ESTATE PLANNING IN TIMES OF LEGISLATIVE UNCERTAINTY

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32ND ANNUAL NASBTS CONFERENCE

OCTOBER 2011

Since the enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"), estate planners have struggled to educate and advise their clients against a backdrop of rising exemptions and falling marginal rates, the potential one-year repeal of the estate and generation-skipping transfer ("GST") taxes in 2010, and the 2011 reinstatement of the gift, estate, and GST taxes to their 2001 levels. As discussed below, the 2010 Tax Act pushed the quest for legislative stability two years down the road, providing for a return to 2001 law after December 31, 2012. Despite this uncertainty, the 2010 Act provides a number of opportunities between now and the end of 2012.

I. EXAMINING THE PAST.

A. **The Reign of EGTRRA**. Benjamin Franklin wrote in a letter to his friend Jean-Baptiste LeRoy, "our new Constitution is now established, and has an appearance that promises permanency; but in this world nothing can be said to be certain, except death and taxes." EGTRRA -- at least with respect to the estate tax -- made us reconsider Franklin's oft-quoted aphorism. The provisions of EGTRRA, which spanned a 10-year period, culminated in 2010 with complete repeal of the estate and GST taxes for one year. EGTRRA was the first legislative success for those wishing to permanently repeal the so-called "death tax."

B. **Brief Summary of The EGTRRA.**

1. EGTRRA was considered in the House of Representatives on May 16, 2001 and, after a relatively short debate, the bill was passed the following day and sent to the Senate. President Bush signed the Economic Growth and Tax Relief Reconciliation Act of 2001 into law on June 7, 2001.

2. Key EGTRRA Changes.

a) Estate Tax Exemption. Under prior law, the effective exemption for estates would have been $700,000 in 2002, rising gradually to $1,000,000 for decedent's dying in 2006. Under EGTRRA, the estate tax exemption rose to $1,000,000 in 2002, then to $1,500,000 in 2004, $2,000,000 in 2006, and to $3,500,000 in 2009. The exemption for 2010 decedents was effectively zero, as EGTRRA repealed the estate tax for persons dying in 2010.

b) Estate Tax Rates. The top effective marginal tax rates on estates and gifts fell from 60% (a top marginal rate of 55%, plus a 5% surtax on large estates) under pre-EGTRRA law to 50% in 2002, and gradually decreasing to 45% in 2007. Again, the rate for 2010 was effectively zero, as the estate tax was repealed for 2010 decedents.

c) GST Rates and Exemptions. The applicable GST tax rate (computed by reference to the highest marginal estate ax rate in effect at the applicable date) decreased with the changes in the estate tax rate. In addition, the $1,000,000 GST exemption, which prior to EGTRRA was indexed for inflation, was tied to the estate tax exemption, thereby rising to $3,500,000 for transfers made in 2009. As with the estate tax, EGTRRA also repealed the GST tax for generation-skipping transfers occurring in 2010.

d) Gift Tax Rates and Exemptions. Prior to EGTRRA, the estate and gift taxes were unified, using common rates and exemptions. EGTRRA "de-unified" this system. While the gift tax rates followed the gradual decrease in the estate tax rates, the available gift tax exemption increased to $1,000,000 and remained at that level, through and after 2010; that is, the gift tax was not subject to the one-year repeal in 2010.

e) Carry-Over Basis. For 2010, in place of the estate tax, EGTRRA enacted a modified carryover basis regime, allowing for the allocation of $1,300,000 of basis increase over a decedent's assets, with an additional $3,000,000 of basis increase for certain property passing to a surviving spouse.

f) State Death Taxes. EGTRRA gradually reduced the credit against federal estate tax available for state death taxes paid, ultimately converting the credit to a deduction for estates of decedents dying after 2004. With the repeal of Section 2011 after 2004, many states which computed their estate tax by reference to the credit allowed under that section basically had their estate repealed.

