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Congress and the Estate Tax:

*Some Cynical Prognostications on
Legislative Behavior*

With all of the political turmoil raging on Capitol Hill, it is little wonder that the estate tax has taken a back seat to other controversial legislative matters. Since the clock is ticking on a significant change in the current tax regime set in motion by the Economic Growth and Tax Relief Reconciliation Act of 2001 (“EGTRRA”), Congress will be called upon to act twice before the end of 2011. Specifically, EGTRRA eliminates the estate and generation-skipping transfer (GST) tax (but retains the \$1 million gift tax exclusion) at the end of 2009. Beginning January 1, 2011, all provisions of EGTRRA are scheduled to “sunset,” meaning that the estate, generation-skipping, and gift tax exclusions all reset and unify at \$1 million.

Current Estate Tax Regime. By way of a refresher, an estate tax and GST tax exclusion of \$3.5 million is in effect for 2009, along with the lifetime gift tax exclusion of \$1 million. These numbers mean that a person may give up to \$1 million during life to his or her heirs without incurring any gift tax, and may pass up to \$3.5 million at death without incurring any estate or GST tax. There is, however, a dollar for dollar reduction in the \$3.5 million estate and GST tax exclusion for gifts made during life that exceed \$13,000 per donee per year.

The Efforts to Change. Numerous legislative efforts have been proposed, from both sides of the aisle, to alter the temporary estate tax repeal in 2010 and the \$1 million reversion in 2011. As of June 1, 2009, fifteen bills (not counting companion bills) had been introduced in both the House and Senate. The proposed legislation ranges from complete repeal of the estate tax to an increase in the exclusion to \$5 million. Other bills would retain the \$1 million gift tax exclusion separate from a higher estate and GST exclusion.

Great Idea, But Will It Work? A few of the proposals included a concept known as the “portable” estate tax exclusion, which generated some (short-lived) excitement in the tax community when it was revealed for discussion. Under this proposal, a married couple could elect to shelter their combined estate tax exclusions without the need for complex estate planning documents. However, the survivor would still be required to file a Form 706 Estate Tax Return, the cost of which could easily exceed the legal fees for the estate planning documents. Furthermore, legislators did not resolve the complexities of multiple marriages and asset tracing on the election. The most troublesome aspect of the proposed portability is that the IRS will have until the death of the second spouse to audit the estate tax return of the first spouse to die and assess any estate tax deficiencies. If the spouses differ significantly in age or health, decades might pass before the audit of the first estate. Thus, while taxpayers might benefit from the cost savings of implementing less complex estate planning documents and elimination of the estate tax exemption trust, the portability exemption may end up being more expensive and cumbersome for both taxpayers and the government.

Predictions by Cynics Prevalent. Predictions as to the resolution of the pending sunset of the estate tax have been complicated (or, viewed in a cynical way, simplified) by the continually increasing budget deficit and national debt. The legislative proposals made in 2009 predate the debate over the cost of cap and trade legislation, health care reform and other costly Presidential programs and objectives. In addition, the legislative spending enacted since last January, combined with shortfalls in federal revenue, seems to have eliminated serious consideration of an increase in the estate tax exclusion beyond the current \$3.5 million. Congress simply cannot afford to allow the estate and gift tax to expire. Instead, it is predicted that the current exemption will be extended into 2010 by a so-called “patch” on EGTRRA, giving this Congress a continuing estate tax income stream for next year. It will, more importantly, give them time to sit and watch the sunset at the end of 2010, after which the estate tax will apply to anyone with an estate in excess of \$1 million in 2011 and beyond. It is difficult to argue with the inevitability of this scenario.

Cynics notwithstanding, there are few certainties in predicting the outcome of legislation on the federal estate tax. Come what may, it can be said with certainty that good estate planning documents should be drafted with flexibility to respond to the wide range of possible estate tax exclusion outcomes. Estate tax provisions in wills and trusts can be structured to take advantage of a number of scenarios through contingent terms and alternative dispositions. Accordingly, the most prudent course of action is to ensure that one’s estate plan is current and to be prepared for whatever Congress may decide in 2010. Stay tuned.

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