

The Estate Tax - What Now?

By Daniel A. Smith

As you know by now, it is 2010 and there is no Estate Tax. This article will briefly describe the current situation, the expectations, and strategies. This article is purely my opinion and speculation, coupled with years of experience. I am not trying to vet all the details here, just the framework upon which you can hang the strategies required.

While the House passed a permanent extension of the current Estate Tax system in 2009, Congress never acted on it prior to recessing for the year. That means that the final year of the Bush tax cuts is in place and the Estate Tax has been repealed. This also means Generation Skipping Transfer Tax (GSTT) is repealed, since GSTT is imposed at the maximum estate tax rate. This author does not expect that to continue, but more on that later. Keep in mind, if Congress lets this continue, in 2011 the current tax law sunsets and we go back to the prior law which means \$1,000,000 free of estate tax rather than today's \$3,500,000.

There are basically two possibilities at this point: Let it play out, or Fix it. Let it play out, means Congress does nothing, the "Bush tax cuts for the rich" expire and we go back to the old rules in 2011. Fix it means, Congress passes legislation early next session that retroactively retains the 2009 tax law from January 1, 2010, even though the law would be passed months later. Let's explore each briefly.

The "let it play out" scenario is an unlikely but devious way of substantially increasing the estate tax while blaming it on the other guy. (Note: I do not take sides politically in this debate, but understand that the people who pass or do not pass this ARE politicians and they DO have political popularity to consider.) Let's say I am a member of Congress and want to raise taxes. This is unpopular, thus I weigh my vote against the political backlash. On the other hand, what if I could raise taxes without voting? What if by simply waiting a year and giving up one year of estate tax revenue I could have an estate tax that affects a much broader segment of the population? Tempting I'm sure to many in Congress. After all, Goldman Sachs projects that US Government outlays will exceed income by \$1.6 trillion in the fiscal year that ends next September and by another \$1.4 trillion the following year. Tax revenues at the federal level are running at only 60% of spending levels, and let's not forget that nearly every state is running a deficit, too.

Client Strategy: A one year estate plan patch, to create an unlimited Bypass trust. If estate tax repeal stands for 2010 and your client dies this year, many would fall into the trap of leaving everything to their spouse – after all, there is no estate tax. If this were done, however, the opportunity to grandfather the trust against future changes, protecting it from current and future estate and GSTT as well as the creditors of heirs by creating a mega-funded Bypass trust would be limited or lost. Instead of being limited to the applicable exclusion amount, that Bypass trust could literally be any amount. Also, based on state law, the trust could continue for several generations, or in a number of states perpetually, without ever being subject to Estate, or GST tax. Nonetheless, the surviving spouse, children and further heirs could have access to all income for any reason, all principal needed to maintain their standard of living and even the ability to alter future beneficiaries. More access and flexibility than many are aware is allowed. The client, of course, would need to die since the repeal does not apply to Gift tax.

The “Fix it” strategy is more likely, in my opinion. It goes like this. “Sorry we were really busy last year with healthcare, but we meant to pass this and we are going to do it now. Repealing the Estate Tax is just a big give away to the rich, so we are permanently extending the 2009 tax laws forward retroactively to the start of 2010.” Three things: First, there is precedent for this kind of retroactive change to the Estate tax, see Bill Clinton’s first year in office. Second, there have been many side issues and variations that have been proposed, like limits on GRATs, Family limited partnerships etc. We won’t get into those here, let’s just stick to the existence of Estate tax for now. Third, there is a hybrid strategy which is to extend for one year and then do nothing, eliminating the year of repeal and then letting the laws return to the old system. No one would admit that was the plan, just that they couldn’t get agreement on a broader bill, feel estate tax repeal is a give away to the rich, so let’s patch it for one year while we work on a long-term solution, which then could be conveniently never agreed upon.

Client Strategy: If the system is fixed, then some version of the previous law is in place meaning an up-to-date estate plan still functions the way it did, and no significant changes are in order. Nonetheless a smart time to review one’s plan to ensure it is up-to date.

Summary Client Strategy: If you are a legal or tax advisor, assuming you have not done so already, I would feel compelled to contact all clients and say that a significant change has occurred in the estate tax laws and that changes to your documents are likely needed. If you are a financial advisor, and therefore discuss these issues, but are not ultimately responsible for legal or tax advice, I would contact all of my clients to mention the same as above, but steer them to their legal or tax advisor or a seminar mentioned later. Focus your one-on-one efforts first on those that you know have assets spread in many places, perhaps among several advisors. In order to address their estate issues have a conversation like Cannon’s “3 greatest risk factors” or “7-step Investment Interview”. This is a time when consolidation of accounts and care in the titling of assets is of real value. For your mass efforts consider a seminar, perhaps in conjunction with a lawyer and CPA, to do outreach not just among your client bases, but to the community as

a whole. Lead this effort. Do not wait to have all the answers, by then much of the opportunity will have passed. Be the person who reaches out, informs, and provides thought-leadership and your clients will stay and more will be attracted to you.

As always, at Cannon we will endeavor to keep you informed and armed with strategies that are client focused. Attend our programs to learn all of the details of the law or the conversation models discussed.

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