C. **Constraint Adding to Uncertainty.** EGTRRA's one-year repeal of the estate and GST taxes was product of the so-called "Byrd Rule." The ninth and last title of EGTRRA is titled "Compliance with Congressional Budget Act" and contains Section 901. Section 901 is entitled "Sunset Provisions of the Act," and Section 901(a) states that "all provisions of, and amendments made by, this Act shall not apply...to estates of decedents dying, gifts made, or generation skipping transfers, after December 31, 2010". This section of EGTRRA was created in order to comply with the Congressional Budget Act of 1974 and, most importantly, with the 1990 amendment. In addition, Section 901(b) of EGTRRA provided that the Internal Revenue Code "shall be applied and administered to years, estates, gifts, and transfers described in subsection (a) as if the provisions and amendments described in subsection (a) has never been enacted."

1. Quick History of Byrd Rule. Throughout the 1980s, Senators often abused the budget reconciliation process by attaching unrelated (special interest) provisions to reconciliation bills. Such special-interest provisions did not violate the Budget Act of 1974 since they were not amendments and were not subjected to filibustering under the Act. In order to limit these tactics, Senator Robert Byrd (D-WV) submitted a Budget Act Amendment which allowed Senators to raise a point of order to provisions that were "extraneous" to the reconciliation bill. For these purposes, an extraneous provision was one that reduced federal revenues in years beyond that covered by the reconciliation bill to which it was attached. Under the Byrd rule, a point of order would be waived with a supermajority vote of 60 Senators. The intent behind the Byrd Rule was to make it difficult to use the quick reconciliation process to enact legislation that would increase long-term budget deficits.

2. Since the 2001 budget resolution covered a ten-year window, the revenue loss created by a permanent repeal of the estate and GST taxes beyond 2010 would be "extraneous". Thus, EGTRRA was structured with a one-year repeal of the estate tax in 2010, thereby avoiding any prospect of a Byrd Rule challenge and ensuring that the tax cuts could be enacted through a simple majority in the Senate.

II. A TEMPORARY STALL-OVERVIEW OF 2010 TAX ACT.

A. **Year of the Repeal**. The end of 2009 came and went with Congress allowing EGTRRA to sunset. As a result, entering 2010, the estate and GST taxes, but not the gift tax, were repealed for one year, and the modified carryover basis provisions of Section 1022 was in effect. As summer passed into fall, and with no concrete legislation on the horizon, planners prepared for the return to the 2001 transfer tax regime: a $1,000,000 exemption for estate and gift taxes, a 55% maximum rate, and a $1,360,000 GST exemption.

B. **2010 Tax Act: Temporary Certainty**. President Obama signed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 into law on December 17, 2010 ("2010 Tax Act"). Under the 2010 Tax Act, the Bush tax cuts under EGTRRA were extended for only two more years, and specific alterations were made to the application of the estate, gift, and GST taxes. With the sunset of the 2010 Tax Act at the end of 2012, we will look to Congress again to see whether they enact new transfer tax legislation or whether the transfer tax regime will revert to the 2001 tax law.

1. Brief Overview of the 2010 Tax Act Transfer Tax Changes:

a) Extended EGTRRA sunset for two more years, until December 31, 2012;

b) Increased estate tax exemption to $5,000,000 (with indexing starting in 2012);

c) Decreased maximum estate tax rate to 35%, retroactively applied to January 1, 2010;

d) Provided the estates of 2010 decedents dying before the December 17, 2010 enactment of the 2010 Tax Act with ability to elect out/opt out of the estate tax and into a carryover basis regime;

e) Increased the GST exemption to $5,000,000, retroactively applied to January 1, 2010, and provided an applicable GST tax rate of 0% for 2010, and 35% for GST transfers made after December 31, 2010; and

f) Enacted provisions allowing for portability of the unified credit between the deceased spouse and the surviving spouse.

2. Decedent's Dying in 2010. Prior to the enactment of the 2010 Tax Act, there was much debate around the constitutionality of a retroactive application of the estate tax in 2010. However, any constitutional challenges were defused by the two options which are contained within the 2010 Tax Act for estates of decedents dying in 2010.

a) *Option 1- Retroactive Estate Tax*. The default rule under section 301(a) of the 2010 Tax Act applied the estate tax retroactively back to January 1, 2010, with an increased estate tax exemption of $5,000,000 per person, a maximum estate tax rate of 35%, taking effect at $500,000, and a fair market value basis adjustment for the estate's assets.

b) *Option 2- Carryover Basis Regime*. Alternatively, section 301(c) of the 2010 Tax Act permitted an executor to elect, or "opt out," of the default retroactive estate tax by choosing to subject the estate to the modified carryover basis rules of section 1022 of the Code (commonly called the "Section 1022 Election"), which were imposed in 2010 under EGTRRA. To make such election, the executor of an estate must file

Form 8939, "Allocation of Increase in Basis for Property Acquired From a Decedent." Once this election is made, it is revocable only with the consent of the Secretary of the Treasury, absent exceptions discussed later.

