THE OBAMA BUDGET TRANSFER TAX PROPOSALS– SOME OLD WINE AND SOME NEW WINE

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Earlier this week, the Obama Administration released its 2013 revenue proposals. In the area of transfer taxes, the Administration's wish list includes many items previously proposed, but also has at least one relatively new item. Given the current political situation in Washington D.C., the ability of the Administration to get all or most of these enacted is questionable. However, it is still useful to know what is in the scope of the Treasury Department's rifle, even though they may not be able to take the shot this year. The proposed modifications are:

1. Restore the 2009 Credit and Exemption Levels. The 2009 unified credit and GST exemption levels will be reinstated and made permanent. These include a 45% maximum estate, gift and GST rate, an exclusion amount of $3.5 million for estate and GST taxes, and a $1 million exemption for gift taxes. However, portability of unused estate and gift tax exemption between spouses, which entered into the law after 2009, will be retained.

COMMENTS: No surprises here, although some would have expected the Administration to retain the 2001 levels which will be reinstated in 2013 if no new legislation is enacted, since they are substantially lower than the 2009 levels. The decoupling of estate and gift tax rates creates unneeded complexity, and the $1 million gift tax exemption is disappointingly low. That proposed gift tax exemption adds further urgency to taxpayers to make larger gifts in 2012 before the exemption shrinks up.

2. Consistency in Value for Transfer and Income Tax Purposes. Taxpayers who receive property by reason of an individual's death or by gift receive a basis step-up or carryover basis for future gain/loss computations, based on various rules. The proposal mandates that the recipient is bound by and must file returns with a

basis consistent with information reported by the transferor, including values when relevant.

COMMENTS: Conceptually, there is nothing wrong with this idea. However, similar to the ability of a taxpayer in the income tax arena to report a tax item in a manner that differs from a Form K-1 entry so long as that different reporting is disclosed to the IRS, hopefully the same opportunity will be open to taxpayers in this area.

Also, the proposal indicates there will be enhanced (*i.e.*, new) reporting on decedents and donors as to value and basis information. Hopefully, this will not be as extensive as that required under the Form 8939 reporting that was required for many 2010 decedents. This raises a number of questions. Will estates that do not have to file a Form 706 still have to obtain values (including appraisals to determine value) for their assets? Will those estates have to report information to the IRS, thus creating a mandatory federal filing for ALL estates that does not currently exist? How will annual exclusion gifts be reported? Is there really such a large problem with inconsistent reporting that a new and burdensome (and costly) reporting obligation needs to be imposed on all decedents and donors? The proposal does note that special provisions may be applicable to nontaxable estates and annual exclusion gifts, but what that means is not discussed.

3. <u>Reduction of Discounting Involving Family-Controlled Entities</u>. In an attempt to reduce discounting of interests in family partnerships and other closely-held entities, valuation rules will be enacted under Section 2704 to disregard limits on an owner's right to liquidate interests and limits on the ability to be admitted as a full partner or hold an equity interest.

4. <u>Minimum Term for Grantor Retained Annuity Trusts</u>. The proposal would require that a GRAT have a minimum of a ten year term. It would also require that the remainder interest be above zero in value, and that no decrease in the annuity would be allowed during the GRAT term.

COMMENTS: GRATs will still remain as a planning tool if this enacted, but the ten year term will make it more unlikely that a donor will survive the term - if the donor does not survive the term, the value shifting benefits will not arise. It will also eliminate quick-hit transfers through the use of short-term rolling GRATs that allow for transfers under a shorter term spike in values before that increase can be offset by later reductions in value. Also, it will make GRATs less attractive in higher interest rate years, since it will increase the payouts back to the grantor for no less than 10 years.

5. Limit GST Exemption Benefits to 90 Years. After a trust has been in existence for 90 years, its generation-skipping tax exemption would be effectively eliminated.

COMMENTS: Yes, the idea of trusts that are exempted from further transfer taxes forever is a wonderful thing (or for 360 years in Florida). But considering that our country was founded only 236 years ago, is a longer time period really going to be missed by many? There are some families where trusts may actually continue beyond 90 years, but I'd venture to say there aren't that many.

6. Create Estate Tax Inclusion for All Grantor Trusts. In a major rewrite of the estate tax provisions, any individual who is taxed as the owner of a trust for grantor trust purposes will have to include the trust assets in his or her gross estate for federal estate tax purposes (at least as I read the proposal). Also, any non-grantor who is deemed the owner of the trust and engages in a sales transaction with the trust will be subject to estate tax on the portion of the trust attributable to the transferred property. The Treasury Department has sales to defective grantor trusts in its sights on this one.

COMMENTS: Many grantor trusts are already subject to gross estate tax inclusion. However, piggybacking the grantor trust rules into the estate tax area jumbles the various tax policies involved, and will result in many trusts being subject to estate tax when it is wholly inappropriate. For example, in the grantor trust area one spouse is generally attributed the rights and powers of another spouse, which can create a grantor trust in a donor spouse even though he or

she retains no rights, powers, or interests over an *inter vivos* irrevocable trust that is created for the other spouse and/or children. Is the donor now going to be subject to estate tax on that trust?

This provision is using an elephant gun to shoot a squirrel. If Treasury is concerned about sales to defective trusts, then it should limit inclusion only to the extent of sale transactions. Indeed, the proposal already addresses sale transactions for non-grantors, so that can simply be expanded to cover all grantors engaged in sale transactions, without an unneeded overexpansion of the gross estate inclusion rules.

7. Extension of Estate Tax Lien Period for Section 6166 Deferrals. Under this provision, the ten-year estate tax lien period will be extended to cover the extended estate tax deferral period of 15 years, 3 months, when a deferral of estate tax is involved.

COMMENT: This proposal avoids the need for estate beneficiaries to come up with security interests to secure the deferred estate tax beyond the ten-year period. As such, this extension is a useful mechanism for both the government and taxpayers.

General Explanations of the Administration's Fiscal year 2013 Revenue Proposals

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