

Estate Planning Update

July 2001

There's Good News and Bad News...

Estate Tax Repeal and the New Tax Law

President Bush has signed the Economic Growth and Tax Relief Reconciliation Act of 2001 (the "Tax Act"). The Tax Act makes significant changes in the income, estate, and gift and generation-skipping transfer ("GST") tax laws. This Update provides a brief summary of the major changes affecting estate planning.

First, The Good News

- Starting in 2002, the estate tax exemption will increase, and the maximum estate tax rate will decrease, as follows:

Calendar Year	Exemption	Highest Rate
2002	\$1.0 million	50%
2003	\$1.0 million	49%
2004	\$1.5 million	48%
2005	\$1.5 million	47%
2006	\$2.0 million	46%
2007	\$2.0 million	45%
2008	\$2.0 million	45%
2009	\$3.5 million	45%
2010	repealed	repealed

- The GST tax exemption will match the higher estate tax exemption beginning in 2004.
- The estate and GST taxes are repealed as of January 1, 2010.
- The maximum gift tax rate will equal the maximum estate tax rate from 2002 through 2009. In 2010, the maximum gift tax rate will equal the maximum income tax rate (expected to be 35%). The lifetime exemption from gift tax exemption will increase from its current level of \$675,000 to \$1 million on January 1, 2002.
- There are many adjustments to the income tax rates. The introduction of a new 10% bracket will result in rebate checks (of up to \$300 for a single taxpayer and \$600 for married taxpayers) arriving this summer. The top income tax rate of 39.6% will be reduced to 38.6% as of July 1st of this year, to 37.6% beginning in 2004, and to 35% beginning in 2006.
- Section 529 Plans are greatly improved. Under the Tax Act, no income taxes will be due on any income attributable to the Plan assets if all withdrawals from the Plan are used to fund qualified education expenses.

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- Although the estate and GST taxes are repealed in 2010, the gift tax is **not** repealed. Beginning January 1, 2002, the gift tax exemption will be increased to \$1 million. However, this exemption will **not increase** along with the estate and GST tax exemptions.
- In 2010, when the estate tax is repealed, inherited property will no longer receive a full step-up in income tax basis. The decedent's assets may receive only \$1.3 million of a step-up in basis. Assets transferred to a surviving spouse may receive an additional \$3 million basis step-up, for a maximum step-up of \$4.3 million. The balance of the decedent's assets will have a basis equal to the lesser of the decedent's cost basis or the fair market value of the asset at the decedent's date of death. Heirs will be responsible for capital gains taxes if and when the inherited property is sold.
- Certain gifts to existing and new irrevocable trusts will not qualify for the annual exclusion beginning in 2003.
- **This entire repeal may be gone after one year!!** Unless a future Congress and President act to make the repeal permanent, all of the changes contained in the Tax Act will disappear, and the provisions of the current tax code again will become law on January 1, 2011.

So What Do You Do?

Do not make drastic changes to your estate plans, life insurance coverage, or beneficiary designations. Most changes do not take effect until 2002 and are phased in slowly.

Some estate plans will require no change, as the documents will adjust automatically for the changes in the new tax law. However, some plans may require substantial redrafting. The best way to determine if changes are needed is to review your existing documents and to call one of our estate planning attorneys to discuss your estate plan.

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SHEPPARD MULLIN PUBLICATIONS

To receive a copy of the publications listed below, or to add a colleague to our mailing list to receive future Update newsletters, please call Sharon Lombardi at (213) 617-5568 or visit our website at www.smrh.com.

"The Structure of the California Coastal Commission," by Joseph E. Petrillo and Peter F. Ziblat, May 2001.

"Ten Steps That Could Save Your Company," *Orange County Business Journal*, by Greg S. Labate, May 2001.

"Clearing the Path to Arbitration," by Julie A. Dunne, April 2001.

"Humphrey Decision," by Terry Chapko, April 2001.

"US Army Corps of Engineers Narrows the Impact of Recent Court Decisions That Attempt to Limit Clean Water Act Jurisdiction," by Robert J. Uram and Jillian Blanchard, March 2001.

"SWANCC v. U.S. Army Corp of Engineers," by Robert J. Uram and Jillian Blanchard, January 2001.

"What the State Giveth, The Feds Taketh Away," by Julie A. Dunne, January 2001.

Applicability of the legal principles discussed may differ substantially in individual situations. The information contained herein should not be construed as individual legal advice.