1,500,000
2006	\$2,000,000	46%	\$1,000,000	46%	\$2,000,000
2007	\$2,000,000	45%	\$1,000,000	45%	\$2,000,000
2008	\$2,000,000	45%	\$1,000,000	45%	\$2,000,000
2009	\$3,500,000	45%	\$1,000,000	45%	\$3,500,000
2010*	Repeal	None	\$1,000,000	35%	Repeal
2011*	\$1,000,000	55%	\$1,000,000	55%	\$1,060,000**

### **Reduction and Elimination of the State Death Tax Credit**

The Act reduces and eventually eliminates the federal estate tax credit for death taxes paid to your state. Because most states rely on this credit for their estate tax revenues, this could lead states to enact new estate or inheritance tax laws.

\* The numbers shown for 2010 and 2011 in this and subsequent charts assume that the repeal and sunset provisions under the Act will take effect without change. There is, however, a significant likelihood of additional tax legislation before then.

\*\* This number will be indexed for inflation after 2001.

### Basis of Property Acquired from a Decedent

Under current law, assets acquired from a decedent receive a “step-up” in basis equal to the fair market value of the assets on the date of the decedent’s death. This eliminates the capital gains tax on the appreciation in value during the decedent’s lifetime that would otherwise be owed when the asset is sold. Beginning in 2010, the unlimited step-up in basis for assets acquired from a decedent is eliminated. Instead, the basis for persons acquiring such assets will be the lesser of the decedent’s adjusted basis in the asset or the fair market value of the asset at the date of the decedent’s death. The Act, however, does allow for an increase in the basis of the property by up to \$1,300,000 in the aggregate. In addition, the basis of property transferred to a surviving spouse can be increased in the aggregate by an additional \$3,000,000. These amounts will be adjusted annually for inflation after 2010.

### IMPACT OF INCREASED EXEMPTION AMOUNT AND REDUCED RATES

The following charts illustrate the effect the increased exemption and reduced rates will have on a typical estate plan for a married couple. The illustrated plan establishes a Family Trust for the amount of the estate tax exemption and Marital Trust for the rest of the estate upon the death of the first spouse. Utilizing the exemption amount and the marital deduction, there would be no estate tax due until the death of the surviving spouse. The charts show the impact of the Act for selected years on estates of \$2,000,000, \$5,000,000 and \$10,000,000, and assume that both spouses die in the same year.

<b>\$2,000,000 ESTATE</b>			
<b>Year</b>	<b>Family Trust</b>	<b>Marital Trust</b>	<b>Estate Tax at Death of Surviving Spouse</b>
2001	\$ 675,000	\$1,325,000	\$260,000
2002	\$1,000,000	\$1,000,000	-0-
2004	\$1,500,000	\$ 500,000	-0-
2006-2010*	\$2,000,000	-0-	-0-
2011*	\$1,000,000	\$1,000,000	-0-

<b>\$5,000,000 ESTATE</b>			
<b>Year</b>	<b>Family Trust</b>	<b>Marital Trust</b>	<b>Estate Tax at Death of Surviving Spouse</b>
2001	\$ 675,000	\$4,325,000	\$1,799,000
2002	\$1,000,000	\$4,000,000	\$1,430,000
2004	\$1,500,000	\$3,500,000	\$ 945,000
2006	\$2,000,000	\$3,000,000	\$ 460,000
2009	\$3,500,000	\$1,500,000	-0-
2010*	\$5,000,000	-0-	-0-
2011*	\$1,000,000	\$4,000,000	\$1,495,000

<b>\$10,000,000 ESTATE</b>			
<b>Year</b>	<b>Family Trust</b>	<b>Marital Trust</b>	<b>Estate Tax at Death of Surviving Spouse</b>
2001	\$ 675,000	\$9,325,000	\$4,549,000
2002	\$ 1,000,000	\$9,000,000	\$3,930,000
2004	\$ 1,500,000	\$8,500,000	\$3,345,000
2006	\$ 2,000,000	\$8,000,000	\$2,760,000
2009	\$ 3,500,000	\$6,500,000	\$1,350,000
2010*	\$10,000,000	-0-	-0-
2011*	\$ 1,000,000	\$9,000,000	\$4,255,000

As these tables illustrate, during the phase-out period the estate tax is still significant for estates over \$2,000,000. Also note that as the exemption amount increases, assets are shifted from the Marital Trust to the Family Trust. Depending upon whether your spouse is a beneficiary of the Family Trust, this reallocation of assets may not be consistent with your planning objectives.