3. 2010 Estate Tax Returns.

a) *Due Date for Form 8939*. The Form 8939 was finally issued on October 6, 2011; the instructions to the Form were issued on October 25, 2011. In light of the late issuance date, the Form is not due until January 17, 2012.

(i) *Final Guidance on Carryover Basis*. IRS Notice 2011-66 provided guidance on the time and manner in which an executor of an estate of a 2010 decedent could elect under the 2010 Tax Act to have the estate tax not apply and, rather, have the carryover basis rules apply to the decedent's estate. Under Notice 2011-66, the original due date for Form 8989 was on or before November 15, 2011. However, in light of the delay in issuing the final form and instructions, Notice 2011-76 extended the due date for Form 8989 until January 17, 2012. If a Form 8939 is filed prior to this date, it may be amended or revoked by a subsequent Form 8939 filed on or before January 17. In Notice 2011-66, the IRS stated that it will not grant extensions of time to file Form 8939 and will not accept Form 8939 or an amended form after the January 17, 2012 due date (unless an exception is applicable).

(ii) *Exceptions Allowing for Supplemental Forms 8939*. Although the due date for the Form 8939 is January 17, 2012, Notice 2011-66 and the instructions to Form 8939 provide four limited exceptions where it will apply relief and allow for an amended Form 8939 to be filed:

(a) An amended Form 8939 may be filed after the due date for the sole purpose of allocating a Spousal Property Basis Increase, as long as two requirements are met: (1) Form 8939 must have been timely filed and complete except for this spousal allocation, and (2) each amended Form 8939 was filed no more than 90 days after the date of distribution of the qualified spousal property.

(b) An executor may file an amended Form 8939 under the automatic six-month extension provisions of §301.9100-2(b) on or before July 17, 2012 for any purpose other than to make or evoke a Section 1022 election. Such relief is permitted so long as the executor timely filed the original Form 8939 for the year the election should have been made, and the executor takes such corrective action within six months of such timely filing. *Note: The executor must write "Filed Pursuant to Section 301.9100-2" at the top of such amended Form 8939.*

(c) The executor may apply for relief under §301.9100-3, to receive an extension of time to allocate any Basis Increase that has not previously been validly allocated. This relief is only permitted in the following two circumstances: (1) the executor discovers additional property after filing Form 8939 and/or (2) the fair market value of property previously reported on the original Form 8939 has been adjusted in an IRS examination. Additionally, an amended Form 8939 under this relief provision may only allocate additional Basis Increase which was not previously allocated to such property- it cannot reduce an allocation Basis Increase already made on the original Form 8939.

(d) The executor may apply for relief under §301.9100-3 in the form of an extension of the time within which to file Form 8939, thus allowing for a 1022 election and allocation of Basis Increase. Relief may be granted only if the requirements of Reg. §301.9100-3 are satisfied. *IRS Notice 2011-66 states that the provisions of Section 9100 will be construed very narrowly in determining whether relief will be granted.*

(iii) *Who files Form 8939.* Generally, the appointed personal representative or executor is responsible for filing the Form 8939. However, if an executor was not appointed over a decedent's estate, any person in actual or constructive possession of property acquired from the decedent may file a Form 8939 for the property he or she actually or constructively possesses. Additionally, 30 days after the executor files a timely filed Form 8939, the executor must provide a statement to each recipient acquiring property reported on the Form, providing information required under 6018(c), regardless of whether the executor actually allocated basis to the distributed property. The Schedule for such notice is found on Schedule A of the Form 8939, which requires (1) an accurate description of the distributed property, (2) adjusted basis for the property in the hands of the decedent, (3) the fair market value of the property at death, (4) the decedent's holding period of the property, and (5) the amount, if any, of basis allocated to each asset.

