

## Estate Taxes; Where Do We Go From Here?

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Due to the ever changing and broadly applied federal estate tax laws, families can face dire and catastrophic consequences, such as a forced-sale of assets at less than optimal values, even with extensive advance planning. Simply put, in the context of family wealth, the unexpected death of a family matriarch or patriarch is not only a family tragedy, but it can also significantly affect the family wealth and business. The federal estate tax can play a large part in this loss.

The reality of the federal estate tax on family wealth is compounded by the tremendous change that has surrounded the estate tax law for the last 10 years. Over the last decade, the federal estate tax has been manipulated by widely changing tax rates and exemptions and such changes make advance estate and succession planning for family wealth all the more challenging. With more dramatic changes to the federal estate tax law looming, and with the economic recovery still struggling to take hold, efforts must be made to solidify the foundation for future growth and family succession planning through a critical examination of the federal estate tax.

### Summary of the Current Law

For the past several years, the federal estate tax law has provided elevated exemptions and lower tax rates. The key provisions of the current federal estate tax law, which sunsets on December 31, 2012, are as follows:

- \$5.12 million gift and estate tax exemption indexed for inflation.
- \$5.12 million Generation Skipping Transfer (“GST”) tax exemption indexed for inflation.
- 35% maximum, estate, gift and GST tax rates.
- For decedent’s dying in 2011 and 2012, a surviving spouse may use the most recent deceased spouse’s unused exemption amount (“portability”).

If no new legislation is enacted prior to December 31, 2012, then the estate, gift and GST tax exemptions revert back to \$1 million, with maximum taxable rates of up to 60%.

**Obama Proposal:**

The Obama Administration's Fiscal Year 2013 Revenue Proposal recommends the following changes to the current federal estate tax law:

- \$3.5 million estate and GST tax exemption.
- \$1 million gift tax exemption.
- 45% maximum estate, gift and GST tax rates.
- Portability to remain intact.
- Require consistency in the reporting basis by the transferee of property received either through a gift or devise, with information reported by the transferor.
- Valuation rules will be enacted to limit the ability to discount closely-held entities for lack of marketability and lack of control.
- Require a minimum term of 10 years for grantor retained annuity trusts. The new proposals would also require the remainder interest to be more than zero in value.
- Require a trust to terminate if it has been in existence for 90 years, thus limiting the effectiveness of the GST tax exemption.
- Require inclusion of irrevocable trust assets in the estate of an individual who, for income tax purposes, is deemed to be the taxpayer of the irrevocable trust.

**Bipartisan Proposal:**

One of the few bipartisan proposals dealing with the federal estate tax law was introduced by Kevin Brady (R-TX) on March 30, 2011. H.R. 1259 is co-sponsored by two (2) Democrats and four (4) Republicans and entitled the "Death Tax Repeal Permanency Act of 2011." This bill is presently before the House Committee on Ways and Means and provides for the following, to become effective upon the date of enactment:

- Repeal of federal estate tax.
- Repeal of the federal GST Tax.
- Make permanent the current \$5 million federal gift tax exemption, with taxes levied at a rate of 35% for transfers over \$5 million.

The reasons for repeal, as cited by sponsoring Representatives, can be summarized as follows:

- **Hurts Small Business Owners, Farmers and Ranchers.** The estate tax hurts families with small businesses and farmers by inhibiting their ability to transfer assets without imposing a second layer of taxes.
- **Job Loss.** By inhibiting the transfer of family businesses from one generation to the next, the estate tax affects jobs and diminishes employment opportunities within those businesses subject to estate tax.
- **Punishes Prudent Investing.** The estate tax punishes families who prudently invest and accumulate wealth over the course of their lifetime, by subjecting them to taxes upon death.
- **Bereavement.** The surviving family members must find ways to pay the estate tax liability at a time when they are struggling with the loss of a loved one, including the matriarch, patriarch or head of the family household. Family members should be allowed to deal with their bereavement, without having to be subjected to estate taxes on the assets which they inherit.
- **Double taxation.** The estate tax subjects taxpayers and their beneficiaries to double taxation, by taxing the same assets first during life and again upon death.

### **Impact of Federal Estate Tax (and Failure to Act by Congress) on Family Wealth**

The worst case scenario for wealthy families is for Congress to ignore the estate tax issue. Indeed, no action by Congress will be more detrimental than the enactment of any of the lesser-favored proposals being debated. For instance, if the current law “sunsets,” many families will face a \$1 million estate and gift tax exemption and increased estate and gift tax rates of 55% (and up to 60% for estates valued over \$10 million).

### **Risk of Claw Back**

There is also considerable uncertainty surrounding the application of any “claw back” penalty for gift and estate tax exemption. In other words, there is a risk that if permissible gifts of up to \$5 million are made prior to December 31, 2012, and no further action is taken to clarify the federal estate tax laws going forward, a decedent’s estate could be forced to incur an additional tax based upon the difference of the gifts made during life and the exemption level upon death. If this occurs, families following the law and engaging in proactive planning to preserve family wealth could still face tax consequences which could undo important plans set in motion to ensure succession to future generations.

## Conclusion

In the midst of such estate tax turmoil, families should still consult with tax and legal professionals to ensure that they are maximizing all planning options and tools available to them to minimize adverse impacts of the estate tax law. Akerman has experts to assist in various areas of tax and estate planning. Please feel free to speak with one of our attorneys to find out more information and maximize your tax and estate planning.

Rick Hurt, Jeffrey M. Gad, Drew LaGrande and Megan Devault counsel families on matters integral to family enterprises, including litigation matters, estate and tax planning, corporate governance, mergers, acquisitions, business succession and more. As all individuals are aware, nothing is simple when it comes to taxes. This paper contains many general statements and simplifies complex concepts. There are many nuances in the issues discussed in this paper and exceptions to the general rules. A tax advisor should be consulted before taking any action with respect to a particular business or situation.

*NOTE: This publication was written in collaboration with Family Enterprise USA.*

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