



# Estate Planning Implications of an Obama Presidency

It is likely that the first half of 2009 will bring to a close an unpleasant period of tax uncertainty for estate planners. Although future legislation may simplify estate tax planning for many clients, many more will still need tax and nontax planning.

HOWARD M. ZARITSKY, ATTORNEY

**N**ow that Barack Obama has become the President-elect, estate planners should consider what his victory and the strengthening of the Democratic majority in both the House of Representatives and the Senate might mean to our practices. Obama included estate tax reform as part of his proposed middle-class tax relief package, and we can now finally look forward to a determination of the future state of the estate, gift and generation-skipping transfer (“GST”) taxes.

## Background

The Economic Growth and Tax Relief Reconciliation Act of 2001 (“EGTRRA”) reduced estate, gift and GST tax rates; increased the estate, gift and GST exemptions; partially disassociated the applicable exclusion amount from the \$1 million gift tax lifetime exemption; and replaced the state death tax credit with a state death tax deduction. The 2001 legislation

also will repeal the estate and GST taxes (but not the gift tax) on 1/1/2010; replace the current estate tax value basis with a carryover basis; and restore the pre-2001 estate, gift and GST tax rules and the pre-2001 basis rules on 1/1/2011.

Estate planners have found it very difficult to create long-term estate plans in light of this uncertainty. We have wondered whether, and to what extent, we should draft documents that make provision for estate tax repeal and carryover basis, and what opportunities might exist for our clients if the estate tax were repealed for just one year.<sup>1</sup>

---

HOWARD M. ZARITSKY is an independent estate planning consultant, in Rapidan, Virginia. He is the author of several treatises published by Thomson Reuters/RIA, including *Tax Planning for Family Wealth Transfers* and *Tax Planning With Life Insurance*. Mr. Zaritsky is a Fellow of the American College of Trust and Estate Counsel and the American College of Tax Counsel, and a member of the Virginia Bar. His website is [www.howardzaritsky.com](http://www.howardzaritsky.com).

These problems have been made worse by the vigorous congressional debate over whether to repeal or reform the estate tax. In 2007, however, the last attempts to repeal the estate tax ended; all estate tax legislation after 5/17/07 has focused instead on reforming the estate tax.<sup>2</sup>

## Elements of estate tax reform

All the bills to reform the estate tax that have been introduced in Congress in 2008 would eliminate the one-year repeal of the estate and GST taxes in 2010 and the resurrection of the pre-2001 tax laws in 2011, and all would retain the current basis rules and eliminate the threat of carryover basis at death. The other key estate tax reforms that are addressed in various bills include:

- Setting the applicable exclusion amount (estate tax exemption) at a higher level than under the present (2008) law;

## EXHIBIT 1 Candidates' Positions on Estate Tax Reform

	Obama	McCain
Repeal	No	No
Stepped-up Basis	Yes	Yes
Portable Exemption	Yes	Yes
Top Rate	45%	15%
Exemption	\$3.5 million	\$5 million
Indexing Exemption	Yes	Yes

- Indexing the applicable exclusion amount to adjust for inflation;
- Completely reintegrating the estate and gift tax exemptions, so that the gift tax exemption would be the same as the estate tax applicable exclusion amount;
- Making a deceased spouse's applicable exclusion amount portable, so that a surviving spouse could take advantage of a deceased spouse's unused applicable exclusion amount; and
- Restoring the state death tax credit and repealing the state death tax deduction.<sup>3</sup>

In preparation for Senate Finance Committee hearings on estate tax reform in 2008, however, the Staff of the Joint Committee on Taxation published a committee print discussing possible reforms in the estate tax. The Joint Committee suggested several additional possible reforms,<sup>4</sup> in addition to those already discussed:

- Enhancing the special rules for farms and small businesses held in an estate;
- Limiting perpetual dynasty trusts by making the GST exemption shelter only one generation of skips;

- Eliminating the use of valuation discount planning for investment assets; and
- Eliminating or dramatically limiting the use of Crummey withdrawal powers to qualify gifts for the annual exclusion.<sup>4</sup>

### The Obama plan

Both Barack Obama and John McCain publicly supported reform of the estate tax, rather than repeal, but neither released specific legislative proposals. Their public statements, however, showed that they took the positions on estate tax reform set forth in Exhibit 1.

