

PERSPECTIVE

ON TRUST AND ESTATE PLANNING

Fiduciary
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International



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“The only certainty about transfer tax laws is the unprecedented level of uncertainty that now exists.”

Is the Death Tax Dead for 2010?

There is an unprecedented, temporary one-year repeal of the Federal estate tax this year. Under current law, the estate tax is zero for 2010, but will come roaring back at a higher 55% rate in 2011 for estates over the \$1 million exemption amount.

In addition, the Generation Skipping Transfer tax has also been repealed for 2010. And, while the Federal gift tax was not repealed, the top marginal tax rate was reduced from 45% to 35%.

These anomalies result from Congress' failure to enact new estate tax laws. Further complicating this difficult estate tax landscape, some believe Congress will try to reinstate these taxes for 2010, possibly retroactive to January 1, 2010. And, if retroactivity is attempted, no one knows whether that attempt will be upheld as constitutional. We believe that, as time elapses, attempts at retroactivity become more difficult.

CURRENT TAX SCHEDULE

Year	FEDERAL TAX EXEMPTION AMOUNTS (millions)			TAX RATES	
	Estate ¹	Generation Skipping Transfer	Cumulative Gift	Top Marginal Federal Estate and Generation Skipping Transfer Tax Rates	Top Marginal Federal Gift Tax Rate
2009	\$3.5	\$3.5	\$1.0	45%	45%
2010	\$0	\$0	\$1.0	0% (no tax)	35%
2011 and thereafter	\$1.0	\$1.0 ²	\$1.0	55%	55%

1. Known as the “Applicable Exclusion Amount.”

2. Indexed for inflation.

HOW THE TAX SCHEDULE MAY AFFECT YOUR ESTATE

As of this writing, the law will have the following consequences on an estate:

Federal Estate Tax. If you die during 2010, your estate will pay no Federal estate tax.

Generation Skipping Transfer (GST) Tax. If you die in 2010 and you leave your property *outright* to your grandchildren or more remote descendants, the property will pass free of Generation Skipping Transfer (GST) taxes. If you leave your property *in trust* for beneficiaries who are grandchildren or more remote descendants, there will be no GST tax in 2010, but there may be GST taxes payable as distributions are made in 2011 and beyond.

Income Tax. The capital gains “step up” rules—that previously allowed inherited assets to receive a new cost basis equal to their estate tax value—have been eliminated. Instead, assets do not receive that “step up” and heirs, for tax purposes, assume the original cost. The law allows a limited “step up,” however, of \$1.3 million of gains. Marital property can be stepped up an additional \$3 million of gains.

State Death Taxes. Many states, including Connecticut, New York and New Jersey, have separate estate taxes that may be applicable to the estate of anyone domiciled in those states at death. You may need special language in your estate planning documents to maximize state death tax benefits such as the marital deduction.

For lifetime gifts made in 2010, as of now the following rules apply:

Gift Tax. The Federal gift tax has not been repealed, and the gift tax exemption remains at \$1 million. The annual exclusion gift amount of \$13,000 per donee remains in place. However, the 2010 Federal gift tax rate for gifts made above the exemption gift amount has been reduced from a top marginal rate of 45% to 35%, a historically low rate. The IRS has determined that transfers to grantor trusts will be subject to gift tax in 2010, in spite of the wording of the statute which would appear to eliminate gift tax on such transfers.

GST Tax. Transfers to trusts are not subject to GST tax in 2010, but may become subject in 2011 as distributions are made.

STEPS TO CONSIDER TAKING NOW

The only certainty about transfer tax laws is the unprecedented level of uncertainty that now exists. There are several actions to consider taking now, until more clarity evolves around the fate of these taxes:

Organize cost basis records. It’s important to be able to show the cost basis of your assets. If the current law remains in effect and your cost basis amount is unable to be proven, cost basis will be zero, and heirs will be assessed capital gains taxes on the entire current value of the assets.

Ensure your estate planning documents reflect your intent. Wills or trusts have often been written to direct assets not subject to estate taxes to be passed on to children (for 2009, up to \$3.5 million) with the rest directed to the spouse. In a year without an estate tax, it’s important to make certain your documents reflect your intent. Depending on the language used in your existing documents, it is possible that less (or more) money would go to your spouse than you would like, or that too much (or too little) may go to your grandchildren or other heirs.

Consider making taxable gifts. It's possible you could significantly increase the after-tax amount transferred to heirs by taking advantage of this year's lower gift tax rate. The example below illustrates why it is better to make lifetime gifts in excess of the gift tax exemption this year and pay the lower 35% gift tax rate, rather than transferring the assets at death after 2010.

EXAMPLE: Why Gifting Now—and Paying the Gift Tax—Could Be Better Than Owning Property at Death¹

GIFTING ASSETS NOW	Mr. Smith, who has \$9.45 million in assets and has made more than \$3.5 million in gifts, gifts the assets in 2010. In this case, the children would receive \$7 MILLION AFTER TAXES.	Assumed Assets \$9.45 million
		Gift to Children \$7.00 million
		Gift Tax Payable \$2.45 million*
		CHILDREN \$7.00 million
		Federal government \$2.45 million
versus		
OWNING PROPERTY AT DEATH	Mr. Smith does not gift his assets to the children in 2010. In 2011, the maximum estate tax jumps to 55% and Mr. Smith passes away.	Assumed Assets \$9.45 million
		Estate Tax Payable \$5.197 million**
		CHILDREN \$4.252 million
		Federal government \$5.197 million

1. This example does not take into account the impact of state gift and death taxes. In New York, for example, the benefits are increased because there is no gift tax but there is an estate tax.

Note: The gift tax is paid only on the amount gifted, while the estate tax is payable on the entire estate.

*\$7 million x 35% gift tax rate

**\$9.45 million x 55% estate tax rate

Of course, in this example if death occurs in 2010, the gift tax may have been paid unnecessarily. And, if Congress passes a retroactive law for 2010, the gift could be assessed with the reinstated 45% top marginal Federal gift tax rate. However, this strategy is still viable because even if Congress retroactively reinstates 2010's 45% gift tax rate, the children in our example would receive approximately \$6.5 million.

CONCLUSION

The impact of this year's tax laws on estate planning documents is unique for every situation. It is advisable to review and discuss your estate planning documents with your attorney to determine whether these radical changes in the law will impact your estate plan in an unintended manner. Together, you can determine the appropriate course of action.

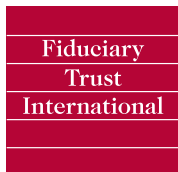
If you have questions about today's tax environment or any other planning strategies, we encourage you to reach out to your trust and estate attorney or your Fiduciary Trust contact.

About the Author

Gail E. Cohen, Esq. is Vice Chairman and General Trust Counsel of Fiduciary Trust. She heads the company's Trust and Estate departments, regional offices and client relationship management. She has over 30 years of experience in the area of trust and estates. Ms. Cohen currently sits on the Investment Committee of the New York City Bar Association. She is a former member of that Bar Association's Committee on Estate and Gift Tax, which she chaired from 1998–2001. She also serves on the Editorial Committee of *Trusts and Estates* magazine.

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