

Economic Growth and Tax Relief Reconciliation Act of 2001

09/05/01

As you probably know, the Economic Growth and Tax Relief Reconciliation Act of 2001 (the "Act") has been enacted. This Act made significant changes to the current estate and gift tax laws. We have prepared a brief description of how the Act changes current estate and gift tax law. We hope that our description will assist you in understanding these changes.

1. Estate Taxes. Under the Act: (i) the estate tax exemption will increase in 2002 to \$1 million and will eventually increase to \$3.5 million by 2009 (currently, the estate tax exemption is \$675,000); (ii) the 5% surtax on estates over \$10 million has been repealed; (iii) there is a gradual reduction in the top marginal estate tax rate (from the current 55% to 45% after 2006); (iv) the estate tax is repealed in 2010 (but only for those persons whose death occurs between January and December 2010); and (v) the "qualified family owned business" exclusion has been repealed, effective in 2004. Many wills and revocable trusts have been designed to leave a part of the estate in a "marital share" exclusively for a surviving spouse and part in a "residual share" held in trust for the joint benefit of the spouse and children. The division between the marital share and the residual share is traditionally governed by the size of the estate tax exemption available. With the estate tax exemption increasing from its current level of \$675,000 to as much as \$3.5 million in 2009, there may be a dramatic (and perhaps undesired) effect on the allocation of the estate, putting much less (perhaps even nothing) in the marital share for the surviving spouse and much more (perhaps everything) in the residual share. All such plans should be reviewed to address this issue.

2. Generation Skipping Taxes. In general terms, the generation skipping tax is imposed whenever there is a transfer to a person more than one generation below that of the transferor. Currently, the generation skipping tax exemption is \$1 million increased by inflation adjustments. In 2004, the generation skipping tax exemption will be increased to \$1.5 million. The generation skipping tax is repealed in 2010, but only for those people whose death occurs between January and December 2010.

3. Gift Taxes. Beginning in 2002, the gift tax exemption is increased to \$1 million from the current \$675,000. The Act permanently freezes the gift tax exemption at \$1 million. In 2010, when estate taxes are repealed for the year, the gift tax remains in place but the top gift tax rate will be reduced to the top individual income tax rate (35% under the Act). The \$10,000 annual exclusion for gifts remains in place.

4. State Death Taxes. Currently, in computing the federal estate tax, a credit is allowed for the State death taxes actually paid. Under the Act, the credit for State death taxes is phased out over years 2002 through 2004. After 2004 there will be no such credit against the federal tax. Thereafter, for states that have a separate death tax in addition to the federal tax, the State death tax will be deductible in computing the federal tax. We are currently uncertain how Georgia will address this issue. Presumably, Georgia will modify its death tax statute.

5. Basis Step-up. Currently, the income tax basis of a decedent's property is adjusted to the property's fair market value at the date of death. Any unrealized capital gain is forever non-taxable to the decedent's estate and heirs. After 2009, however, this basis "step-up" is limited to \$1.3 million, plus up to \$3 million for assets passing to (or in trust for) a surviving spouse, with certain exceptions. In addition, these limitations may be increased by the amount of any "loss carryforward" amounts unused by the decedent and unrealized capital losses as of the date of death. Further, after 2009, the capital gain exclusion on sale of a principal residence is available to the decedent's estate and beneficiaries if the decedent would have qualified before death. For amounts in excess of these limitations, the estate and the heirs will assume the decedent's basis in property.

6. Sunset Provision. The Act covers tax years 2001 through 2010. The Act provides that all of its provisions and all amendments made by the Act shall not apply after December 31, 2010. In order to permanently eliminate the estate tax, new legislation must be passed.

SCHEDULE OF CHANGES

Year	Estate Tax Exemption	Gen. Skipping Exemption	Highest Tax Rate Estate/Gift	Gift Tax Exemption
2002	\$1,000,000	\$1,060,000 ⁺¹	50%/50%	\$1,000,000
2003	\$1,000,000	\$1,060,000 ⁺¹	49%/49%	\$1,000,000
2004	\$1,500,000	\$1,500,000	48%/48%	\$1,000,000
2005	\$1,500,000	\$1,500,000	47%/47%	\$1,000,000
2006	\$2,000,000	\$2,000,000	46%/46%	\$1,000,000
2007	\$2,000,000	\$2,000,000	45%/45%	\$1,000,000
2008	\$2,000,000	\$2,000,000	45%/45%	\$1,000,000
2009	\$3,500,000	\$3,500,000	45%/45%	\$1,000,000
2010	Repealed	Repealed	0%/35%	\$1,000,000

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⁺¹ Until 2004 the GST Exemption is indexed for inflation, \$1,060,0.000 in 2001.

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