President-elect Obama included estate tax reform in his proposed middle-class tax plan, which appears to be a high priority of his administration. It is quite likely, therefore, that the reform of the estate tax, along the lines described by the President-elect, will be enacted in the first half of 2009.

It is far less clear whether the reform of the estate tax will include a full reintegration of the estate and gift tax exemptions, restoration of the state death tax credit, enhancement of the special rules for farms and small businesses held in an estate, limitations on perpetual dynasty trusts, limitations

on the use of valuation discount planning for investment assets, elimination or limitation of the use of Crummey withdrawal powers, or some combination of these proposals. The final bill may include one or more of these items, or none of them, depending on the revenue impact of and legislative interest in each item.

### Planning implications

A \$3.5 million estate tax applicable exclusion amount and GST exemption, with or without a concomitant increase in the gift tax exemption, will mean that a large percentage of estate planning clients will need little more than basic marital deduction estate planning, in order to avoid all estate, gift, and GST taxes. On the other hand, even if the unused estate tax applicable exclusion amount of a deceased spouse is made portable, marital deduction estate planning, including the creation of a nonmarital credit-shelter trust, will remain important.

There are several reasons why merely transferring one spouse's unused applicable exclusion amount to the surviving spouse is far inferior to the proper use of a marital and nonmarital share. First, under the various proposals that have been submitted to Congress,

<sup>1</sup> See, e.g., Zaritsky, *Waiting Out EGTRRA's Sunset Period: Practical Planning While Congress Debates Estate Tax Repeal* (Thomson Reuters/WG&L); Aucutt, "Predictability Wrapped in Bewilderment Inside Uncertainty," 30 ETPL 299 (June 2003); Graham, Gans, and Blattmachr, "Quadpartite Will Redux: Coping With the Effects of Decoupling," 32 ETPL 15 (Oct. 2005); Scroggin, "Estate Planning to Cope With Legislative Uncertainty," 34 ETPL 10 (May 2007).

<sup>2</sup> The last of the estate tax repeal bills was H.R. 2380, 110th Cong., 1st Sess. (5/17/07).

<sup>3</sup> See H.R. 4172, 110th Cong., 1st Sess. (11/14/07); H.R. 4235, 110th Cong., 1st Sess. (11/15/07); H.R. 4242, 110th Cong., 1st Sess. (11/15/07); H.R. 6499, 110th Cong., 2nd Sess. (7/15/08); S. 3284, 110th Cong., 2nd Sess. (7/17/08).

<sup>4</sup> Staff of the Joint Committee on Taxation, 110th Cong., 2nd Sess., "Taxation of Wealth Transfers Within a Family: A Discussion of Selected Areas for Possible Reform" (4/2/08) (Committee Print).

the first spouse's applicable exclusion amount received by the surviving spouse is not indexed. Thus, only the surviving spouse's applicable exclusion amount is thereafter affected by indexing.

Second, the surviving spouse could take advantage of a carry-over of unused applicable exclusion amounts from more than one predeceasing spouse, but not more than a total of \$5 million. Hence, one could use serial marriages as an estate tax shelter, though with a \$5 million limitation. There is no limit on how many nonmarital trusts can be created at a first spouse's death for the benefit of the same surviving spouse, making traditional planning more desirable for serial spouses.

Third, there is no portability for the first spouse's unused GST exemption. Congress apparently believes that those who have GST tax concerns can afford to do prop-

er estate planning to take full advantage of each spouse's GST exemption.

Fourth, unlike a nonmarital trust, the portable applicable exclusion amount does not shelter income and growth in asset values. Consequently, a nonmarital trust can ultimately shelter a far greater amount from estate and GST taxes than can a portable applicable exclusion amount.

