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Transfer Tax Rates and Credits

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The Taxpayer Relief Act 1997 and the Economic Growth and Tax Relief Reconciliation Act 2001 mandated changes to US transfer taxes over a period of years. The result is that tax professionals and trustees must confirm rates and exemption amounts annually. In addition, certain annual exclusion amounts are now indexed for inflation and must be confirmed each year to ensure maximum advantage for the client.

Estate, Gift and Generation-Skipping Transfer Taxes

US citizens and non-citizens who are resident in the United States are subject to US gift and estate taxes on their worldwide assets. Non-resident alien individuals are subject to US gift and estate taxes on their real property and tangible personal property located in the United States. In the absence of an overriding treaty provision, the estate tax also applies to securities or obligations issued by US persons or entities. A lifetime credit is allowed which effectively exempts a certain amount from these taxes. For further details please see the Overview (March 2003).

When a US citizen or resident makes a transfer, whether by gift or bequest, to a person two or more generations below that of the transferor (a 'skip person'), a generation-skipping transfer (GST) tax is imposed in addition to any gift or estate tax that may be due. A transfer of non-US property by a non-resident alien is not subject to the GST tax, since it is not subject to estate or gift tax; but the tax applies when a non-resident alien transfers US property (other than intangibles transferred by gift). For further details please see the Overview (March 2003).

Increasing Credits and Decreasing Rates until 2010

As can be seen from the chart below, the amounts exempt from transfer tax as a result of applicable credits are increasing and the maximum tax rates are decreasing until 2010.

Calendar year
Estate tax exemption
Gift tax exemption
GST tax exemption
Maximum estate tax rate
Maximum gift tax rate
GST tax rate

2004	$1.5 million	$1 million	$1.5 million	48%	48%	48%
2005	$1.5 million	$1 million	$1.5 million	47%	47%	47%
2006	$2 million	$1 million	$2 million	46%	46%	46%

2007	$2 million	$1 million	$2 million	45%	45%	45%
2008	$2 million	$1 million	$2 million	45%	45%	45%
2009	$3.5 million	$1 million	$3.5 million	45%	45%	45%

2010
repealed
$1 million
repealed
repealed
35%
repealed
2011
$1 million
$1 million
$1.12 million
55%
55%
55%

The above tax rates also apply to certain US situs property transferred by non-resident aliens, but the exemption amounts do not. Instead, the credit available to the estate of a non-resident alien decedent exempts only $60,000 of US situs assets from estate tax and is not scheduled to increase. In addition, there is no credit available to a non-resident alien to exempt transfers from gift tax, although the annual exclusion amounts do apply.

Annual Exclusion Amounts Indexed for Inflation

In addition to credits and rates that are scheduled to change annually, the amounts which can be given free of gift tax each year to a donee who is not a spouse, and to a non-citizen spouse, are indexed annually for inflation. Outright gifts to a US citizen spouse are not subject to gift tax (for further details please see the Overview (March 2003)). For the 2004 tax year, the relevant annual exclusion amounts are as follows.

Annual tax-free gifts per donee
$11,000
Tax-free gifts to non-citizen spouse
$114,000

Tax Year 2010 and the Sunset Provision

Under the provisions of the 2001 act, the estate tax and GST tax are to be repealed in 2010. The act replaces for that year the existing 'step-up' in basis rule for inherited property with a 'carry-over' basis rule. The existing rule adjusts the income tax basis of most types of property inherited from a decedent to its fair market value at the date of death. The carry-over basis rule would, for inherited amounts over $1.3 million (plus an additional $3 million for property passing to a surviving spouse), result in the heir's basis in property inherited from a decedent who dies in 2010 being the smaller of the deceased owner's basis or the date-of-death market value. This potentially increases the amount of gain (and tax) when the heir sells the property.

The 2001 act does not repeal the gift tax. Instead, the maximum marginal gift tax rate is to be reduced for the year 2010 to the top income tax rate, currently 35%.

Under the 'sunset' provision of the 2001 act, all provisions of the act are repealed as of January 1 2011. Thus, on January 1 2011 the estate, gift and GST tax provisions are scheduled to revert to those in effect prior to the act - that is, a credit that will shelter $1 million from transfer and GST tax and a maximum tax rate of 55% (plus a 5% estate tax surcharge on certain large estates). The exemption from GST tax would be indexed for inflation.

Uncertain Estate Tax Repeal

The above numbers can only be relied on if Congress takes no further action with respect to the provisions set out in the Taxpayer Relief Act 1997 and the Economic Growth and Tax Relief Reconciliation Act 2001. It is unlikely that Congress will allow the estate and GST taxes to be repealed for just one year; but it is unclear whether it will abolish these taxes altogether or enact an alternative. Senate Finance Committee Chairman Charles Grassley suggested in March this year that he would prefer to concentrate on increasing the estate tax exemption amount and lowering estate tax rates than on winning a full repeal of the tax. He suggested a $5 million exemption amount, but did not say what tax rate he would recommend.

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