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Federal Estate Tax Reform – No News is Good News?

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Following a flurry of activity in late 2010, the focus turns more toward compliance than reform.

After a year of debate and confusion over the fate of the federal estate tax, year 2010 ended with Congress finally voting to keep the federal estate, gift and generation-skipping transfer (“GST”) tax exemptions at \$5 million each . . . temporarily. The 2010 single year of repeal saw the deaths of no fewer than five billionaires, potentially costing the government billions of dollars in estate tax revenue.

Still, Congress was unable to agree on permanent reform and, unless Congress takes further action, the federal estate tax and gift tax exemptions are to reset in year 2013 at \$1 million each, and the GST tax exemption will reset at \$1 million (indexed for inflation). The top estate, gift and GST tax rates all will be reset at 55% (with a 5% surcharge on the estate tax for very large estates).

No one knows what will happen between now and year 2013, and Congress has been strangely silent on the issue since last December. At one extreme, the federal estate tax exemption could be reset at \$1 million with a 55% tax rate. At the other extreme, the tax could be repealed again, either temporarily or permanently.

The few recent proposals out of Washington center around limiting the duration of popular estate planning techniques that result in gift or GST tax savings for multiple generations, such as grantor retained annuity trusts and perpetual dynasty trusts. The long-term planning windows available for these trusts and the resulting transfer tax

savings may be decreased significantly if their potential terms are cut short, thus removing the incentive for keeping property in these trusts indefinitely. In addition, some members of Congress have advocated for placing limits on the use of popular discounting techniques (such as the family limited partnership). If implemented, the use of this extremely effective tool for transferring property to future generations at a reduced transfer tax cost would be significantly curtailed.

Given today's generous exemption levels, the continued availability of discounts, and the longer planning horizon for certain estate planning techniques, now is the time to reduce the size of your taxable estate and/or to simply pass wealth to future generations free of transfer tax.

If you are interested in lifetime gifting to your beneficiaries, transfers of particular items or types of property, charitable gifting or asset protection planning, we urge you to contact your advisors to discuss your options as soon as possible.

Beware of Gifts of Real Property

While there has been very little talk about further estate tax reform since last December, there has been an increase in the rate of audits of gift and estate tax returns. Of particular note, the IRS recently filed suit to compel the California State Board of Equalization to turn over its computer database in an attempt to identify taxpayers who have transferred real property to relatives (especially children or grandchildren) for little or no consideration between 2005 and 2009 without filing a corresponding federal gift tax return (Form 709).

The IRS is focusing on intrafamily property transfers because they require the filing of a form for reassessment with the County Assessor. By matching the reassessment forms with filed Form 709s, the IRS is able to determine who might have failed to comply with the federal gift tax laws. There is no statute of limitations for unfiled gift tax returns, so the donee of the property will be liable to pay the gift tax (and interest and penalties thereon), if the donor fails to do so.

The IRS's actions will not affect taxpayers who have been complying with the gift tax rules, filing their returns and adequately disclosing their gifts of real estate. It is important, however, to be certain when making these types of transfers that there are appraisals on file supporting the value of the gifts and that all of the appropriate forms

and supporting documentation are completed and filed with the IRS and other authorities on a timely basis.

If you have made a gift of real estate in the past several years and are uncertain if you filed a corresponding federal gift tax return, you should contact your tax advisor immediately.

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