(iv) *Multiple Forms Filed.* If multiple Forms 8939 are filed or the IRS receives a Form 706 and a Form 8939 for the same estate and the filers do not agree on whether to make the election, the IRS will grant the filers a 90-day window within which to resolve their conflict and together file a single restated Form 706 or Form 8939. However, if the filers fail within the permitted 90 days to agree, the IRS will consider all the relevant facts and circumstances and will determine whether the election has been made and how the allocations should be granted.

b) *Due Date for Form 706 Estate Tax Return*. For decedents whose death occurred after December 31, 2009 and before the December 17, 2010 date of enactment of the 2010 Act, and who do not elect out of the retroactive application of the estate tax, the estate tax return, Form 706, is due by September 17, 2011. However, since September 17 falls on a Saturday, Form 706 is due on or before September 19, 2011. On September 3, 2011, mere weeks before the September 19 due date, the IRS issued the 2010 Form 706. For decedents dying on or after December 17, 2010, the traditional nine month filing deadlines apply. A revised Form 706 , applicable to post-December 16, 2010 decedents, has also been issues. The automatic six-month extension of time within which to file the Form 706 Is available.

c) *No Protective Filings*. Notice 2011-66 and the instructions to Form 8939 make clear that protective Form 8939 elections are not permitted. Thus, a taxpayer may not file both an estate tax return Form 706 and a conditional Form 8939, which would only be effective if an IRS estate tax audit results in increasing the gross estate above the exclusion amount.

4. GST. EGTRRA provided a so called "GST tax holiday" in 2010 by "repealing" the GST tax for one year under section 2664. Although EGTRRA eliminated the GST taxes for transfers made in 2010, the 2010 Tax Act reinstated the GST tax retroactively. Under section 302(c) of the 2010 Tax Act, the GST rates and application were reintroduced in 2010 with a $5,000,000 exemption. However, the GST 2010 tax rate was 0%, thereby still allowing taxpayers a "vacation" from GST tax in 2010 as originally intended and anticipated under EGTRRA.

a) Even though an executor may elect out of the estate tax under the 2010 Tax Act, they may not elect out of the GST tax. Section 301(d)(2) of the 2010 Tax Act extends the due date for filing a return for any GST transfer made after December 31, 2009 but before December 17, 2010 to September 17, 2011 (actually September 19, as mentioned above). However, if the executor of a 2010 decedent makes a Section 1022 election (the carryover basis election), the executor allocates the decedent's available GST exemption by attaching Schedule R to Form 8939. In that case, Schedule R will be due by January 17, 2012. For GST transfers made in 2011 and 2012, the 2010 Tax Act maintains the increased exemption level at $5,000,000 and applies a maximum tax rate of 35%.

5. Decedent's Dying in 2011 and 2012.

a) *Estate Tax Rates and Exemptions.* Under the 2010 Tax Act, the estate tax exclusion remains at $5,000,000, with indexing beginning in 2012. In addition, the top marginal rate remains at 35%.

b) *Portability.* Under prior law, a taxpayer's estate tax exemption was nontransferable. Therefore, a decedent whose estate was below the available estate tax exemption, or who failed to fully utilize his or her estate tax exemption (e.g., because all property passed to the surviving spouse or to charity) wasted the unused portion of his or exemption. However, Section 303 of the 2010 Act enacted so-called "portability," under which any remaining unused portion of the decedent's $5,000,000 exemption can be made available to the surviving spouse, provided the first spouse's executor timely files an estate tax return, computes the deceased spouse's unused exclusion amount ("DSUEA"), and elects to have the unused exemption available to the surviving spouse. This election permits a surviving spouse to later use the unused estate and gift exclusion amount of the decedent spouse, so long as the surviving spouse does not remarry. Presently, this portability feature of the 2010 Tax Act is only available if the first spouse dies in 2011 or 2012 and the surviving spouse either dies or fully uses the combined applicable exclusion amount by gift or death in 2011 or 2012, since the portability feature is set to sunset in 2013 with the rest of the 2010 Tax Act. Also, any exemption of the surviving spouse which was inherited through portability will not be adjusted to reflect inflation.

