

FEDERAL ESTATE AND GST TAX REPEAL

As a result of congressional deadlock last month, the one-year repeal of federal estate and generation-skipping transfer (GST) taxes scheduled to take effect under 2001 tax legislation has become a reality. Under the law as it currently stands, the estates of decedents who die in 2010 will not be subject to either federal estate or federal GST tax, regardless of the size of the estate. Furthermore, for 2010, individuals who make gifts directly to grandchildren or great-grandchildren or to trusts for their benefit will not incur any GST tax, regardless of the size of the gifts. The one-year reduction in the federal gift tax rate enacted as part of the 2001 legislation also has taken effect. For 2010, an individual who makes taxable gifts (i.e., gifts that are in excess of the US\$1 million lifetime gift tax exemption and that do not qualify for the US\$13,000 annual exclusion from gift tax) pays gift tax at a rate of 35%—down from 45% in 2009. Effective January 1, 2011, federal estate, gift, and GST taxes will return at a rate of 55% (with a US\$1 million exemption for each type of tax).

Now that it has reconvened following winter recess, Congress will consider legislative “fixes” to eliminate the temporary repeal of estate and GST taxes (and, presumably, the temporary reduction in the gift tax rate). Some congressional leaders (Senate Finance Committee Chairman Max Baucus among them) already have taken the position that any such “fix” should be retroactive to January 1, 2010. Given its inability to reach a solution prior to the recess, it is far from certain that Congress will succeed in passing any legislation, whether retroactive or prospective, in the near term. In addition, the enactment of retroactive tax legislation raises thorny constitutional issues that likely will play themselves out in the courts for years to come. The situation is further complicated by the fact that, even in the absence of congressional action of any kind, January 2011 will see the return of a federal estate, GST, and gift tax regime that is even more onerous than the one in effect for 2009.

While the temporary repeal of the federal estate and GST taxes and the reduction in the rate of the federal gift tax present some potential planning opportunities,

Brussels

+32 (0)2 290 7800

Denver

+1 303.863.1000

London

+44 (0)20 7786 6100

Los Angeles

+1 213.243.4000

New York

+1 212.715.1000

Northern Virginia

+1 703.720.7000

San Francisco

+1 415.356.3000

Washington, DC

+1 202.942.5000

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the uncertainty as to how long these changes will remain in effect and as to whether Congress will attempt to eliminate them retroactively calls for careful deliberation.

If you wish to discuss the options that might be available to you, or if you would like us to review your existing estate planning documents, please contact your Arnold & Porter attorney or:

Anne J. O'Brien

+1 202.942.6080
Anne.O'Brien@aporter.com

Thomas W. Richardson

+1 202.942.5171
Thomas.Richardson@aporter.com

Alison F. Egan

+1 202.942.5256
Alison.Egan@aporter.com

Brenda Jackson-Cooper

+1 202.942.6228
Brenda.Jackson-Cooper@aporter.com

Laura A. Jeltema

+1 202.942.6664
Laura.Jeltema@aporter.com