



LAND SHARK AT THE DOOR



The purpose of computing is insight, not numbers.

—R. W. Hamming

Only six out of every 1,000 estates paid federal estate tax in 2009.^{1,2} So the estate tax is something akin to a great white shark, widely feared but seldom encountered (save the poor fellow pictured below and many readers of this pithy newsletter).

The new federal tax exemption will likely mean that the federal estate tax will hit two-thirds fewer estates in 2011 and 2012.³ Why would the federal government raise the tax exemption to \$5 million? Of the annual \$20 billion the tax generates, most of that comes from the very biggest estates. For example, had there been an estate tax in 2010, two men - George Steinbrenner and Texas billionaire Dan Duncan - could have paid approximately \$5 billion in estate taxes, about 25% of the revenue from all estates.

Note that the exemption and lower rate of 35% (it was 45% in 2009) are in effect for only two years. So what should be done now with this new regime?

1. Take advantage of the new law, as there is no guaranty it will last. One can now gift up to \$5 million tax free. Given that a person may feel the need to keep that kind of money close-by rather than see a son-in-law driving a new red Maserati, consider gifting in trust to a spouse. Assuming that the spouse is younger (and perhaps better looking), the funds essentially remain at the same generational level, and the gifted assets will thereafter grow perpetually free of estate tax.



In 2011, perhaps only 5,000 estates will be federally taxable.

2. The new concept of “portability” means that a surviving spouse can use a predeceased spouse’s unused estate tax exemption. This concept is inapplicable to spouses passing before 2011. Portability suggests that asset titling and balancing of assets between spouses is less important than it previously was. Nevertheless, it is still prudent to balance estates and use portability as a safety net.

3. They say it is not over until the fat lady sings. In estate planning, that has to be a reference to Gov. Quinn. Illinois raised about \$240 million⁴ from its state estate tax in 2009, when it had a \$2 million exemption and a tax rate as high as 16%. Currently, there are no indications as to what the Illinois exemption will be for 2011 and beyond. There is every indication that the state will need to raise revenue (from you) and could even lower the prior exemption. Former Illinoisans may laugh at this since they now reside in different states. But don’t laugh too hard - Illinois will aggressively tax all Illinois assets.

4. The grantor retained annuity trust (GRAT) may still be the best IRS-blessed idea available. It allows appreciation on assets to effectively escape estate taxation. It has tremendous upside potential and minimal risk. Although Congress has threatened to limit the flexibility of this powerful tool, it remains enormously useful.

5. There have been over 4,400⁵ changes to the Internal Revenue Code in the last decade. Change is the only constant in tax law. Surprisingly, too many clients defer acting, waiting for the tax code to settle, which may never happen. Of course, the IRS applauds that approach.

Lastly, remember that estate planning can be less a tool to avoid tax and more a process to protect what may be most important — family, health, and wealth. Plan today to protect loved ones from possible misfortunes, like divorce or lawsuits. In a difficult economic environment awash in litigation, the real great white shark may be a former business partner, former in-law, or pedestrian.

¹ In 2009, 14,713 estates paid federal estate tax (out of an estimated 2.4 million Americans that died). Statistics of Income Division of the IRS.

² In 1977, 10% of decedents paid estate tax. “Estate Tax Will Return Next Year, but Few Will Pay It.” *New York Times*, 17-12-2010.

³ Only 4,296 taxable estates had assets exceeding \$5 million in 2009. Statistics of Income Division of the IRS.

⁴ *Ibid.*

⁵ IRS Commissioner D. Shulman’s AICPA speech 10/10.