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NEWSLETTER

Keeping You Informed

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**ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT OF
2001**

Introduction

On June 7, 2001, President Bush signed into law a ten year tax relief program - promoted as one of the largest tax cuts in over twenty years. Among other things, the new program eliminates the federal estate tax, but only for one year. The new tax program is anything but simple and taxpayers should be wary about sitting back and "letting nature run its course". An understanding of the new rules relating to the

estate and gift tax is necessary so that one's estate plan may be kept current. The purpose of this newsletter is to highlight the changes in the estate planning arena and to provide you with a basic understanding of the changes.

The law may provide some estate tax relief if you die prior to 12/31/2010. If you live past 12/31/2010 then your estate will be taxed based on the Old Rules.

Old Rules

Under prior law, gift tax is imposed on lifetime transfers and estate tax is imposed on transfers at death. The gift and estate tax were unified so that a single tax rate schedule applies to cumulative taxable transfers, both lifetime and at death. A unified credit applies for transfers by gift and at death. It effectively exempts transfers totaling \$675,000 in the year 2001. The unified credit was scheduled to increase over the next few years until 2006, at which time, the credit would exempt transfers totaling \$1 million.

A generation skipping transfer (GST) tax generally is imposed on transfers, either directly or through a trust or similar arrangement, to a skip person. A skip person is a beneficiary who is a generation more than one generation below that of the transferor (e.g., a grandchild).

These Old Rules will become the law once again starting on 1/1/2011.

New Tax Law For Estate, Generation Skipping and Gift Tax Purposes

The new tax law is only a temporary measure. During the next eight years there will be a gradual reduction in the estate and gift tax rates and an increase in the unified credit exemption amount for estate tax purposes and in the GST tax exemption. The reduction in the new rates takes place over a period of eight years. No federal estate tax will be imposed on estates of people who die in

2010 only. Starting in 2011 the new law goes away and the Old Rules are once again effective.

How It Works

The gradual rate reduction and unified credit increase actually occurs in the fashion of a phase out. The following chart demonstrates how the tax rates will decrease while the credit increases:

Phase-Out and Tax Rate Reduction Schedule

Year	Top Estate & Gift Tax Rate	Estate & GST Tax Deathbed Transfer Exemption
2002	50%	\$1 million
2003	49%	\$1 million
2004	48%	\$1.5 million
2005	47%	\$1.5 million
2006	46%	\$2 million
2007	45%	\$2 million
2008	45%	\$2 million
2009	45%	\$3.5 million
2010	Top Individual Rate (Gift Tax Only)	Repealed
2011	55%	\$1 million

This chart clearly shows that larger estates will be subject to the estate tax unless death occurs in the year 2010.

Gift Tax

The effective gift tax exemption amount would increase to \$1 million in the year 2002 and remain at that level until 2010. In order to prevent the significant use of gifts to transfer income-laden property from higher to lower rate taxpayers, the new law retains a modified gift tax. In the year 2010, gifts in excess of the lifetime \$1 million exemption would be subject to a gift tax equal to the top individual income tax rate at that time.

Step-up in Basis

Under the Old Rules, the income tax basis of property acquired from a decedent at death is generally stepped up (or down) to an amount equal to the value of the property as of the date of the decedent's death. This basis rule allows the recipient of property to avoid capital gains tax on appreciated property.

Once the estate taxes are fully repealed in 2010, a modified carryover basis rule goes into effect. Therefore, the income tax basis of property received from a decedent will be equal to the lesser of the decedent's basis in the property or the fair market value of the property on the date of death. For the year 2010, death becomes an income tax problem, not an estate tax problem. There are *two* exceptions under the modified carryover basis rule.

1. Up to \$1.3 million of certain assets will be allowed a basis increase; and

2. Up to \$3 million of assets will be permitted a basis increase if transferred to a surviving spouse.

The Personal Representative could elect the assets that would receive the basis increase. The allowable amounts of additional basis will be indexed for inflation after the year 2010.

An important issue that arises under the modified carryover basis rule is the need for taxpayers to keep accurate records for basis purposes. For example, with respect to real property, taxpayers will not only have to keep records from the original purchase, but they will also have to keep detailed records of all items that affect the tax basis of the property. For stocks, taxpayers will need to keep track of all splits, forward or reverse. Mutual Funds taxpayers will need to keep track of all income items such as interest, dividends and gains in order to determine basis. Additionally, basis records must be kept for all assets acquired by gift or by inheritance.

If basis cannot be determined, basis will be zero.

What happens in 2011?

Starting in 2011, estates valued at more than \$1 million would again be taxed at a top rate of 55%. The way the new tax program is set up Congress must vote to continue to repeal the estate tax. Because the tax provisions 'sunset' on December 31, 2010, as required by the 'Byrd Rule,' it will take a 3/5 vote or better in the Senate to override the 'sunset provisions.' If the 'sunset provisions'

are not overridden the law reverts to the Old Rules. Considering the fact that four congressional and two presidential elections will take place prior to this "reconsideration", it is anyone's guess as what may or may not happen.

The new law provides only temporary tax relief.

What Do You Do?

The question becomes, "What do you do?" That depends on whether you believe the total repeal of the estate tax will or will not happen.

We, at the law firm of KATZ, LOOK & MOISON, P.C., have ideas for you and are committed to keeping you informed on the new temporary tax law and future developments relating to such a program. If you have a taxable estate your estate planning documents may need to be updated. We will provide more information to you in the Fall. If you want to meet sooner, please give us a call.

What Should You Watch Out For?

The new tax law seems very appealing and may well encourage complacency. However, it would be unwise to sit back and allow things to happen. "Proactive" taxpayers will be the ones whose estate plans will continue to function favorably with the existing tax law.

Currently, the federal estate tax is shared with the state or states where the deceased owned property. Under the new law, this revenue sharing will be gradually reduced and completely eliminated by the year 2005. This rapid phase out will reduce state revenues and could cause increases in state taxes. Most states repealed their inheritance tax laws because the portion of the federal estate tax received generate as much, if not more, money than the state's inheritance tax. States may be forced to implement new inheritance tax laws to replace the lost revenues.

In the Meantime

Estate planning is not just about reducing or eliminating estate taxes. There are other issues as or more important than the estate tax issue. For instance, is your estate plan disability proofed? Why is this important? If your plan is not set up for management in the event of a disability, a future disability could prevent necessary updates to the estate plan.

For most people, the goal of estate planning is to plan for one's family. Therefore, it is important to review your estate planning documents on a regular basis to reaffirm that the following are still consistent with your goals and objectives:

1. Who are the beneficiaries? How much of the estate is to pass to each beneficiary? How is each beneficiary to receive his/her share of the estate?

2. Who is the Trustee and/or Personal Representative? Is this the proper individual(s) to serve as Trustee or Personal Representative?
3. Who are the agents under both your financial and health care Powers of Attorney? Again, are these the proper individuals to serve in these capacities?
4. Are your assets properly coordinated with your estate plan? Are you concerned about asset protection?
5. What have you done with respect to long term care planning?

Again, estate planning encompasses much more than just reducing or eliminating estate taxes.

Conclusion

The new tax program offers relief, but it also offers a challenge to taxpayers. It requires a taxpayer to stay current with the tax law, and to make changes to one's estate plan in order to remain current with the new temporary law.

It is our goal to keep you informed of all relevant changes and to provide you with advice consistent with your goals and objectives.



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