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# Just Do It

*With greater uncertainty than ever surrounding the estate tax, Washington must act soon.*

By Eric L. Reiner

Remember the old joke about advising clients to die in 2010 when there is no estate tax? Now that we're there, no one's laughing. "Absolute bedlam" and "congressional malpractice" are some of the nicer things normally mild-mannered professionals are calling the current estate tax situation.

Before Congress adjourned for the holidays, who dared believe the tax really would be eliminated as promised by George W. Bush's Economic Growth and Tax Relief Reconciliation Act of 2001? Conventional wisdom held that 2009's 45% death-tax rate and $3.5 million-per-individual exemption (inflation-adjusted, perhaps) would be extended.

But it didn't happen. And so on New Year's Day the federal estate tax expired, along with the basis step-up at death for all assets and several other transfer-tax rules, if only for a year. As you undoubtedly know, the EGTRRA itself expires at the end of 2010, resulting in the 2011 return of the estate tax with a $1 million exemption, among other things. Except the story doesn't end there.

**Still Uncertain After All These Years**

Congress may seek to restore the death tax retroactively to January 1 (with presumably something akin to '09 parameters). Treasury Secretary Timothy Geithner voiced support for retroactive reimposition at a February 2 Senate Finance Committee hearing. The problem is, retroactivity may not be constitutional.

"If an existing law is merely being modified, the courts have given great discretion to Congress to make that retroactive," says Mark Luscombe, the principal federal tax analyst at business-information provider CCH Inc. "But when a new law is being created, it's less clear whether retroactivity can be applied, although there haven't been any cases that have denied it."

The longer Washington dillydallies, the stronger the argument against retroactivity, potentially. "A brief period without an estate tax makes retroactive reinstatement look like a fix of an old law. There's more of a constitutional issue if Congress puts the tax in retroactively after some time without it," Luscombe says.

Meanwhile, at a February 4 press conference, Senate Majority Leader Harry Reid, D-Nev., was asked if the estate tax would be addressed in a jobs package. "Not in the near future," he responded.

**Now What?**

With estate tax uncertainty accreting by the day, advisors and clients alike are breathless with anticipation. "We spent January, along with our clients, in a state of mutual confusion," confesses Norvell E. Brasch, special counsel at Holme Roberts & Owen LLP in Denver. "It has been a little difficult to put a finger on exactly what to do."

The fog is particularly thick around 2010 deaths. How do you handle an estate knowing a tax might later be imposed on it? Already there are stories about heirs hounding executors to distribute assets quickly while there is no estate tax is on the books.

But distributions this year won't necessarily get them off the hook for taxes, says attorney/CPA Kenneth P. Brier, a partner at Brier & Geurden LLP in Needham, Mass. "The estate tax will or will not be imposed on 2010 estates depending on any effective date, possibly retroactive, that Congress might impose, not on the happenstance of when the executor might make distributions," Brier says.

Even so, if the death tax is imposed retroactively and beneficiaries receive less than they would have under present law, attorneys say that they'll go to court over it if the estate is large enough. Even if Congress allows executors to elect either 2010 law or reinstated rules, that might simply trigger a lawsuit by family members who come out worse under the executor's

election. “It’s a question of whose ox is getting gored,” Brier says.

**Planning To Live**

Most clients won’t pass away in 2010, of course, and they figure they will owe estate tax, as they did in the past. So to a great extent it’s business as usual at Oshins & Associates LLC, a Las Vegas estate-law boutique. “We are still using a lot of advanced techniques to save estate taxes and are planning as though Congress may enact a retroactive tax,” says Steve Oshins, a firm principal.

Nevertheless, there is no estate tax today, and plans must account for that, too. Some clients may benefit from having their estate-planning documents amended or redrawn during this unusual period. In such cases, the lawyer should build in maximum flexibility, according to attorney Melissa Montgomery-Fitzsimmons, director of wealth planning at First Western Trust Bank in Denver. She says, “The best language is along the lines of, ‘If at my death the federal estate tax does not exist or does not apply to my estate, then follow one set of instructions. If the tax does apply to my estate, follow these other instructions.”

