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DEATH AND TAXES:

The Estate Tax is Certainly Here to Stay!

BY GARY ALTMAN, ESQ.

With tax season upon us, I thought it would be timely to update you on the status of the federal estate tax. Well, friends, as it turns out, any possibility of a repeal of the estate tax is unofficially out the window! The estate tax is here to stay!

Certain Estate Tax Relief Act of 2009

While no one knows exactly what will happen or when it will happen, the first step in the process to permanently revise the estate tax laws has been the introduction of legislation in Congress. Called "Certain Estate Tax Relief Act of 2009" (H.R. 436), the bill proposes changes to the current estate tax law. The chances are good that Congress will enact legislation this year in order to avoid the full repeal of the estate tax, which is currently set to occur in 2010 (and then revert back to a 1 million exemption in 2011 and thereafter). Let's take a look at what this bill (HR 436) could possibly mean for many of us.

The Exclusion Amount

The exclusion amount (the amount you can pass to your children and others without any federal estate tax) will be permanently set at $3.5 million. Estates in excess of $3.5 million will be taxed at a rate of 45%. Estates in excess of $10,000,000 will be taxed at a rate of 50%. While these rates are still lower than the maximum rate in effect prior to 2001, they are still so high that advanced estate planning should still be a priority.

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Discounts on Passive Assets

Discounts on passive assets are to be repealed. The discount for lack of control and marketability, a mainstay of current estate planning techniques, will no longer apply to transfers of interest in entities that hold non business assets. This means that if you transfer an interest in an entity that is controlled by members of your family, your interest in the entity (no matter how small) must be valued without the traditional valuation discounts. However, if persons unrelated to you control the entity, valuation discounts could still apply.

Under current law, when an individual transfers an interest in a closely–held family entity, during life or at death, the interest would be valued by appraisers applying both a lack of marketability discount and a lack of control or minority interest discount (since it is difficult to sell an interest in a non-publicly traded entity, especially if that interest does not control the entity). The proposed bill in Congress disallows all valuation discounts for transfers of interests in closely-held family entities for all transfers after the date the bill is enacted. This means that if you are contemplating transferring any interest in a closely-held family entity where a valuation discount would be important, it is imperative that any be completed before Congress acts.

So, if you plan on making a gift of an interest in a closely-held entity or entering into a transaction taking advantage of a discounted interest (such as a sale to a Grantor trust) this calendar year, it would be best to get your planning completed immediately.

Portability

There is another proposal before Congress on portability of the estate tax exclusion. Portability means that if your

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spouse dies you can use any exclusion (currently $3.5 million) that he or she did not use at time of his or her death (or during life). So, if your spouse dies and leaves you everything, your spouse did not use of any of his or her exclusion. Thus, the unused exclusion is added to your exclusion. Then, at your death, you can pass Federal estate tax free to your children and other heirs up to $7.0 million (under current law). While this sounds wonderful for its simplicity, it may not be the best way to plan:

1. Any appreciation after the first death will still be subject to estate tax.

2. The surviving spouse may get remarried and not leave anything to the first deceased spouse's children.

3. The surviving spouse can end up in a nursing home or be sued, thereby subjecting all of the assets to these creditors.

4. Since many states have estate taxes at levels below the Federal exemption, portability could mean less Federal estate tax and more state estate taxes.

5. Estate planning is much more than tax planning, but with portability, many people may be fooled into thinking that it is no longer necessary to do estate planning.

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The Bottom Line

Even though the chances are good that Congress will act this year, it is also possible that Congress will not enact any tax legislation and instead let the Bush tax cuts phase out after 2010. That means that in 2011, the estate tax exclusion will be $1 million and rates will be as high as 55%.

The bottom line is that estate planning continues to be a process that involves changes when the tax laws change and when your family situation changes. It is also important to make sure that the right persons are selected to make decisions for you, in the event you can no longer act for yourself. And, it is important to make sure that your decision makers have the ability to access your medical records. There is no better time than the present to make sure that all of your affairs and beneficiary designations are correct, both in terms of tax savings and in terms of making sure that the right persons receive your assets at the right time.

For regular updates on the Federal estate tax, follow our estate planning blog, *Altman Speaks.*

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