Price & Farrington's Estate and Tax Planning *Fast*Facts

June, 2009

Estate, Tax and Family Wealth Planning for Advisors and Clients

Price & Farrington, PLLC
Attorneys and Counselors at Law
12501 Bel-Red Road, Suite 215
Bellevue, Washington 98005
425-451-3583
Email: contact@pricefarrington.com

Congress and Estate Tax Legislation: *Gazing Into the Crystal Ball*

Crystal ball-gazing to predict federal legislation is always a fool's errand. Five months into the Obama administration, the 111th Congress will probably do the least possible and at the latest moment when it comes to estate tax legislation. Congress has many larger issues than estate taxes to confront, and any short term or targeted response to the estate tax issue might not occur until late in 2009.

Repeal. Under the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) signed into law by George Bush way back in June, 2001, the federal estate tax is repealed for tax year 2010 (only to re-rear it's ugly head with a vengenace in 2011). This has created fodder over the past eight years for much morbid humor about the willingness of many children to keep their parents on life support until January 1, 2010, when the plug can be unceremoniousloy pulled and the estate transferred to the kids totally free of estate tax. Millions of dollars (maybe billions) in wealth would transfer unmolested by the tax man.

Not likely. In this time of explosive spending and the government's need to generate tax revenues to underwite its burgeoning costs, it's a safe bet that Congress won't allow this estate tax loophole to see the light of day. But given the difficulty Congress has had in the recent past accomplishing meaningful tax reform, passage of a bill that pays for the continued operation of the federal government might not occur until sometime in 2010 — presumably before any estate tax returns for deaths in 2010 are due. For Congress to make such a delayed legislative response *retroactive* to the beginning of 2010 would, in fact, be constitutional.

One bill in the hopper calls for a $5 million per person exclusion amount and a 35% maximum tax rate. Other bills call for extending the 2009 tax year's $3.5 million exclusion amount and a maximum rate of 45%. This is most often viewed as the likeliest outcome. As an example of proposed

Charles P. Farrington and Glenn D. Price

legislation, House Ways and Means member Rep. Jim McDermott of Seattle has introduced H.R. 2023 (known as the Sensible Estate Tax Act of 2009). Among other provisions, McDermott's bill would make the estate and generation-skipping transfer tax applicable exclusion amount $2 million with an inflation adjustment.

Portability. McDermott's bill and others would allow ***"portability",*** the ability of a surviving spouse to take advantage of any *unused portion* of the first spouse to die's ***applicable exclusion amount*** (that is the amount the law allows to pass free of estate tax) *without the need to do* ***credit shelter bypass trust*** *planning* on the first death. That would certainly simplify estate planning. The downside to this, though, would be a requirement that the executor file a ***Form 706 federal estate tax return*** on the first death in order to exercise an election to give the survivor portability. One purpose of portability is to take the taxpayer out of the transfer tax system — if you can transfer $7 million, few would pay tax. But you haven't accomplished this goal if the taxpayer still has to file the estate tax return on

The Evergreen Freedom Foundation presents:

"Planning for Life"

Legacy and Estate Planning for You and Your Family

A Free Workshop
Complimentary Buffet Luncheon
Thursday, June 25, 2009
9:30 a.m.-4:00 p.m.
Red Lion Vancouver at the Quay
Quayside Room
Vancouver, Washington
Speakers:
Glenn D. Price, J.D.
Alan W. Pratt, CEP, CAP

Learn about: Choosing the right tools; Using life values in estate planning; Tuning up your planning; Planning in a turbulent economy; Charitable and tax planning strategies; Where to get help in planning; other important topics

A day of great information and good conversation
Attendance is limited.
Registration is required.
For complete information and a flyer e-mail Irene Endicott by June 22 at
Iendicott@effwa.org
or
RSVP Laurie at
1-800-769-6617

A day well-spent if you, a friend, a family member or a colleague can attend . Registration is required.

the first death. If the lengthy 706 form were to be simplified (something else that is always discussed), filing might not be such an onerous requirement.

Bypass trust advantages. The overall impact of a lower *applicable exclusion amount* (allowing more to pass to a surviving spouse and escape tax on the survivor's death) and of *portability* might not be so significant. Why? Because there have always been significant advantages to setting up a *bypass trust* on the first death. Among these are: (1) asset protection planning for the surviving spouse; (2) avoidance of estate tax on appreciation of the assets in the bypass trust on the death of the survivor; and (3) the ability of the surviving spouse to make distributions from the bypass trust to the children and avoid gift tax. One caveat is that assets transferred into a bypass trust on the first death will not enjoy a ***step-up in cost basis*** on the survivor's death, as they would if the assets were owned by the surviving spouse on his/her death.