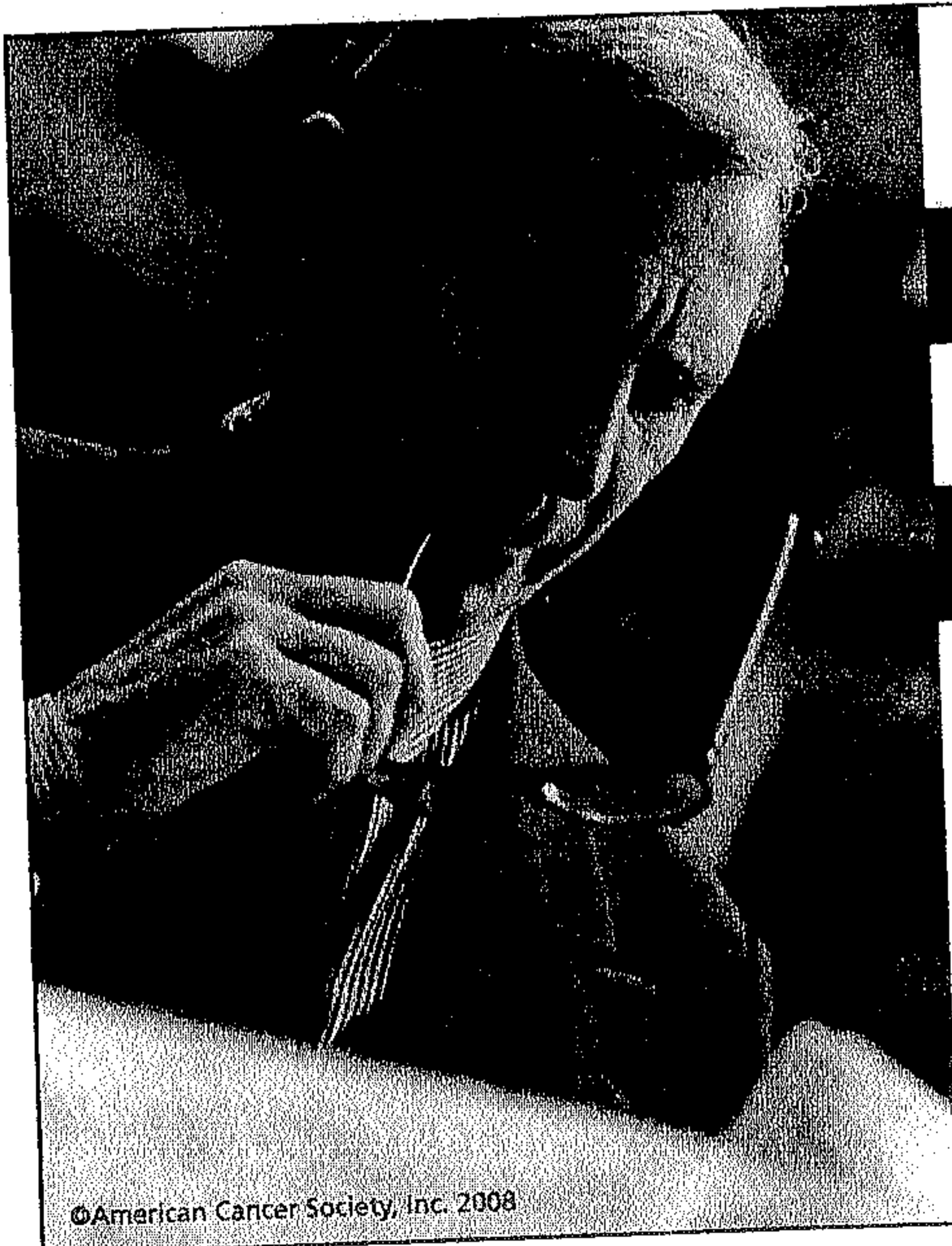
Fifth, unlike a nonmarital trust, a portable applicable exclusion amount does not provide any of the other benefits associated with a trust, including asset protection, protection from the claims of a new spouse, diversion of the assets from the first spouse's family to a new family created upon remarriage of the surviving spouse, or professional asset management.

Furthermore, President-elect Obama has proposed reinstating

the 36% and 38.6% top income tax rate brackets. This will reinvigorate the use of various techniques to shift income to lower-bracket family members, as well as the use of gifts made through grantor trusts, to retain to the grantor the higher income taxes, thereby enhancing the value of the gift to the donee/beneficiaries.

### Conclusions

We will not know the full scope of the estate tax reform until Congress passes the bill, but it is likely that the first half of 2009 will bring to a close a most unpleasant period of tax uncertainty for estate planners. It is also likely that these changes will simplify estate tax planning for a great many clients, but leave many more still in need of both tax planning and nontax planning. Estate planners need not yet begin to search for new careers. ■



©American Cancer Society, Inc. 2008

**Help the American Cancer Society**

**ELIMINATE CANCER**

**and we will help your clients**

**LEAVE A LASTING LEGACY.**

**Call today!**

**1-866-332-3216**

**[www.cancer.org/plannedgiving](http://www.cancer.org/plannedgiving)**

Progress begins with you. Please remember the American Cancer Society in your will, trust, or financial plans.