(i) If the surviving spouse desires to use the decedent spouse's unused exclusion amount, section 2010(c)(5)(A) states that the executor of the decedent's estate must file a timely estate tax return where the executor of the decedent spouse irrevocably elects to provide his or her DSUEA to the surviving spouse.

(ii) Additional guidance regarding the portability election was made available in IRS Notice 2011-82. Among other matters, the Notice clarified that the first spouse's estate will be considered to have made the portability election merely be the timely filing of the Form 706.

(iii) This means that every estate must timely file an estate return to preserve the DSUEA. Also, portability is a federal estate tax concept. This means that there is no portability of state estate tax exemption amounts between spouses.

(iv) The statute also does not address the issue of spouses having simultaneous deaths.

(v) It is also important to note that portability only applies to the estate tax exemption and not to the GST tax exemption.

c) Gift Tax. Under the 2010 Tax Act, the gift tax exemption remained at \$1,000,000 for 2010, with a maximum gift tax rate of 35% for taxable gifts made in 2010. As mentioned before, the 2010 Tax Act reunified the gift tax with the estate tax for tax years 2011 and 2012, increasing the gift tax exemption to \$5,000,000 with the maximum gift tax rate remaining at 35%.

(i) *"Clawback" Debate.* There has been much discussion regarding the effect of making large gifts utilizing the current \$5,000,000 exemption, followed by reenactment of the \$1,000,000 exemption or the subsequent enactment of new law with a lower (e.g., \$3,500,000) exemption. Specifically, the concern is whether the donor's estate tax liability would be increased as a result of the relationship between the decedent's lifetime gifts and the computation of his or her estate tax liability.

(a) Generally, a decedent's estate tax liability is computed by determining the estate on a tax base equal to the sum of the decedent's taxable estate plus post-1976 lifetime gifts made by the decedent, and then reducing that amount by the gift tax that would have been imposed on the lifetime gifts. Specifically, Section 2001(b)(2), as in effect prior to the 2010 Act says that after calculating the tentative tax on the sum of the taxable estate and adjusted taxable gifts, there is subtracted "the aggregate amount of tax which would have been payable under [the gift tax] with respect to such gifts made by the decedent after December 31, 1976, if the provisions of subsection (c) [that is, the gift tax rates, and not exemption] (as in effect at the decedent's death) had been applicable at the time of such gifts."

(b) Because the Section 2001(b)(2) computation is subtracted from the gross estate tax in determining the decedent's estate tax liability, if the computation results in a lower amount, the estate tax will be increased. As written, the (b)(2) computation would use the rates in effect at the decedent's death, but would apply the higher (\$5,000,000) exemption in effect when the gifts were made. Because this would result in a lower gift tax offset to the gross estate tax, the decedent's estate tax would be increased by the recapture of some of the gift tax savings.

(c) In an apparent effort to avoid this result, Section 2001(g), enacted as part of the 2010 Tax Act, provides that when computing gift tax that is deemed to have been paid, the tax rates in effect at the decedent's date of death are to be used rather than the applicable rates at the time the gift was made. However, the language of Section 2001(g) again speaks to the gift tax rates in effect at the decedent's death rather than the rates and gift tax exemption then in effect.

(d) Moreover, section 2001(g) is scheduled to sunset with the 2010 Tax Act at the end of 2012, and there is a concern that without this section, the applicable tax exemption in effect on the date of the gift will be used to compute the gift tax that was previously paid.

(ii) *Uncertainty for the Future.* The debate about whether there will be such a clawback continues due to the lack of guidance over the proper interpretation of these provisions. Of course, if the 2010 Act provisions are made permanent, then there will be no recapture of the gift tax. Moreover, the consensus among persons who have spoken with Congressional staffers involved in the drafting of the 2010 Act appears to be that the clawback was not intended and will be fixed. However, Congress's actions cannot be predicted and we are left with uncertainty and speculation until clarifying action is taken.

