Abstract: The Economic Growth and Tax Relief Reconciliation Act of 2001 provides new opportunities to reduce estate tax during the next decade. But while the act will repeal estate tax by 2010, there is no reprieve in the need for estate planning. The new estate tax laws take effect Jan. 1, 2002. Therefore, it's critical to revisit and revise estate plans this year. This article explains the new estate tax provisions and explores planning strategy options.

Is Your Estate Plan Still on Target?
How the Recent Tax Law Changes Affect Your Strategy

Before Congress passed the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001, estate planning was a bit like shooting at a slow-moving target -- the estate tax exemption. That wasn't really so bad, because the target was poking along at a steady pace on a smooth road, not scheduled to stop moving until 2006.

But the target will move faster beginning next year, bounce along a dirt road, fall into a pothole in 2010, and then finally reemerge and come to a screeching halt in 2011 -- unless Congress passes additional legislation. That's the bad news. The good news is most of us will probably pay less estate tax. And if you die in 2010, your estate will owe no tax at all.

Of course, you can't predict when you'll die, so you must continue to plan your estate using traditional methods: wills, trusts, powers of attorney, life insurance and giving away assets. But with the tax law changes, how should you change your estate plan? Let's briefly review the changes and explore your options.

What's Changed?
No matter what your situation, the act provides new ways to reduce your estate tax during the next decade. Here is a simplified look at what has changed:

- The estate tax exemption (also known as "credit equivalent") for 2001 is $675,000 ($1.35 million for married couples). It will increase until it reaches $3.5 million in 2009. In 2010, the exemption will end along with the estate tax. But it will reappear, along with the estate tax Jan. 1, 2011, at $1 million unless a future Congress passes additional legislation. The exemption is the amount you can pass to your heirs estate tax free. Under previous law, the exemption was to rise to only $1 million by 2006. The most the new law exempts from gift tax (not including annual exclusion gifts) is $1 million beginning in 2002. Before EGTRRA, the estate and gift tax exemptions were the same.

- The highest marginal estate tax rate, now 55%, will decrease until it reaches 45% in 2007 where it will remain until 2009. It will then disappear in 2010 and spring back to 55% in 2011. The top gift tax rate will decrease along with the estate tax through 2009, then drop to 35% in 2010 and pop back to 55% in 2011.

- The generation-skipping transfer (GST) tax, like the highest marginal estate tax rate, is currently 55%. It will drop along with the estate tax until it reaches 45% in 2009, then also disappear in 2010, only to be reinstated in 2011 at the 55% rate. For 2001, the GST tax exemption is $1.06 million. The exemption is indexed for inflation and will continue to be in 2002 and 2003 (and after 2010). Under the act, the GST exemption will increase along with the estate tax exemption beginning in 2004.

- Under current law, when you pass stock and other appreciated assets to your heirs, they receive a step-up in basis to market value at the time of your death. When the estate tax temporarily disappears in 2010, the step-up in basis will be limited to $1.3 million for assets you leave to your heirs plus another $3 million for assets going to your spouse. Thus, chances are if you die in 2010, your heirs will pay more capital gains tax. This part of the law is complex, so consult your advisor on how it will affect your plan. Again, in 2011, unless Congress passes additional legislation, the automatic step-up in basis returns.

Estate Planning Strategy

For long-range estate planning, remember that Congress is reasonably likely to revise the estate tax law during the next 10 years. Estate tax law changes will begin to take effect Jan. 1, 2002, so you should act before the end of this year. Exactly what action you should take depends largely on your estate's value.

If your credit shelter trust planning has been designated to accommodate values up to $675,000, consider gradually increasing the amount that could be used to fund the trust to a maximum of $3.5 million by 2009. But do so only with professional advice, because you'll need to position your assets and coordinate your beneficiary designations to fund the trust properly.

Gifts

If your estate is worth less than $3 million, giving some of it away to take advantage of the $10,000 annual gift tax exclusion becomes less imperative because of the increasing estate tax exemption. But if you wish to continue giving assets away during your lifetime, continue to make annual exclusion gifts because the lifetime exemption is going up only to $1 million.

If your estate is worth more than $3 million, making annual exclusion gifts will continue to be a key element of your estate plan. If Congress passes additional legislation and permanently eliminates the estate tax, and your gifts turn out to have been unnecessary, so much the better. But if the tax resurrects in 2011 as planned, gifts may save you literally millions of dollars.

One area of your gift strategy that no longer applies is making taxable gifts. Before EGTRRA, sometimes making taxable gifts beyond the exemption made sense because future appreciation would be removed from your estate that otherwise would be taxed on your death. And gift tax was less expensive than estate tax. But after 2004, the gift tax will be no less than the estate tax. (Previously, federal gift and estate taxes were unified by applying the same tax rate to your cumulative transfers.)

Under the new act, this will remain true until 2004 when the estate tax exemption rises to $1.5 million and continues on until 2009, when the exemption will be $3.5 million. In 2010 the estate tax will not exist. The gift tax exemption, on the other hand, remains at $1 million through 2010. (See "Transfer Tax Exemption and Rate Increases" on page 3.)

Smart Planning Is Key

One thing the EGTRRA hasn't eliminated is the need for smart estate planning. In fact, the complexity the act has created has made planning more important than ever. If you're unsure how the act's changes affect your estate planning, please contact us. We'll be happy to review your current estate plan and help you hit a bull's eye.

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Transfer Tax Exemption and Rate Increases

Year	Gift Tax Exemption	Estate and GST Tax Exemption	Highest Estate, GST and Gift Tax Rates
2002	$1 million	$1 million*	50%
2003	$1 million	$1 million*	49%
2004	$1 million	$1.5 million	48%
2005	$1 million	$1.5 million	47%
2006	$1 million	$2 million	46%
2007	$1 million	$2 million	45%
2008	$1 million	$2 million	45%
2009	$1 million	$3.5 million	45%
2010	$1 million	NA	35% (gift tax only)

*The GST exemption is adjusted for inflation