

**Special points of interest:**

- Estate Tax Repeal
- New Rule...
- GST Tax
- Federal Gift Tax Rates

## Estate Tax Repeal!

On June 7, 2001, President George W. Bush fulfilled his campaign promise to reduce taxes by signing the Economic Growth and Tax Relief Reconciliation Act of 2001 (“EGTRRA”). The new tax package gradually increased the estate tax exemption from \$675,000 in 2001 to \$1 million in 2002 and 2003, \$1.5 million in 2004 and 2005, \$2 million for 2006 through 2008 and \$3.5 million in 2009. IRC §2010(c). EGTRRA also included a repeal of the estate tax in 2010. IRC §2210(a). Attorneys, CPAs, and lawmakers alike



anticipated and predicated a change in the law before 2010, but healthcare, cap and trade, and overseas wars put the estate tax on the backburner. As a result, 2010 is here and there is no estate tax...for now.

EGTRRA does not make the repeal of the estate tax permanent. EGTRRA reinstates the estate tax in 2011 with an exemption amount of only \$1,000,000 and a tax rate of 55%.

Most lawmakers still anticipate a change in the law early this year. How-

ever, debate continues as to the appropriate exemption amount, applicable tax rate, and whether to make the new law retroactive. Congress will likely establish an estate and GST tax sometime during 2010. The issue is whether there will be a “repeal window” available for donor and decedents. Rumors abound that Senator Baucus, Chairman of the Senate Finance Committee, and Representative Rangel, Chairman of the House Ways and Means Committee, will sign a “letter of intent” to give notice to taxpayers not to rely on the repeal and to anticipate a retroactive estate tax applicable to January 1, 2010. Baucus and friends are sponsoring similar bills (SB 722 and HR 4154) that would carry 2009 tax laws forward into

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## New Rule - Cost Basis of Inherited Assets

Perhaps the most significant benefit eliminated as the sunset provisions of EGTRRA take effect is the step-up in basis on inherited assets. IRC §1014(f). Under EGTRRA, the basis of inherited property equals the fair market value of the property at the date of the decedent's death. IRC §1014(f). As of January 1, 2010, the basis of inherited property equals the *lesser of* the adjusted basis of the property, or the fair market value of the property at the date of the decedent's death. IRC §1022(a)(2).

The Code provides some “relief.” The executor or trustee, whichever is applicable, may increase the tax basis of assets transferred, as determined on an asset-by-asset basis, by (i) up to a total of \$1.3 million and (ii) the amount of the decedent's unused capital losses, net operating losses, and certain built-in losses. IRC §1022(b)(2)(B)-(C). The Code allows an additional \$3 million increase to the basis of outright transfer property and “qualified terminable interest

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## Estate Tax Repeal (Cont'd from page 1)

**“Constitutional law scholars question the constitutionality of instituting an estate tax and GST tax system retroactively”**

2010, serving as a band-aid until Congress can take more substantive action. Constitutional law scholars question the constitutionality of instituting an estate tax and GST tax system retroactively when no system exists, and many Senate Republicans will use this delay to push for either favorable estate tax changes (e.g., an increase of the estate tax lifetime exclusion to \$5 million) or a permanent repeal of the estate tax altogether. So this issue could continue well into 2010, and the result is uncertain.

### *Estate Planning with No Estate Tax*

Estate planning for the married couple, while more difficult now, is still necessary. Prior to 2010, the exemption imposed a limitation on funding the bypass

or credit shelter trust. Now, there is no limitation, which means it is possible to place a deceased spouse's entire estate in the bypass trust. However, allocation of cost basis to a QTIP trust or other property passing to a surviving spouse is eliminated. Taxpayers must also consider generation skipping taxes. Thus, while many think that no estate tax means no planning, the opposite is true with a shift in focus. As estate planning Professionals, we must now concentrate on (1) minimizing estate and generation skipping taxes

that Congress may one day reinstate; (2) maximizing use of the nontax benefits of various trusts; and (3) minimizing capital gains taxes by providing for the maximum step-up in basis at the first spouse's death.

The future of the estate tax remains uncertain, but that does not mean planning stops. We must work with the law as it is currently written and plan for every contingency. The current law and any changes that are made this year particularly effect those who die in 2010.



## Federal Gift Tax Rates

Unlike the estate and GST tax, the gift tax remains in effect for 2010 with a lower maximum rate. Under EGTRRA the maximum gift tax rate was at 45%. IRC §2502(a)(2). The maximum rate is now 35%. Absent a political compromise, it too will rise to 55% in 2011. From a planning perspective this rate increase equates to more gifts in 2010. Now is a great time for

clients to implement succession plans and transfer assets to the next generation in order to take advantage of the lower gift tax rate. In fact, the Congressional Budget Office predicted



gift tax receipts in 2011 would increase to \$14.7 billion from \$1.4 billion in 2009 as the wealthy rushed to cash in on the one year rate break. With fast action, creative planning and artfully drafted trust provisions, you can help your clients capitalize on a reality that most professionals thought they would never see.

