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## **H.R. 1836: THE ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT OF 2001 (“ACT”)**

On June 7, 2001, President George W. Bush signed the Act into law. The following is a summary of some of the important provisions of the Act.

### **SUMMARY**

#### **A. SUNSET PROVISION**

The Act contains a sunset provision, which provides that without further legislative action, none of the provisions of the Act will apply to tax years beginning after December 31, 2010. Thus, without further legislative action, all laws changed by the Act would revert to the pre-Act system.

#### **B. INDIVIDUAL INCOME TAX RATE REDUCTIONS**

Individual income tax rates will undergo a reduction, effective July 1, 2001, as follows:

| <b>CALENDAR</b> | <b>28% rate</b> | <b>31% rate</b> | <b>36% rate</b> | <b>39.6% rate</b> | <b>YEAR</b> |
|-----------------|-----------------|-----------------|-----------------|-------------------|-------------|
| reduced to:     | reduced to:     | reduced to:     | reduced to:     |                   |             |
| 2001            | 27.5%           | 30.5%           | 35.5%           | 39.1%             |             |
| 2002-2003       | 27%             | 30%             | 35%             | 38.6%             |             |
| 2004-2005       | 26%             | 29%             | 34%             | 37.6%             |             |
| 2006 and later  | 25%             | 28%             | 33%             | 35%               |             |

In addition, for tax years beginning after December 31, 2001, a new 10% rate bracket will be instituted and applied to the first US\$6,000.00 of taxable income for single individuals (US\$7,000.00 for 2008 and thereafter), US\$10,000.00 for heads of households, and US\$12,000.00 for married couples filing joint returns (US\$14,000.00 for 2008 and thereafter). Taxpayers will receive a 5% credit in 2001 because of the creation of this 10% rate bracket. The maximum credit allowed is US\$300.00 for single individuals, US\$500.00 for head

of households, and US\$600.00 for married couples filing jointly. All taxpayers entitled to this credit will receive a check issued by the United States Department of Treasury. The last two digits of the taxpayer's social security number will determine when the checks are mailed. The schedule is as follows:

| If the last two digits of your<br>Social Security number are: | You should receive your<br>refund the week of: |
|---|--|
| 00 - 09   | July 23  |
| 10 - 19   | July 30  |
| 20 - 29   | August 6                                       |
| 30 - 39   | August 13                                      |
| 40 - 49   | August 20                                      |
| 50 - 59   | August 27                                      |
| 60 - 69   | September 3                                    |
| 70 - 79   | September 10                                   |
| 80 - 89   | September 17                                   |
| 90 - 99   | September 24                                   |

**C. ESTATE, GIFT, AND GENERATION-SKIPPING TRANSFER TAXES**

**1. DECREASE IN ESTATE, GIFT, AND GENERATION-SKIPPING TRANSFER TAX RATES, AND INCREASE IN EXEMPTION AMOUNTS**

The Act incorporates a major revision to the estate, gift, and generation-skipping transfer (“GST”) tax rates and exemption amounts. The pre-Act estate and gift tax rates of 53% and 55% will be replaced in 2002 with a 50% tax rate, and such rate will decrease thereafter. The GST tax rate of 55% will be replaced in 2002 and thereafter with the highest estate and gift tax rate at the time of the transfer, which is 50% in 2002. The exemption amounts in 2001 remain at US\$675,000.00 for estate and gift tax and US\$1,000,000.00 (US\$1,060,000.00 as adjusted for inflation) for GST tax. The estate tax and GST tax exemptions will increase dramatically over the following 9 years. The gift tax exemption, however, will be US\$1,000,000.00 in 2002 and remain at that level thereafter. The estate tax and GST tax will be repealed in 2010. Thus, no estate tax or GST tax will be imposed on estates of decedents dying after December 31, 2009 and before January 1, 2011, unless further legislative action is taken. The gift tax will not be repealed. The maximum gift tax rate for gifts made after December 31, 2009 will be the highest individual income tax rate under law at the time of the gift, which will be 35% in 2010. Additionally, the 5% surtax on estates over US\$10,000,000.00 will be repealed effective January 1, 2002. The following table illustrates most of these changes:

| CALENDAR<br>YEAR                          | ESTATE AND GST<br>TAX EXEMPTION<br>AMOUNT | MAXIMUM ESTATE<br>AND GIFT TAX<br>RATE                        |
|---|---|---|
| 2002.....                                 | US\$1 million.....                        | 50%   |
| 2003.....                                 | US\$1 million.....                        | 49%   |
| 2004.....                                 | US\$1.5 million.....                      | 48%   |
| 2005.....                                 | US\$1.5 million.....                      | 47%   |
| 2006.....                                 | US\$2 million.....                        | 46%   |
| 2007.....                                 | US\$2 million.....                        | 45%   |
| 2008.....                                 | US\$2 million.....                        | 45%   |
| 2009.....                                 | US\$3.5 million.....                      | 45%   |
| 2010.....                                 | N/A (tax repealed).....                   | top individual<br>incometax rate under<br>law (gift tax only) |
| 2011(without further<br>legislation)..... | US\$1 million.....                        | 55%   |

Notwithstanding the foregoing, the estate tax exemption amount for nonresident aliens will remain at US\$60,000.00. There still is no gift tax exemption amount for nonresident aliens.

## **2. FAMILY-OWNED BUSINESS**

For decedents dying after December 31, 2003, the US\$675,000.00 exemption for qualified family-owned business interests is repealed.

## **3. STEP-UP/CARRYOVER IN BASIS**

When the estate tax is repealed in 2010, the Act replaces the estate tax with a capital gains tax, and provides some relief in the form of a step-up in basis for certain property. The step-up in basis limitation for resident decedents is US\$1,300,000.00 (plus certain losses) and is US\$60,000.00 for nonresident alien decedents. There is an additional basis increase of up to US\$3,000,000.00 for “qualified property” acquired by a surviving spouse. For this purpose, the term “qualified property” means outright transfers or qualified terminable interest property.

These increases in basis apply only if the property acquired was owned by the decedent at the time of his death. The following rules apply in determining whether the decedent owned such property.

### **JOINTLY HELD PROPERTY**

If such property was jointly held with only the surviving spouse, the decedent is treated as the owner of 50% of the property. If the joint owner is not the surviving spouse, the decedent is treated as the owner

of the portion of the property which is proportionate to the consideration he provided toward the purchase of the property. If the decedent acquired property by gift, bequest, devise, or inheritance with another as joint tenants with right of survivorship and this interest is not otherwise fixed, the decedent will be treated as the owner of the property to the extent of the value of his fractional part.

#### REVOCABLE TRUSTS

The decedent is deemed to be the owner of property transferred by him during his lifetime to a qualified revocable trust.

#### POWERS OF APPOINTMENT

The decedent shall not be treated as owner of property over which he holds a power of appointment.

#### COMMUNITY PROPERTY

A surviving spouse's one-half share of community property held by the decedent and the surviving spouse shall be treated as owned by (and acquired from) the decedent if at least one-half of the whole of the community interest in such property is treated as owned by (and acquired from) the decedent without regard to this provision of the Act.

The step-up in basis will not apply to stock or securities of a foreign personal holding company, stock of a DISC or former DISC, stock of a foreign investment company, or stock of a passive foreign investment company unless such company is a qualified electing fund with respect to the decedent.

#### **4. TRANSFERS TO FOREIGN PERSONS UPON DEATH**

After December 31, 2009, transfers by a United States person to a nonresident alien will be treated as a sale or exchange if such transfer is made after the lifetime of the transferor. Until then, the transfer of property by a United States person only to a foreign trust or estate is treated as a sale or exchange (with certain exceptions), regardless of when the transfer is made.

#### **5. DISTRIBUTIONS FROM A QUALIFIED DOMESTIC TRUST**

The Act changes the imposition of estate tax on distributions from a qualified domestic trust ("QDOT"). Distributions made after December 31, 2020 during the lifetime of a surviving spouse are not subject to estate tax if the decedent spouse died before January 1, 2010. Moreover, the value of property remaining in trust upon the death of a surviving spouse is not subject to estate tax if the decedent spouse died before January 1, 2010 and the surviving spouse died after December 31, 2009. If a nonresident alien dies during 2010, a QDOT is not necessary because there will not be any estate tax to defer.