But we’re getting ahead of ourselves. The planning process begins with a formal review of the plan with the client. Brasch says, “The real question is, ‘If you die today, does this plan accomplish what you want?’ The conversation starts on a non-tax basis.”
Once the client has articulated objectives, walk her through her documents. That will reveal any unintended consequences or ambiguities if this year’s anomalous rules suddenly had to be applied.

For instance, Montgomery-Fitzsimmons recently helped a woman whose trust agreement read, “Give as much as can pass estate-tax-free to my heirs, and give the rest to charity.” With no estate tax this year, charity gets nada if she dies. The client was asked to put a figure on her charitable intent and the $5 million she indicated was then funneled to a private foundation, which yielded an additional benefit because it involved family members in philanthropy.

A more common problem is the divvying up of assets between the marital-deduction and exemption (or “family”) trusts. “Based on the laws today, one of the trusts might end up with all the assets,” Montgomery-Fitzsimmons says. Someone could get disinherited that way—probably not the client’s objective.

**Adventures In Basis**

Another concern when all the money gets pushed into one pot is the inefficient allocation of the limited basis adjustments now allowed. An executor may step up the basis of any estate assets by a total of $1.3 million, in addition to stepping up by $3 million assets that pass to the surviving spouse, whether outright or in a qualified terminable interest property (QTIP) trust.

If the spouse receives nothing because of an ambiguous will or trust agreement, the marital basis adjustment is lost, and at a cost. After the permitted basis increases have been used, inherited property arrives with the decedent’s adjusted basis—in other words, the basis carries over to the heir—forcing inheritors to pay capital gains tax when selling appreciated assets.

Consider the terminally ill man who Kristin Tyler, an associate attorney at Oshins & Associates, recently met with. If the client passes away this year, his trust would send everything to the exemption trust and nothing to the marital-deduction trust. Tyler recommended an amendment to the trust that will pour into the marital-deduction trust the assets the heirs anticipate selling upon his death. Her objective: to give more assets a stepped-up basis and save the beneficiaries capital gains tax.

But this approach could backfire if the heirs later decide not to sell the assets. Passing too much property to the surviving spouse could cause extra estate tax at the survivor’s death.

**To Gift, Or Not To Gift**

The $1 million lifetime gift-tax exemption remains intact for 2010 but the tax on gifts has fallen. It’s now 35%, compared with 45% last year. But don’t get too excited. Oshins says, “I would not suggest anyone pay a gift tax today under the belief that there won’t be a retroactive gift tax that is higher.”

His advice now is to pursue gifting strategies that can be curtailed later. “Wealthy individuals should get their valuation discounts done this year because Congress might restrict them to some extent in 2011,” Oshins says.

Now is also the time for GRATs, or grantor-retained annuity trusts, he adds. Individuals who create and place property in

these trusts today must outlive the term of years set in the GRAT in order for the property to fully escape estate taxation. There's talk in Congress of upping the minimum term to ten years.

Perhaps the greatest opportunities lie in transfers of wealth to grandchildren or later descendants—that is, generation-skipping transfers. "It could also be the area with the most risk," says Brier, the Massachusetts attorney/CPA.

There is no generation-skipping transfer tax this year. "So in theory," Brier says, "you could make unlimited gifts that skip a generation—no estate tax or gift tax payable by your children on the assets—for the price of a 35% gift tax after you've used your $1 million lifetime gift-tax exemption." But that's for the high-stakes gamblers, he says, because the gift tax could be increased to 45% retroactively while the generation-skipping transfer tax, which was also 45% in 2009, could also be imposed retroactively and in any event is set to reappear in 2011. "A lifetime generation-skipping transfer attracts both gift tax and GST tax," Brier says.

Technically, the tax isn't repealed this year. "The code provisions are still there; there's just no tax being imposed," Brier says. "The question is, if you make a gift to a generation-skipping trust this year, can you apply a GST exemption so that if the tax exists in the future, the applicable trust assets will be exempt from it?" That isn't clear, he concludes. "Generation-skipping is the most bollixed area of the law."

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