Washington estate tax. Keep in mind that many states, including Washington, have a separate stand-alone state estate tax. The current applicable exclusion amount in Washington is $2 million. It did not increase to $3.5 million in 2009. This means that tax planning that protects the federal exclusion amount of $3.5 million in 2009 protects only $2 million of the amount from state estate tax. The parlous budget deficits that states like Washington are experiencing makes it very unlikely that state legislators will be interested in insulating *more* taxpayer dollars from state estate tax coffers.

Who takes the tax hit? The I.R.S. provides statistics on taxable estates. In 2001 there were 125,000 estate tax returns filed with the then-$600,000 exemption. In 2007 there were 38,000 returns filed when the exclusion was $2 million. Only 17,000 of those paid any estate tax. With an exclusion amount of $3.5 million, only 14,000 returns would have been filed with 7,000 paying tax. If the exclusion amount had been $5 million, there wouild have been only 8,338 returns filed with 4,600 paying tax. Above $10 million? Only 3,000 returns with 1,700 paying tax. Fifity percent (50%) of the federal estate tax is paid by estates of over $20 million. Gift tax returns have continually numbered about 250,000 in recent years.

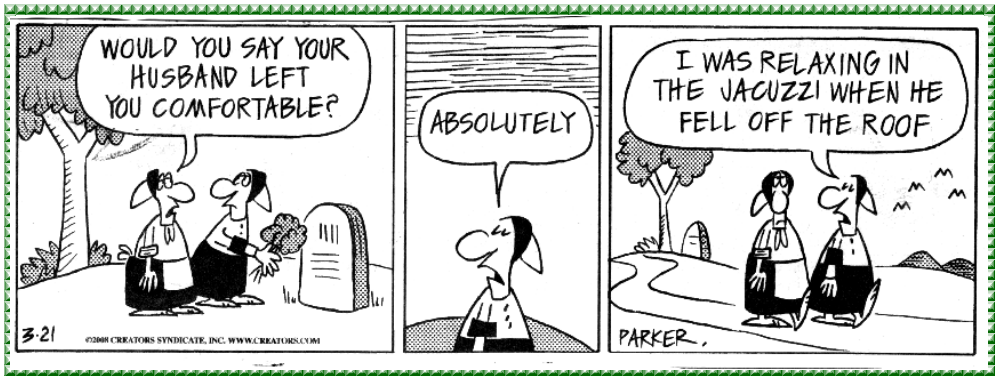
Revenue raisers. Some commentators speculate that Congress might impose a 5% ***surcharge*** on estates of $10 or $20 million and larger to pay for the revenue that would be lost by portability.

There has also been more and more talk lately — both in and outside of Congress — about elimination of the ***discounting*** strategy typically used with family limited partnerships (FLPs) and limited liability companies (LLCs). These business entities are commonly used as family wealth transfer mechanisms. ***Valuation discounts*** are ***leveraging*** tools that allow a lower ***gift tax*** value to be assigned to shares transferred by the parents (as controlling owners) to their children (as partners/members) for reasons of ***lack of marketability*** and/or ***minority interest*** in the shares. While courts have upheld these discounts under appropriate circumstances, the I.R.S. has always been leery about their frequent abuse in the family business context. Discounts could be on the chopping block as an estate and gift tax reduction strategy.

Temporary patch. Congress may opt for a one year patch by extending the 2009 law rather than enacting new provisions.This would be par for the course. The continuing long- and short-term uncertainty in estate tax law has created an uncertain estate planning environment during the entire first decade of the 21st century, frustrating professional advisors and their clients. Certainty is, maybe, finally in the offing. ■

With uncertainty in our lives and in the law, your estate planning should be focused but flexible. We're here to help.

GDP



Ponderables

Happiness is a how, not a what; a talent, not an object.

Hermann Hesse

The happiest people are those who seem to have no particular reason for being happy except that they are so.

W.R. Inge

Golden dreams make men awake hungry.

Thomas Fuller

There are two things for which animals are to be envied: they know nothing of future evils, or of what people say about them.

Voltaire

It is of no avail to weep for the loss of a loved one, which is why we weep.

Solon

From *The Oxford Book of Aphorisms*