

# DYING TO PAY TAXES: CONGRESS DOES IT AGAIN...THE ODD FUTURE OF THE ESTATE TAX: GONE IN 2010: BACK IN 2011!

(December, 2003 Newsletter)



## Introduction:

For those of you not yet angry at Congress, perhaps the story of the current confusion as to the Estate Tax will inspire you to the state of annoyance most attorneys and accountants in estate planning have expressed.

Because the way Congress left the law in 2001 resulted in an estate tax slowly, ever so slowly, being reduced between 2002-2009 ending with it being *entirely eliminated in 2010...BUT* then *entirely reimposed at the 2001 rate on January 1, 2011*. Thus, what could cost you zero in estate taxes on December 31, 2010 will cost you perhaps ten million dollars a day later! (Recall estate tax is at 55% in 2011 and zero in 2010!)

How do you plan for that when you don't know if you will die in the "magic year" of 2010? That is discussed in this newsletter...

## THE DISAPPEARING TAX BREAK...

In June of 2001, President Bush signed into law the Economic Growth and Tax Relief Reconciliation Act of 2001 ("ACT") and the portion of it relating to estate and gift tax is the subject of this article.

The Act phases out and repeals by 2010 the FEDERAL ESTATE TAX and repeals the federal generation-skipping transfer tax; retains the federal gift tax in modified form with new reporting requirements; and substantially eliminates the step up in basis at death for income tax purposes in favor of a modified carry over basis.

The current tax laws are reinstated in full, however, on January 1, 2011. In other words, the new law that repeals the estate tax and the generation skipping transfer tax is, itself, eliminated in 2011 by a "sunset" provision and, unless there is further legislation, in 2011 we will be right back where we were in 2001. Put another way, unless you are "lucky" enough to die in 2010, you could end up with a disastrous estate plan.

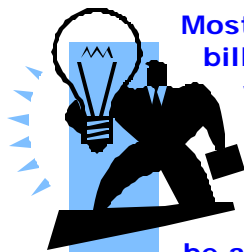
Graphically, it works like this:

The estate and gift tax law in 2001 had a \$675,000 exemption (unified for estate and gift tax) which means you can give away up to \$675,000 over your life and by your death before taxes are due. Thereafter, the rates begin and they top out at 55%.

The new law provides as follows

YEAR	EXEMPTION	HIGHEST RATE
2004	1.5 MILLION	48%
2005	1.5 MILLION	47%
2006	2 MILLION	46%
2007	2 MILLION	45%
2008	2 MILLION	45%
2009	3.5 MILLION	45%
2010	NO TAX	TOP INDIVIDUAL INCOME TAX RATE FOR GIFT TAX ONLY
2011	1 MILLION?	55%?

Study the figures above and you will quickly determine why it is increasingly difficult to make intelligent tax planning for estates and trusts. An estate worth ten million dollars will pay no taxes in 2010 and could easily pay four million dollars in taxes a week into 2011. Complex plans to cut that make perfect sense for 2011 but may distort the wishes of the family and cost tens of thousands of dollars...for nothing...in 2010!



Most experts predict that the Legislature will have to pass a new bill and that this ploy...taking the credit for reducing taxes while actually not reducing them significantly or permanently...will backfire as the year 2011 approaches. Perhaps...but the risk could be losing half of what you accumulated over your life and to assume intelligence and common sense on the part of the Federal Government may be a optimistic view...given the terms of the law they did pass.

And note that the income tax advantage of the estate tax law...the stepped up basis for property (if you inherit, the capital gains basis gets a new value based on fair market value as of date of death) also is modified and reduced. The cynics predict that this benefit will be left to die while the estate tax is allowed to come back.

Note also that GIFT TAX is not repealed and its top rate, in 2010, is the top income tax rate at that time. The gift tax exemption is frozen at one million dollars from 2002 forward. Generally, any transfer to a trust will be

considered a taxable gift unless it is, essentially, revocable (thus of little use for estate tax planning.)

## WHAT TO DO?

1. The fact that you are reading this newsletter means you already have one weapon: you know what is going to happen until 2011. Most people do not and while there was some initial outcry when this law passed, the sad fact is that Americans think in short term increments and 2011 seems a long time away.

2. But the plan you must make to protect your family is NOW, not in 2011 since the underlying truth of estate planning is that when the documents become effective you are no longer there to change them...right?

3. So NOW is the time to ponder what to do and to do it with good tax and legal advice. What does that mean?

a. Compute, or have your CPA compute, what your estate tax would be if you die for each year both in the period before 2011... *and after*. Find out how much money we are talking about. Be sure to plan for both your own death...and the simultaneous death of you and your spouse. (Unless you are quite elderly, the chances are you and your spouse will die together in an accident so do not ignore that very real danger.)

b. If the Tax is significant, taking into account inflation of real property in your area, create TWO estate plans...and make the plans now how to integrate them so that you can transition back and forth quickly should the law change...or not change. Make no plan that does not allow such flexibility. (For example, permanent gifts to lower your estate to avoid the danger of 2011 permanently eliminate your access to assets that may be vital for you if the economy goes badly...and cannot be retrieved without gift tax being paid once again!)

c. Do not expect your plan to be elegant or perfect. You are doing what you can but until we get closer to 2011 we will not know for sure what the situation is likely to be. This is a compromise solution.

d. Do NOT distort your family situation assuming either the good times of 2010 or the disaster of 2011 is likely. We simply do not know. Seek flexibility in your structure, know that such flexibility may have some tax cost, and be ready to switch from one plan to the other as the situation clarifies.

e. Watch Congress. Follow the changes in the law...if any. Keep in touch with your CPA and attorney and know this: more than half your wealth depends on you understanding the current "flim flam" of the law and if you wish to protect your family this is a task you must undertake seriously.

*Perhaps some humor is what we need as we watch Congress, like cheating children, try to fop off this game playing as a real tax reform, leaving for a Congress ten years later the hard choices they have created. Or perhaps it is our fault in that we seem to elect people who do not have the courage to make the hard choices? There is an old Turkish proverb that might be appropriate: "When you speak the truth, have a foot in the stirrup."*

