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Tuesday, January 13, 2009

Planning for the Unknown for 2010 and Beyond - Carryover Basis and No Estate Tax or a Revised Wealth Transfer Tax System
Presenter: Jonathan G. Blattmachr
Reporter: John Warnick Esq.

2009 will represent a watershed year for estate planners and their clients -- $3.5 million estate and GST exemptions. How does one "profit" from these in light of the possibility of no estate or GST tax and only a 35% gift tax rate for 2010, where it is possible that radical changes to these tax systems will be enacted and might be retroactive? What you should and should not be recommending.

Jonathan Blattmachr opened his presentation with a frank discussion of the political risks facing President-Elect Obama.

He noted the front page story from the Wall Street journal on January 12th about a decision of the Obama administration to quickly move to block the repeal of the estate tax taking effect in 2010. Mr. Blattmachr noted, however, that later that day the U.S. Chamber of Commerce responded with a statement inviting the Obama administration to jumpstart the economy and create jobs by sending the death tax to the "grave once and for all."

The federal budget will be under incredible stress as President Obama has to deal with financing the economic stimulus package, lower revenues in 2009 from both income tax (because of the deteriorating business climate) and estate tax (because of increased exemption and lower asset values). The forecasts of the costs of President-Elect Obama's promised tax policy and expenditures suggested there would be a $3.5 trillion increase in the our national debt. That Mr. Blattmachr noted was before the economic downturn.

We may be underestimating the political risks President-Elect Obama is facing if he tackles the estate tax repeal dilemma. The neocons (neoconservatives), as Mr. Blattmachr referred to the proponents of estate tax repeal, firmly believe that the estate tax is a job killer. So if the Obama Administration saves the estate tax from extinction and the economy doesn't recover the neocons will criticize the new President for his flawed tax policy. So Mr. Blattmachr is suggesting that the safest political course for President Obama to take is to do nothing with the estate tax or income tax. Therefore, he argues we can not and should not discount the possibility that we will live to see repeal of the death tax in 2010 and carryover basis.

He also suggests in his outline that one resolution of the repeal dilemma that makes sense long-term in terms of raising revenue is an extension of the 2009 provisions into 2010 and then allowing the estate tax system to revert to pre-2001 law in 2011.

Mr. Blattmachr also threw out several possibilities which he believes will receive serious consideration as the new administration decides what course to take. One, which we have heard several other presenters mention, is imposing on GRATs a requirement of a remainder value of at least 10%. He also suggests that the QPRT exception from section 2702 may be eliminated. Finally, the third significant revenue raiser might be disallowing discounts for family entities unless a substantial portion of the entities receipts are from the public (i.e. operating businesses).

Should we plan for the possibility that there won't be any change in the estate tax system this year and we will have clients passing away in 2010 without any estate tax? Mr. Blattmachr's answer is a resounding yes! If so, what type of planning should we considering?

First, we need to be prepared to deal with carry-over basis. The decedent’s personal representative can allocate up to $1.3 million to increase the basis of assets (but not above the FMV at death). Should there be an independent, rather than interested, personal representative making these allocations of basis. Is there a potential legal or tax issue if a beneficiary holds that power of allocation? Mr. Blattmachr offered language to permit an interested fiduciary to allocate additional basis to assets which he or she will receive as well as language which would prevent any fiduciary from inadvertently making taxable gifts through the making of a basis adjustment allocation.

Next, Mr. Blattmachr reminded us of the importance of being prepared to deal with the "qualified spousal property" that comes into play if we have carry-over basis in 2010. In addition to the $1.3 million step-up in basis the decedent's personal representative can allocate up to $3 million to increase the basis of assets that the surviving spouse receives outright or through qualified spousal property. Mr. Blattmachr pointed out a potential trap that practitioners could fall into if they have drafted a plan that would still create a by-pass trust in 2010. If the by-pass trust wouldn't qualify as a QTIP trust then the decedent's personal representative won't be able to use the by-pass trust to take advantage of the step-up in basis opportunity through qualified spousal property. Mr. Blattmachr isn't suggesting that we leave everything outright to the surviving spouse in 2010 but rather the importance of making sure your plan will permit full absorption of the step-up in basis through qualified spousal property. To that end Jonathan Blattmachr offers suggestions in his outline for language that would give the decedent’s personal representative maximum flexibility in adjusting the basis of estate assets.