For unmarried persons, the estate tax would be as shown in the following table:

<b>ESTATE TAX FOR UNMARRIED PERSON</b>			
<b>Year</b>	<b>Estate tax on a \$2,000,000 estate</b>	<b>Estate tax on a \$5,000,000 estate</b>	<b>Estate tax on a \$10,000,000 estate</b>
2001	\$560,250	\$2,170,250	\$4,920,250
2002	\$435,000	\$1,930,000	\$4,430,000
2004	\$225,000	\$1,665,000	\$4,065,000
2006	-0-	\$1,380,000	\$3,680,000
2009	-0-	\$ 675,000	\$2,925,000
2010*	-0-	-0-	-0-
2011*	\$435,000	\$2,045,000	\$4,779,200

### **ESTATE PLANNING STRATEGIES IN LIGHT OF THE ACT**

This legislation highlights the need for thoughtful, individualized estate plans. It is essential to remember that there will still be an estate tax applicable to the estates of persons dying before 2010. In addition, the inclusion of the sunset provision in the Act, as well as the fact that there is ample time for Congress to change the law before the repeal takes effect, makes it risky to assume that there will be no estate tax applicable to your estate. In the short term, your current estate plan will not materially change under the new legislation. However, as the tax-law changes are phased-in, modifications may be necessary to meet your estate planning objectives.

**Defer Estate Tax as Long as Possible**

As the tables above illustrate, for married couples utilizing the estate tax exemption amount for a Family Trust and the marital deduction (for a Marital Trust or a Marital Gift), there would be no estate tax due until the death of the surviving spouse. Tax deferral becomes an even more important strategy with the prospect of the estate tax repeal.

**Review "Formula" Clauses**

Many estate plans use formula clauses which tie into the estate tax or GST tax exemptions. One common formula used by many married couples is the one that allocates assets between the Family Trust and the Marital Trust at the death of the first spouse. As illustrated above, a change in the exemption can dramatically alter the application of the formula. As the increase in the estate tax exemption is phased in, these formula clauses may need to be reviewed. You may want to increase the amount passing to the Marital Trust if there are no estate tax savings to be realized from the maximum funding of the Family Trust. In the alternative, you may want to change the terms of the Family Trust to add your spouse as a beneficiary if your spouse is not one already, or provide more generously for your spouse in the Family Trust.

**Continue Lifetime Gifts**

During the phase-out period, it will make sense for many people to continue making lifetime gifts. The increase in the gift-tax exemption to \$1,000,000 in 2002 will present new opportunities to make tax-free gifts, perhaps utilizing leveraged gifts and discount vehicles such as family limited partnerships, Qualified Personal Residence Trusts and Grantor Retained Annuity Trusts. The law still allows annual exclusion gifts of \$10,000 per recipient as well as early use of the GST exemption. During the phase-out period, you will still want to move assets and post-gift appreciation on such assets out of your estate to reduce estate taxes. However, in most situations it will not be advisable to make any transfers that require a payment of gift tax.

**Life Insurance Considerations**

You should keep any insurance policies that are designed to cover estate taxes and continue to maintain existing life insurance trusts. This is not the time to allow insurance to lapse given the fact that death may occur during the phase-out period and the uncertainties of whether and for how long the repeal will take effect. In addition, it may be appropriate in certain circumstances to consider obtaining new or additional life insurance.

**Maintain Cost Basis Records**

With the elimination of the basis step-up in 2010, keeping good records on original investment cost and costs of improvements takes on greater importance.

**Charitable Giving**

You may still want to provide for charity in your estate plan, although the estate tax benefits will be less. There will continue to be significant income tax savings in using qualified retirement plan benefits to fund charitable gifts at death. Lifetime split-interest charitable gifts (such as charitable remainder trusts and charitable lead trusts), which combine charities and individuals as beneficiaries, can also be used to leverage the \$1,000,000 gift tax exemption. The lifetime income tax advantages of certain kinds of charitable giving, such as

gifts of appreciated securities to a charitable remainder trust or creation of a private foundation, will make such gifts attractive regardless of the estate or gift tax rules.

### **Succession Planning for Closely-Held Businesses**

For business owners, the reduction or repeal of the estate tax will eliminate only some of the issues that you face. You will still need to consider how you want to provide for succession and continuity in a closely-held business if such a business is part of your estate.

### **CONCLUSION**

The initial impact of the Act is limited as most of the changes do not take effect for some time. In addition, due to the inclusion in the Act of the sunset provision and the long time lapse before many of the provisions take effect, the repeal of the estate tax is not a certainty. Although there may be adjustments which need to be made to your estate plan over the next few years, there is no need to make hasty decisions. Since the changes under the Act do not begin to take place until 2002 and repeal will not take effect until 2010, there is more than enough time for thoughtful review and decision making.

\* \* \* \* \*

*This Tax and Estate Planning Alert was prepared by Foley & Lardner's Estates and Trusts Practice Group. For assistance in evaluating the impact of the Act on your own estate plan, please contact any of the following partners and senior counsel of the Estates and Trusts Practice group or your Foley & Lardner attorney.*

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