#### **6. CREDIT FOR STATE DEATH TAXES**

Pre-Act law allowed for any "estate, inheritance, legacy, or succession taxes actually paid to any state or the District of Columbia" to be credited against the estate tax. Under the Act, this credit is reduced over time

and eventually repealed. The phaseout begins in 2002 with a 25% reduction in the credit and an additional 25% reduction each year thereafter until 2005 when it is repealed.

The Florida state estate tax is the maximum credit allowed under federal law. The state constitution prohibits Florida from collecting estate tax if the federal estate tax is repealed. As a result of the Act, Florida will lose approximately US\$800,000,000.00 each year after the repeal of the state death tax credit.

## **7. EXTENSION OF TIME FOR PAYMENT OF ESTATE TAX**

Under pre-Act law, estates consisting largely of interests in closely held businesses (such as certain partnerships and corporations) were allowed an extension of time of up to 15 years to pay estate taxes. The Act expands that provision by allowing a corporation or partnership to have 45 shareholders or partners, as opposed to 15, when determining whether a corporation or partnership is a closely held business for such purpose.

The Act creates another type of business interest which qualifies for an extension of time for the payment of estate tax. If an estate consists of stock in a qualifying lending and finance business, the executor of that estate may elect to take an extension of time for payment of estate tax. Under this added provision, however, the required payments must be made within 5 years rather than the 15 years allowed for other defined business interests.

All of these new provisions apply to estates of decedents dying after December 31, 2001.

## **D. REPORTING REQUIREMENTS**

The Act requires executors of estates of residents and nonresident aliens dying after December 31, 2009 to furnish certain information to the Internal Revenue Service.

### **EXECUTORS OF ESTATES OF RESIDENTS**

After December 31, 2009, executors of estates of residents are required to report transfers of more than US\$1,300,000.00 in property acquired from the decedent (other than cash), including gifts acquired from the decedent within three years of his death if a gift tax return was required to be filed with regard to such gift.

### **EXECUTORS OF ESTATES OF NONRESIDENTS**

After December, 31, 2009, executors of estates of nonresident aliens are required to report transfers of more than US\$60,000.00 in property acquired from the decedent (other than cash), including gifts acquired from the decedent within three years of his death if a gift tax return was required to be filed with regard to such gift, but only if such property was tangible property situated in the United States or other property acquired from the decedent by a United States person.

The following chart lists the information to be reported:

1. Name and taxpayer identification number of the recipient,
2. Accurate description of the property,
3. Adjusted basis of the property in the hands of the decedent and its fair market value at the time of death,
4. Decedent's holding period for such property,
5. Sufficient information to determine whether any gain on the sale of the property would be treated as ordinary income,
6. Amount of basis increase allocated to the property under the step-up rules, and
7. Such other information the Treasury Secretary may prescribe.

Executors must furnish this information to each person named in the return. Penalties apply for noncompliance, except with reasonable cause.

**E. CHILD TAX CREDIT INCREASE**

The pre-Act child tax credit of US\$500.00 per child will significantly increase under the Act. The increase will be phased in as follows:

| <b>CALENDAR YEAR</b> | <b>CREDIT AMOUNT PER CHILD</b> |
|----------------------|--------------------------------|
| 2001-2004            | US\$600.00                     |
| 2005-2008            | US\$700.00                     |
| 2009                 | US\$800.00                     |
| 2010 and thereafter  | US\$1,000.00                   |

**F. STANDARD DEDUCTION INCREASE—REMOVAL OF MARRIAGE PENALTY**

In 2005, the Act will give relief to married couples filing joint returns by phasing in an increase to their basic standard deduction to twice the basic standard deduction for unmarried individuals filing single returns. The increase will be fully phased in beginning in 2009 and, therefore, will eliminate the "marriage penalty."

**G. EDUCATION IRA REVISIONS**

Beginning January 1, 2002, taxpayers who contribute to educational IRAs will be allowed to contribute up to US\$2,000.00 annually, as opposed to the present US\$500.00 limit. In addition, elementary and secondary school expenses, such as tuition, fees, academic tutoring, required uniforms, computer technology, and Internet access, will qualify as educational expenses which may be paid tax-free from an educational IRA. Furthermore, corporations and other entities may make contributions to educational IRAs, notwithstanding their income levels.