## New Rule...(Cont'd from Page 1)

property” transferred to a surviving spouse. IRC §1022(c). Nonresident/noncitizens are only allowed a \$60,000 basis increase and in no case may the tax basis of an asset be adjusted above its fair market value in the hands of the decedent as of the time of the decedent's death. IRC §1022(b)(3), (d)(2).

ALL estates with appreciated assets are affected by the elimination of the step-up in basis, not just larger estates. The beneficiaries of an estate must know the decedent's basis in the assets and property to properly report capital gain. If the beneficiaries can't substantiate the decedent's basis then it is likely

that the IRS would treat the basis as zero. The elimination of the step-up in basis flew under the radar with the clamor over the estate tax, but it has far greater consequences and affects a greater number of estates.



## GST Tax

The Generation Skipping Transfer Tax ("GST") mirrored the estate tax in its annual increases from 2001-2010 and follows suit in its repeal for 2010 and reinstatement in 2011.

### *What is the GST?*

The GST is one of the most complicated taxes to understand. The basic Estate Tax imposes a tax on assets when they are passed from one generation to another, such as a parent to a child. The GST, on the other hand, imposes a tax on taxpayers who bequeath property to a skip person.

The Code imposes GST on the following three types of "skip" transfers:

1. Direct skip (e.g., a transfer from grandparent to grandchild)
2. Taxable distribution (e.g., in the example below, if the trust made a distribution of principal to the grandchildren); and

3. Taxable termination (e.g., in the example below, upon termination of the trust).

For example, Jack Green dies with a \$10,000,000 estate and leaves all of his property in trust with income payable to his children. Upon their deaths the trust assets transfer to his grandchildren. Jack's estate may be subject to estate taxes depending on the exemption amount. However, on the subsequent death of his children, none of the trust property will be taxable in the children's estate; the family would have "skipped" a generation of estate

taxes. The GST imposes a tax comparable to the estate tax on the "skip." A simple example is that of a grandparent leaving money to a grandchild where the grandchild's parent is still alive thus directly "skipping" the grandparent's child. But GST can also apply in non-family situations -- GST may apply if a beneficiary of a gift or estate is 37.5 years younger than the donor or deceased.

The annual gift tax exclusion remains at \$13,000 and the lifetime exemption remains \$1,000,000. The GST exemption in 2011 is \$1,000,000.

Careful drafting of a client's trusts ensures maximum transfer to younger generations and minimization of estate taxes.



"The Generation Skipping Transfer Tax ("GST") mirrored the estate tax in its annual increases from 2001-2010 and follows suit in its repeal for 2010 and reinstatement in 2011."

## Featured Attorney

Nick Dupre is a native Houstonian, and joined Stone & Associates, LLP, in October 2008. He previously clerked for Judge King and Judge Ferchil in the Tarrant County Probate Courts and another estate planning firm in the Houston area.

In 2004, he earned his Bachelor of Arts in Political Science from Trinity University. In 2006, he earned his law degree (Juris Doctorate) from the Texas Wesleyan School of Law, where he graduated cum laude.

Nick's practice concentrates on probate, estate and gift tax planning, business planning and taxation, asset protection, estate administration, elder law, and charitable organizations.

Entering his second year in practice, Nick has substantial probate, estate, and

tax planning experience, regularly drafts a myriad of contracts and agreements, and resolves tax disputes with the IRS. Regardless of the plan, Nick's and Stone and Associates, LLP's, highest priority is to obtain the best and most cost effective result for the client.

In addition to his career as an attorney, Nick, and Adryan, his wife of four years, attend Berechuh Church. Nick regularly competes in marathons and is an accomplished pianist. He is also a member of the Houston Business and Estate Planning Counsel and the Disability and Elder Law Attorneys Association.



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*Business, Estate, and  
Tax Planning for  
Generations*



**Stone & Associates, LLP's, practice focuses on estate planning, probate and estate administration, business law, tax planning and controversies, and business litigation. Additional credentials such as Board Certification in Estate Planning and Probate by the Texas Board of Legal Specialization, CPA and Masters of Laws in Taxation (LLM), combined with years of practical experience, make our attorneys uniquely qualified to address the business and tax issues inherent in these areas of law.**

**Our clients desire to minimize taxes and protect their assets, with the ultimate goal of maintaining and preserving wealth for themselves and future generations. We lead our clients through the complex maze of Federal and State laws to this ultimate goal.**

**The four attorneys of Stone & Associates, LLP, frequently present continuing education seminars to certified public accountants, certified financial planners, realtors, and licensed insurance agents. We explain complicated business, estate, and tax laws in an understandable manner that our clients and other professionals appreciate. Not surprisingly, Stone & Associates, LLP, has quickly become the firm that professionals turn to for their clients' estate planning, taxation, and business law needs.**

**This is a special issue of the Stone and Associates, LLP's, newsletter with four new articles addressing the change in estate, gift, and generation skipping tax law effective January 1, 2010. The articles give you an overview of the changes so that you can better assist your clients and their needs. We are here to serve as a resource to you and your clients, so please call or e-mail if we can help.**



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