

Trusts & Estates Notes

A Series of Articles on Legal Issues Regarding Estate Planning and Estate Administration

Death, Taxes & Congressional Malpractice

By Michael Curtis

Transfer Tax Moratorium.

The certainty of death and taxes took a partial hit when Congress failed to take action to extend the gift, estate and generation-skipping transfer taxes as they existed in 2009 or to pass more comprehensive legislation. Confusion and uncertainty now reigns supreme for all taxpayers and their estate planning advisers. Some commentators have characterized this failure to act as congressional malpractice.

On January 1, 2010 the federal estate and generation-skipping transfer tax laws were repealed, but only for one year, based on major transfer tax legislation passed in 2001. Families who must deal with a death during 2010 will have to contend with a number of uncertainties, including the possibility that Congress will reinstate these taxes in 2010 and attempt to make them retroactive. And even then, the constitutionality of such action is likely to be challenged and until the U.S. Supreme Court passes judgment taxpayers and their advisers will struggle with the appropriate action to take in administering those estates. It is a tragedy that we must deal with such uncertainty.

The temporary repeal of the estate and generation-skipping transfer taxes is just that – temporary. During this moratorium year, the gift tax continues to exist. The annual exclusion remains at \$13,000 per person, per year, the \$1,000,000 gift tax exemption amount is the same, the tax rate on gifts in excess of the exemption amount is reduced from 45% to 35% and the basis adjustments to fair market value at date of death are changed significantly. The basis adjustment is now only \$1,300,000, which is added to the basis just prior to death (instead of being the value of the asset at date of death) and an additional \$3,000,000 basis adjustment is permitted for qualifying transfers to spouses. Issues concerning the allocation of the basis adjustment, reporting requirements and many others have yet to be addressed by the IRS.

Among the action that Congress could take in 2010, if they can get past the partisan politics that caused this problem in the first place, would be to (a) reinstate the law in effect in 2009 retroactively, (b) reinstate the law in effect in 2009 prospectively during 2010, and (c) pass a new estate and generation-skipping transfer tax law effective prospectively or on January 1, 2011. Or Congress could again fail to take any action, which will reinstate of the gift, estate and generation-skipping transfer tax laws in effect prior to the 2001 legislation. Inaction again in 2010 will cause a return to a unified gift and estate tax law with a \$1,000,000 exemption amount (that could be used during lifetime with any balance remaining available to be used at death), a graduated tax rate beginning at 41% and reaching 55% for the portion of the estate over \$3,000,000 and a 60% rate for the portion of the estate over \$10,000,000, and a generation-skipping transfer tax exemption amount of \$1,000,000 that must be indexed for inflation through 2010. And there may be a return to a complete basis adjustment to the fair market value of the assets at the date of death.

What Should You Do?

If a person dies in 2010, many estates, large and small, will need to wait and see what action the IRS and Congress take before they will be able to complete the administration of the estate. Some actions remain the same. Executors and Trustees still need to identify all assets, determine how title is held and decide whether any legal action is necessary to change title. For example, if title is in the decedent's name and it should have been in the decedent's trust, a determination of the appropriate manner of transferring that asset to the trust will need to be made. All assets must be appraised in the same manner as before the temporary repeal. Other steps, such as the allocation of basis and all required reporting to the IRS will have to await further guidance. And because most all Wills and trusts refer to tax terms that are no longer in effect for 2010, there may be questions of interpretation that may necessitate filing petitions with the Probate Court to answer such questions.

Existing estate plans should be reviewed by everyone, regardless of the size of their estate. Interpretation issues can be addressed by amendments to documents to clarify how they should be terms no longer a part of the law in 2010 should be interpreted in the event of a death during 2010. Many plans divided the community and separate property of married couples into 2, 3 or 4 new trust after the death of the first spouse to die. In 2010 this will generally result in the decedent's 50% community property interest and 100% separate property interest passing into a trust that previously was designed to receive assets with a value approximately equal to the estate tax exemption amount remaining at the person's death. For estates of married couples over \$7,000,000 this means that substantially more assets than was originally planned will not go to the surviving spouse. And for those who were leaving the remaining exemption amount to children or grandchildren instead of the surviving spouse, the survivor may receive a significantly smaller share of the estate than is desired or was intended. These plans require immediate attention.

Planning opportunities still exist in 2010. Low interest rates make techniques such as Grantor Retained Annuity Trusts (GRATs) and Charitable Lead Trusts (CLTs) attractive. And as noted above, making taxable gifts in 2010 can be attractive for larger estates because of the reduced 35% gift tax rate on amounts in excess of the \$1,000,000 exemption. Because many assets, particularly real estate, have depressed values and gifts of less than 100% of the assets will qualify for marketability and other discounts, these types of gifts can provide significant current transfer tax planning savings despite the existing long term transfer tax uncertainty. Beware, however, of the possibility of retroactive legislation that would subject any taxable gifts to tax at a 45% rate. If you believe, as I do, that we will always have a transfer tax system that will include gift, estate and generation-skipping transfer taxes, then now could be one of the best times to take action to implement an aggressive gifting program.

This article is intended to provide a simple, straightforward summary of the major impacts of the one year repeal of the estate and generation skipping transfer taxes on your estate plan or the post-death estate administration of persons who die in 2010 before there is clarity. It is not intended to be exhaustive and there are many, many other technical issues that will need to be addressed in any given situation.

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