

Estate Planning and Taxation – 2010 and Beyond

We are now entering the ninth month of 2010 - a year in which we have had no estate tax, but a new income tax regime known as carry over basis. We are also facing possible legislation and uncertainty on other estate planning issues including the allowable terms and forms of grantor retained annuity trusts (GRATs) and the continuation of the valuation discounts in family limited partnerships (FLPs).

On January 1, 2011, we are looking at legislative resurrection of the 2001 version of the federal estate tax and the generation-skipping transfer tax. This means that the federal estate tax and generation-skipping transfer tax exemptions will return to \$1 Million and the federal estate tax, gift tax and generation-skipping transfer tax rates return to the 55% maximum tax rate. Under the law passed in 2001, the exemption for lifetime gifts was increased to \$1 Million effective for gifts made after 2001. No provision was made for any further increases in the amount of the gift tax exemption (equivalent to a unified credit of \$345,800.00). Any use of the gift tax exemption during an individual's lifetime will reduce the applicable exclusion amount available when that individual dies.

Why did Congress retain the federal gift tax? Apparently, there was a fear that the revenue loss would be too great if high income bracket taxpayers could transfer appreciated assets to lower bracket owners without first paying a gift tax. The lower bracket owners, so the theory goes, would then sell the assets at a much lower income tax cost than the donor might have incurred.

What do the experts think about possible retroactive changes involving re-instatement of the estate tax and repeal of carryover basis for 2010? Most experts feel that retroactive re-instatement of the federal estate tax and generation-skipping transfer tax for 2010 will not occur. First, the developed law does not clearly establish that retroactive re-instatement would pass muster under the due process clause. Those who believe retroactive re-instatement would be constitutional often cite *U.S. v. Carlton*, 512 U.S. 26 (1994), to support their position. However, the facts of *Carlton* are so far distinguishable from what would be a Congressional attempt to resurrect an entire tax system from the ashes that *Carlton*, although undeniably relevant, would by no means be controlling precedent.

Second, as a practical matter, Congress has waited too long to implement retroactive re-instatement. The longer Congress dithers, the less likely the courts would sanction retroactive re-instatement and the more pressure members of Congress will feel (particularly from the anti-“death” tax crowd) to just turn the page and make any transfer tax changes prospective only.

Third, upon calm reflection (if that's possible inside the beltway), Congress will see that, on balance, there is less to gain than to lose with retroactive re-instatement. Already in 2010, several citizens (including George Steinbrenner) of astounding wealth have died. The fiduciaries and beneficiaries of the estates of these decedents have both the economic incentive and ability to carry on a years-long fight against retroactive re-instatement. This would invite further scorn and ridicule if Congress were to enact a law that would be certain to extend significantly the estate tax hiatus of 2010.

Will Congress allow 2010 to pass without changing the current state of the gift and estate tax laws, despite politics and revenue concerns? While your writer was wrongly convinced that Congress would act before the end of 2009, I am even more convinced that Congress will not allow the estate and gift tax system to revert to the 2001 level of exemptions. Nor do I believe that revenue concerns will change that result. There are too many people, including small business owners, who have come to rely on exemptions of \$3.5 Million per person. Whether the legislation accomplishing that will occur before 2011 is another question. Given the highly partisan atmosphere in Washington, it seems quite likely that no agreement will be reached until they are at the brink. Skeptics have noted that estate tax reform is a topic that seems to generate intense lobbying and very large campaign contributions. The question those skeptics ask is why would Congress finalize this any sooner than absolutely necessary. That could be as late as the due date for a tax payment for the first people to die in 2011, which will be September 30, 2011.

If we reach 2011 without any changes in federal estate tax law (meaning the pre-2001 tax act transfer tax law automatically returns), federal revenue results may be mixed. On the one hand, estates having a value of between \$1 Million and \$3.5 Million would become subject to federal estate tax. On the other hand, a large majority of estates having a value greater than \$3.5 Million would actually generate smaller federal estate tax revenues than under 2009 tax law because the federal credit for state death taxes would be restored, and, as a direct result, the "pick up" estate tax systems of many states (including New York), now dormant, would be revived.

A political reality is that the longer members of Congress can drag out estate tax reform, the more campaign contributions they can extract from those who seek to influence the outcome. Therefore, it is my belief that 2010 will pass with no changes in federal transfer tax law. Political paralysis and the lure of additional campaign funds will prevail for the rest of this year and into the next.

Finally, what planning techniques should you ask your estate planning advisors about during the rest of 2010? The following are estate planning techniques that make sense this year:

Short term rolling GRATs with marketable securities.

Longer term GRATs with family business assets.

Installment sales to intentionally defective grantor trust and partnership freezes. All of which techniques take advantage of the current low interest rate environment.

To schedule a meeting with one of Tully Rinckey PLLC's estate planning attorneys call 1-888-LAW-4-LIFE.