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Congress allows estate tax repeal for 2010

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Background

The new year has brought new tax law provisions that US accountants, lawyers and family advisers thought would never take effect. Congress did nothing before the end of 2009 to alter the provisions of the Tax Relief Reconciliation Act 2001, which calls for a one-year repeal of estate tax in 2010. Tax practitioners are wondering whether Congress will take action in 2010 and whether such action will be retroactive. The end of 2009 brought some certainty to entity classification of *anstalts* (establishments) and *stiftungs* (formations) for US tax purposes, which is a welcome development since guidance has been limited for many years to the general rules of the trust and business entity classification regulations.

Estate tax repeal for 2010

Under the act, amounts sheltered from estate tax increased over the years from \$675,000 to \$3.5 million and the maximum estate tax rate decreased from 55% (60% on certain larger estates) to 45%. Estate tax and

generation-skipping transfer tax are repealed under the act for the tax year 2010. The act also replaces the 'step-up' in basis rule for inherited property with a 'carry-over' basis rule for 2010. Under the step-up in basis rule, the income tax basis for most types of property inherited from a decedent was adjusted to fair market value at the date of death. Now instead, the carry-over rule applies to inherited amounts over \$1.3 million (plus an additional \$3 million for property which passes to a surviving spouse), and results 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.

Gift tax rate lowered

The act does not repeal gift tax. Instead, the maximum marginal gift tax rate has been reduced for 2010 to the 35% top income tax rate.

Reinstatement of estate and gift taxes in 2011

Under the sunset clause of the act, all provisions will be repealed on January 1 2011, so that the tax system reverts to pre-2001 law. Generally, that law provides for higher taxes than those under the act: there will be a credit sheltering \$1 million from gift and estate taxes, a \$1 million exemption from generation-skipping transfer tax (indexed for inflation) and a maximum tax rate of 55% (plus a 5% estate tax surcharge on certain large estates). The carry-over basis rules will not apply to estates of decedents who die after December 31 2010; instead, the basis rules revert back to the step-up in basis regime.

Retroactive extension of 2009 rates?

Senate Finance Committee Chairman Max Baucus has said that Congress will seek to restore the estate tax retroactively in 2010, but also said that it may incorporate estate tax reform into a broader tax reform bill. Questions have been raised as to whether a retroactive law would be unconstitutional. Although lawsuits would certainly result (and there is at least one well-known wealthy individual who has died during this gap period), practitioners generally believe that courts would sustain a retroactive law if it were enacted this year and was not a radical departure from prior law.

Tax classification of *Anstalts* and *Stiftungs*

There is no legal entity equivalent to an *anstalt* or *stiftung* in US law. The determination of their classification for tax purposes has been subject to entity classification regulations, under which a foreign entity is classified as a business entity for federal tax purposes if it is not classified as a trust. Business entities are categorized as *per se* corporations and eligible entities. An eligible entity may elect its classification from a list of Internal Revenue Service (IRS)-accepted legal business forms.

On October 7 2009 the IRS Office of Chief Counsel issued advice to the IRS (released to the public on October 16 2009), stating that subject to the facts and circumstances of each situation, Liechtenstein *anstalts* generally are not properly treated as trusts because in most situations their primary purpose is to carry on business activities. Therefore, in most cases *anstalts* are classified as business entities. However, Liechtenstein *stiftungs* are generally classified as trusts unless, according to the facts and circumstances, the entity was created primarily for commercial purposes.

Comment

Although facts and circumstances may dictate a different tax classification for *anstalts* and *stiftungs*, advisers to international families can expect that in general, the advised classifications will apply. Although the advice did not specifically address such structures formed under the laws of other jurisdictions, family advisers can reasonably conclude that they will be subject to similar classification. The situation is at least clearer than that regarding estate and gift tax.

Because the stakes are high and so many other major political and governmental issues have intervened that warrant more attention, Congress has been unable to reach any consensus as to how much, and how, to apply wealth transfer taxes to the more numerous estates and gifts that would be subject to the higher tax regime unless a new law were passed this year. Efforts are underway to streamline the legislative process and bring a bill to the Senate floor that skips over the Senate Finance Committee and clears the way to restore the 2009 estate and gift tax law - at least for a few years. Nevertheless, it is extremely difficult at this time to predict an outcome and this uncertainty may continue throughout most of the year.

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