



Estate and Gift Tax Update

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“The less people know about how sausage and laws are made, the better they’ll sleep at night.”

— Otto von Bismarck

The tax code and regulations are 16,845 pages long and most of the rules contained therein affect our clients one way or another. But some provisions of the tax code generate significantly more interest and comments from clients than others. Such is the case with the rules established by the **Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001**. This act did provide significant estate tax relief in the form of reducing the maximum tax rate from 55% to 45% and increasing the unified exemption from \$675,000 to \$3,500,000. But it also set in motion a myriad of complex, phased-in measures and transitional rules. Many of the new laws that were set into motion with this legislation disappear at the end of 2010 and the rules in effect in 2001 will be reinstated in 2011. The result could be particularly arbitrary, even draconian, on taxpayers in the estate tax area. For instance, under the law, the estates of people dying in 2010 will pay **NO** transfer tax, while the estates of those dying in 2011 or beyond will pay up to a 55% rate on estates over \$1 million. (This “Alice in Wonderland” situation developed because of budget constraints that Congress did not want to deal with at that time and voted to let others confront the problem later.)

How does one effectively plan in these circumstances? From the first day this law came into effect, virtually all commentators predicted that Congress would quickly address the issue. It’s been 8 years and no serious effort has been made to fix the problem. Until now, that is —

On March 26th, Chairman of the Senate Finance Committee, Max Baucus (D. Montana), introduced the **Taxpayer Certainty and Relief Act of 2009 (S. 722)**.

Estate and Gift Tax Details – Proposed

S. 722 would make several important modifications to the Code—

For example, the 2009 applicable exclusion amount of \$3.5 million (\$7 million for married couples) and the maximum 45% rate would be carried over into 2010 and beyond. The generation-skipping tax (GST) exemption would also have the current \$3.5 million exclusion made permanent. The applicable exclusion amount would be adjusted for inflation after 2010.

In a major change from current law, the proposed legislation would allow for “portability” of the applicable exclusion amount from a decedent to his or her surviving spouse. On the surface, this would appear to constitute tax simplification in that the goal would be to eliminate trust planning for many couples who merely wish to preserve their combined \$7 million exclusion from the estate tax. This provision will not necessarily obviate the need for trusts, particularly in cases involving multiple marriages, family business interests, creditor protection, and very wealthy clients who may wish to take advantage of more sophisticated estate planning strategies.

The bill also contains a proposal for “reunification” of the estate and gift tax applicable exclusion amounts. In other words, taxpayers would be allowed to make lifetime gifts of \$3.5 million instead of the current \$1 million.

By eliminating the sunset provision of the 2001 tax act, there will be another bonus. Under the current rule, in 2010, beneficiaries would inherit property with a carryover basis instead of a “stepped-up” basis. If the new law passes as proposed, stepped-up basis will remain in place.

One of the most important issues we are monitoring is the placing of restrictions on valuation discounts for fractional interests. This is a favorite planning tool used by tax professionals but is looked upon

unfavorably by the IRS. It is not currently in the Senate bill, but has been discussed.

Conclusion

Senator Grassley (a leading proponent of eliminating the estate tax altogether), speaking at a recent seminar, said he expects the Senate to pass an estate tax bill by August.

Obviously, the bill will undergo numerous changes before becoming law (if it passes at all). In fact, the Senate recently voted on a budget resolution calling for an increase of the exemption amount to \$5 million (\$10 million for married couples). They then modified the resolution by injecting a provision that allows the increase only if more tax relief is first given to taxpayers earning less than \$100,000.

Then we have to consider what the House of Representatives will do. Ways and Means Chairman Rangel (D-NY) doesn’t believe estate tax revision is a burning issue; on one occasion he said he would take no action at all until next year and, on another occasion, said the House would deal with it by the end of the year. (I always thought that finance bills have to start in the House; apparently Congress has worked through this constitutional nuance.)

All these budget gymnastics only reinforce the advice that you should consult with your CPA and lawyer often to make sure your will/trust contains all the amendments needed to take advantage of the constantly changing rules.

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