Mr. Blattmachr offered the Supercharged Credit Shelter Trust(sm), which is an inter vivos QTIP Trust, as one of his favorite strategies to consider in light of the uncertainty surrounding the unified credit.

The Supercharged Credit Shelter Trust(sm) is a credit shelter trust that maximizes the existing unified credit available to a decedent . The Supercharged Credit Shelter Trust(sm) avoids the tax inefficiency of mandatory distributions of trust income to the surviving spouse. The tax efficiency can be further enhanced by drafting the marital trust to permit the trustee to distribute principal from the marital trust and accumulate income in the credit shelter trust. The supercharging of the credit shelter trust comes from avoiding the DNI rules under subchapter J through grantor trust status. This results in the credit shelter's trust being taxable to the grantor even though no distributions are made from that trust. Mr. Blattmachr points out that the practical difficulty with existing this strategy through a will or revocable trust is that the surviving spouse can not be viewed as the grantor of the trust for income tax purposes. So he has clients create a lifetime QTIP but structures that trust so that if the grantor survives the spousal beneficiary of the QTIP that the trustee has discretion to make distributions of income and principal to the grantor. To make sure that the Supercharged Credit Shelter Trust(sm) isn't brought back into the estate of the grantor Mr. Blattmachr suggests his client establish the trust in a state where the grantor's creditors can't reach the assets of the trust.

Mr. Blattmachr further amplifies the tax efficiency of the Supercharged Credit Shelter Trust(sm) by suggesting that clients allocate their unused GST exemption to a lifetime QTIP so that it will be perpetually outside the reach of the GST tax. That benefit he suggests is huge even though the QTIP trust will result in estate tax if there is an estate tax in effect when the spouse who is the beneficiary of the lifetime QTIP passes away.

This period of economic turbulence and political uncertainty is what Mr. Blattmachr describes as a perfect storm for planning. He reminded us of several basic estate planning axioms. Transfers during life are more efficient than those at death. It is best to transfer property when values are low. Many wealth transfer planning strategies work best in periods of low interest rates. All of these conditions appear to be in play today. Finally, amidst all the current gloom in the economy and in the investment community he suggested we must remember that "in the long run values must increase."

So what are the additional techniques or steps Mr. Blattmachr is suggesting to his clients today?

> First, utilize the unified credit now.
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> Second, consider short-term declining GRATS (for instance Mr. Blattmachr is suggesting that you pay-out as much as the regulations will permit in the first year on the theory that allows you to not only lock in the success of a GRAT which has experienced a run-up but also allows you to reload a GRAT sooner). You can re-GRAT assuming the law hasn't changed. Don't do a two year steeply (20%) increasing GRAT and don't use a long-term GRAT. Mr. Blattmachr feels you have two problems with long-term GRATs: estate tax inclusion and the risk of poor investment performance.

Third, make all of your wealth transfers through grantor trusts which are designed with the ability to toggle that status off

Fourth, do extremely long-term installment sales to grantor trusts (but within the grantor's life expectancy to avoid the issues rose in PLR 9535026). Reset the AFR rate as it drops. Prepay when adequate appreciation has been achieved and consider reselling (i.e. the IDGT analog to the reloading of a GRAT).

Fifth, create and transfer family entities before the law changes and takes away the discounting opportunity

Sixth, consider QPRTS or Split-Purchase Trusts(sm) (a technique Mr. Blattmachr has pioneered).

Seventh, do a reverse freeze (the kids get the preferred and the parents get the common) with disregarded entities and a grantor trust. Mr. Blattmachr reported one valuation expert had suggested a 25% return might be necessary on the preferred in today's investment climate.

Eighth, CLATs.

In closing Mr. Blattmachr offered some suggestions to deal with the clients who are suffering from planning paralysis due to all of the uncertainty and economic turbulence. He called these suggestions to overcome the King Lear effect and the "I'm too poor" fears. He suggested using a Self-Settled Trust but giving someone the power to remove the grantor as a beneficiary. Removing the grantor on his or her deathbed shouldn't be a problem according to Jonathan Blattmachr. He suggested you study the Paolozzi case which dealt with the section 2036(a)(1) issue and he argued that section 2035 should not apply because there has been no transfer by the decedent.

Notes taken from www.abanet.org