III. 2012, 2013 AND BEYOND…

A. **Continued Uncertainty**. Unless transfer tax provisions are attached to other legislation, or made a part of the Bipartisan Debt Reduction "Super Committee" solution, there is nothing to indicate that Congress will address the December 31, 2012 estate tax "sunset" much before December of 2012. In the interim, then, estate planning will continue to take place in the midst of continuing uncertainty, with many clients taking a "wait-and-see" approach.

B. **Current Planning Options**. Given the historically high exemptions and low marginal rates currently in effect, there are great opportunities to move substantial wealth.

1. Planning for Decedent's Dying in 2010:

a) *Opt Out Election.* For estate of decedents dying after December 31, 2009 and before December 17, 2010, estate tax returns were required to be filed by September 17, 2011. However, if the automatic 6-month extension of time to file was made, the due date would be extended until May 17, 2012. Such an extension would also provide more time within which to decide whether to opt out of the estate tax and elect into the modified carryover basis regime of Section 1022.

(i) The opt out election may increase complexities and difficulties in the administration of the estate. Executors may find that potential capital gains and estate taxes do not fall equally among the beneficiaries and that some beneficiaries are benefited more than others by an election or lack thereof.

(ii) It is generally assumed that the choice to elect out of the estate tax and into the carryover basis regime would be clearer for taxable estates in excess of the $5,000,000 exemption level, since it would eliminate estate taxes in exchange for potentially higher capital gains taxes at some point in the future. However with the estate tax rate lowered to 35% and the maximum capital gains rate being 15% plus state capital gains tax, the intersection of the income and estate tax regimes are much closer than they have been in the past.

(iii) At the end of the day, estate planning attorneys will need to work through both estate tax and carryover basis regimes with the executor to determine whether or not to elect out. Some of the factors that will have to reviewed include (1) the size of the taxable estate; (2) the decedent's basis in his or her assets; (3) date-of-death value of the assets; (4) the nature of the decedent's assets, including the existence of hard-to-value assets such as LP or LLC interests; (5) the needs of the beneficiaries; and (6) the potential growth in value and earnings of the decedent's assets, to name a few.

(iv) <u>*GST Concerns*</u> The provisions of Section 2664, which stated simply that "This chapter [chapter 13 governing the GST Tax] shall not apply to generation-skipping transfers after December 31, 2009" created substantial uncertainty regarding the application of the GST tax in 2010 and beyond. The solution contained in the 2010 Act – to retain the GST tax in 2010 but make the rate equal to 0% for GSTs in 2010 -- was a simple solution that answered most of the questions regarding the applicability of Chapter 13. Questions remain as whether to allocate GST exemption to generation-skipping transfers -- other than outright direct skips -- made in 2010.

(a) GST exemption in respect to 2010 gifts should be reflected on a 2010 gift tax return.

(b) Similarly, allocations in respect of testamentary transfers affecting 2010 decedents are made of Schedule R of Form 706. However, for eligible estate electing out of the estate tax, the allocation is made by attaching the appropriate portions of Schedule R to the Form 8939.

2. Planning Issues and Opportunities in 2011 & 2012:

a) *Formula Provisions*. The dramatic increase in estate and GST exemptions may cause unintended results in estate plans utilizing formula bequests and allocations. Bequests to children tied to the available estate tax exemption may substantially deplete funds available to the surviving spouse. Similarly, bequests of the decedent's available GST exemption may overfund provisions for grandchildren at the expense of the surviving spouse and children. Consider placing hard dollar or percentage caps on some of these formula bequests.

b) *Optimize Exemption Amount.* The increase in the gift tax exemption from \$1,000,000 to \$5,000,000, at least through the end of 2012, provides a tremendous opportunity to make lifetime gifts and remove significant wealth from clients' estates. The increased exemption, in combination with family limited partnerships and limited liability companies, also allows significant leveraging of the \$5,000,000 exemption. It is important to note that whether or not the exemption remains at \$5,000,000 after 2012, it can be valuable to make use of the exemption now since this will allow for the maximum growth for post-gift appreciation and, if the exemption is decreased, not cause individuals to lose this increased planning opportunity.

(i) *Techniques for Optimization*. The leveraging techniques utilized before the enactment of the 2010 Tax Act still play a central role in many estate plans; however, the benefits of many of these techniques can be increased with the use of the increased exemption amount.

