

CURRENT ESTATE, AND GST TAX ISSUES

OCTOBER 6, 2004

Risk of Increased State Estate Tax on your Estate

Married taxpayers can design their estate plans so that on the death of the first spouse to die there is no Federal estate tax and so that the maximum amount from the assets of the first to die is sheltered from tax at the death of the second to die. This maximum amount is called the Federal Applicable Exclusion amount. The amount, currently \$1.5 million, is scheduled to increase in increments until it reaches \$3.5 million in 2009 (and then falls to \$1 million in 2011).

The way to take advantage of the Federal Applicable Exclusion amount on the death of the first spouse to die is to give the Applicable Exclusion amount to someone other than the spouse. So, many estate plans provide for the maximum Federal Applicable Exclusion amount to be held in a trust for the spouse and descendants. However, this approach now may create a state estate tax at the death of the first spouse to die, because in some states the state Applicable Exclusion amount is now less than the Federal amount. To avoid the state tax, you may want to change your Will if your Will currently provides that the maximum Federal Applicable Exclusion amount passes other than to the spouse.

For example, in New York the Applicable Exclusion amount is \$1 million and, therefore, if you are a New York resident, New York estate tax will be imposed on any amount over \$1 million that does not pass to a U.S. citizen spouse (or charity). So, if you are a New York resident and die in 2004, and a trust for your spouse and descendants is funded with the full Federal Applicable Exclusion amount, \$1.5 million, no Federal estate tax will be due at your death, but New York estate tax in the amount of \$64,400 will be payable. In subsequent years, the New York estate tax cost will grow as the Federal Applicable Exclusion amount rises but the New York amount remains fixed.¹ You can avoid the New York tax by capping the amount passing to the trust for spouse and descendants at the lesser of the Federal and New York Applicable Exclusion amounts.

¹ As noted above, under current Federal law, the applicable exclusion is increasing gradually to \$3.5 million in 2009. As the applicable exclusion increases, so will the New York estate tax bill. The chart below shows the New York estate tax payable for a New York resident dying with a taxable estate equal to the Federal applicable exclusion amount in the years subsequent to 2004 assuming there is no change in the law.

<u>Calendar Year</u>	<u>Federal Applicable Exclusion</u>	<u>New York Estate Tax</u>
2005	\$1,500,000	\$ 64,400
2006	\$2,000,000	\$ 99,600
2007	\$2,000,000	\$ 99,600
2008	\$2,000,000	\$ 99,600
2009	\$3,500,000	\$229,200

Automatic Allocation of GST Tax Exemption

Starting in 2004, the generation-skipping transfer (“GST”) tax exemption is tied to the estate tax applicable exclusion amount for the particular calendar year. Therefore, in 2004, each individual has a GST tax exemption of \$1,500,000. The GST tax exemption is valuable because, if GST tax exemption is allocated to a transfer to a trust, the transfer and all post-transfer appreciation thereon is exempt from any further gift, estate or GST tax for the entire life of the trust. Prior to 2001, GST tax exemption was not allocated to a transfer to a trust unless the donor affirmatively allocated GST tax exemption on his or her gift tax return for the year of the transfer. However, with respect to all transfers made to certain trusts beginning January 1, 2001, GST tax exemption is automatically allocated to such transfers unless the donor affirmatively opts out of automatic allocation on his or her gift tax return.

Each year, you should alert your accountant to transfers you make to trusts (including life insurance premiums paid on behalf of insurance trusts) to determine whether or not you should opt out of automatic allocation, so that your gift tax return, which is due the April 15th of the year following the year of the transfer, can be prepared appropriately.

Effective Combined Tax Rate for New York Residents

For your information, the following chart shows the combined effective Federal and New York estate tax top marginal rates for the years 2004-2010:

<u>Calendar Year</u>	<u>Federal Rate</u>	<u>New York Rate</u>	<u>Effective Combined Rate after Credit or Deduction</u>
2004	44%	16%	60%
2005	47%	16%	55.48%
2006	46%	16%	54.64%
2007-2009	45%	16%	53.80%
2010	0	16%	16%

We note that, while the New York estate tax is onerous, New York no longer has a gift tax.

If you have any questions about the estate planning issues described in this update, please contact Mildred Kalik (mkalik@stblaw.com; 212-455-2778), Pamela L. Rollins (prollins@stblaw.com; 212-455-3468), David J. Stoll (dstoll@stblaw.com; 212-455-2766) or any other member of our Personal Planning Department.

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