(a) Perpetuities Trusts. Using the larger gift and GST exemptions together to create substantial mutigenerational trusts.

(b) Sales to Grantor Trust. The larger exemption allow for more substantial "seed money" gifts to an irrevocable trusty, thereby allowing for larger asset purchases from the grantor.

(c) Life Insurance Trusts. Using the larger gift and GST exemptions to prefund future premiums.

(d) Grantor Retained Annuity Trusts. Annuity rates are usually set very high to reduce the taxable gift to zero or near zero. A larger gift tax exemption may encourage the grantor to retain a smaller annuity, allowing more property to remain in the GRAT at termination.

(e) Qualified Residence Trusts. Generally, QPRTs are not as beneficial in a low interest rate environment; however, given the higher gift tax exemption, a QPRT may be more palatable, especially where the settlor believe there is potential for substantial appreciation in the real property.

c) *Fear the Clawback?* If the estate tax exemption at a decedent's death is the same or higher than the gift tax exemption in effect during the decedent's life, then the clawback/recapture discussed above should have no application. Because of the uncertainty regarding what the gift and estate tax regime will be in the years following 2012, it is possible that the future estate tax exemption may be less than the current $5,000,000 level, potentially causing such a recapture of gift tax on the donor's death. For many clients, the benefits of removing future appreciation and income from their estates may outweigh what is perceived to be a minimal risk. One option is for the donees of a gift to contractually agree to pay any recaptured estate tax.

d) *Portability*.

(i) Under current law, both spouses must die before 2013 (or at least one must die and the other makes a significant taxable gift by the end of 2012 using the deceased spouse's unused exclusion amount in order to take advantage of portability. However, it seems reasonable to anticipate that portability will be on the books on January 1, 2013.

(ii) While portability may be very useful in simplifying the estate plans of many couples with smaller estates, its usefulness may not be as broad as some initially had believed, and tax planning, including the use of by-pass trusts, will ordinarily still be necessary.

(a) Relying on portability does not provide the asset protection provided by a testamentary trust.

(b) Relying on portability does not exclude post-death appreciation from the surviving spouse's estate, as a credit shelter trust might.

(c) Portability does not apply to the GST exemption, so failure to create a GST Trust at the death of the first spouse may cause the GST exemption to be wasted.

(d) Portability does not apply to state estate tax exemptions; therefore, clients living in states with an estate or inheritance tax must undertake affirmative planning to ensure that the state exemption is not wasted.

C. **State Law Planning Implications**. Through the interplay of EGTRRA and state estate tax statutes, many states no longer impose an estate tax. Some states, however, have taken affirmative steps to "decouple" their estate tax laws from the federal estate tax, and as result continue to impose an estate tax. Furthermore, in many of these jurisdictions, the available state estate tax exemption may be significantly lower than the $ 5,000,000 exemption available; as a result, in such "gap" estates, state estate tax returns will need to be filed even if a federal return is not required. Furthermore, as mentioned earlier, portability is a federal law concept and is not available for the transfer of state estate tax exemptions between spouses. Finally, in states that impose an estate tax but no gift tax, significant gifting utilizing the larger federal gift tax exemption may decrease the state estate tax liability without increasing federal gift and estate taxes.

D. **2013 and Beyond -- What's Next?** In trying to determine what the transfer tax laws will be on January 1, 2013, there are several possibilities:

1. Sunset. Congress does nothing, and the 2001 law returns, with a $1,000,000 gift and estate tax exemption, a top marginal rate of 55%; an indexed GST exemption of approximately $1.3-$1.4 million; and no portability between spouses.

2. Stability/Status Quo. Congress makes the current law permanent.

3. Stability/Less Generous. Congress eliminates the sunset provision, but reduces gift, estate, and GST exemptions and increases rates, perhaps to the 2009 levels of $3,500,000 and 45%.

4. Kick the Can Down the Road. Congress maintains the status quo by pushing the sunset date 1-2 years ahead, further preventing certainty.

5. Repeal. Congress repeals the estate and GST tax, and perhaps the gift tax.

Trying to divine what Congress will do in the next 13 months is a frustrating and, ultimately, unsuccessful undertaking. Flexibility remains the key.

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