



# JONES DAY COMMENTARY

## THE FUTURE OF THE ESTATE TAX; DEPRESSED VALUES AND LOW INTEREST RATES CREATE GIFTING OPPORTUNITIES

### ELECTION POSTSCRIPT

Change is coming. Last week's election of Barack Obama and solidification of Democratic majorities in the House and Senate make federal transfer tax (estate, gift, and generation-skipping tax) reform almost a certainty for 2009. The likelihood that 2010 will be an estate tax-free year is virtually zero. The "good" news is that the hiatus between administrations and the current low valuations in the stock and real estate markets may present estate planning and gifting opportunities. Admittedly, the depressed stock and real estate prices are painful, but if you are optimistic about the long-term economic prospects of our country, there may be a current window of opportunity from an estate and gift perspective.

### THE FUTURE OF THE FEDERAL ESTATE TAX

It has been seven years since Congress created estate planning paralysis by enacting an estate tax phaseout with rising exemption levels (\$675,000 in 2001 to \$3,500,000 in 2009) and reduced top rates (60% in 2001 to 45% in 2008 and 2009). Most significantly, Congress created a federal estate tax-free 2010. The "problem" is that the 2010 "holiday" is to last for only 12 months, with a scheduled reversion in 2011 to the 2001 top estate tax rate of 60% and an exemption level of \$1,000,000. (The 60% rate would apply only on taxable estates between \$10,000,000 and \$17,184,000. A maximum 55% rate would apply on taxable estates below \$10,000,000 or above \$17,184,000.) The current law would maintain the \$1,000,000 lifetime gift



exemption in 2010, although the federal generation-skipping tax would disappear for calendar year 2010 and reemerge in 2011 in similar fashion to the estate tax. If this sounds ridiculously confusing, it has been and continues to be.

The estate tax, or “death tax,” has been a political football since 2001. Repeal seemed a real possibility in 2005, but since then, because of federal budget and other considerations, it has become apparent that the death tax will live and that Congress will act before the currently scheduled “holiday” year of 2010. Speculation is dangerous, of course, but our current predictions, based in part on President-elect Obama's campaign positions, are as follows:

1. The federal estate, gift, and generation-skipping taxes will continue in some form.
2. The 2009 estate and generation-skipping exemption amount of \$3,500,000, perhaps indexed for inflation, is likely to apply in 2010 and subsequent years.
3. The \$1,000,000 gift tax exemption may be increased to the same amount as the estate and generation-skipping tax exemptions in 2010, thus reunifying all transfer tax rates.
4. The top estate, gift, and generation-skipping tax rates will probably remain at 45%.
5. Valuation discounts, like minority, fractional interest, and lack-of-marketability discounts, will be under heavy attack and may be disallowed or limited by legislation. Such discounts are useful and respected under current law and permit the base upon which the gift, estate, or generation-skipping tax applies to be reduced.

## LIFETIME GIFTING—BEAR MARKET AND LOW-INTEREST OPPORTUNITIES

We do not recommend gifting for tax or economic reasons alone. Nevertheless, for those who are otherwise motivated to give to their children, grandchildren, or others, we believe today's relatively low valuations (whether equity or real estate), combined with low interest rates, make lifetime gifting very attractive. Gifts are typically designed to transfer appreciation on and income generated by gifted property to others. While in most cases we have not been strong proponents of gifts that generate gift tax (especially in an environment where the gift tax exemption may increase), we believe that prudent use of a donor's current \$1,000,000 federal gift tax exemption (\$2,000,000 per married couple) should be considered.

Even if you have used your \$1,000,000 (or \$2,000,000) gift tax exemption, there are certain “gift-leveraging” techniques that enable you to take advantage of the IRS's comparatively low monthly published Applicable Federal Rates (or “AFRs”). For November 2008, the AFRs range from 1.63% for loans with up to three-year terms, to 2.97% for loans with three- to nine-year terms, to 4.24% for loans with more than nine-year terms.

A combination of possibly historically low valuations and low AFRs can be a powerful gifting or gift-leveraging engine if you believe in the long-term strength of our economic system. Furthermore, making gifts or implementing gift-leveraging techniques this year could enable you to take advantage of valuation discounts before Congress eliminates or restricts such discounts.

We believe that the following techniques merit special consideration:

1. Use of the per recipient annual gift exclusion, which for 2009 will rise from \$12,000 to \$13,000.



2. Gifts above the annual exclusion (but within the current gift tax exemption amount of \$1,000,000 per donor) designed to pass appreciation and income from the gifted assets to designated recipients.
3. Taking advantage of low interest rates to engage in intra-family loans.
4. Use of a Grantor Retained Annuity Trust ("GRAT"). In many ways this is analogous to a loan of assets in a trust format established for a fixed period of time, such as two or three years. Appreciation of assets in excess of the IRS's monthly hurdle rate (3.6% for November 2008) passes gift tax-free to the grantor's children or other designated beneficiaries. If the assets do not appreciate in excess of that monthly hurdle rate during the term of the GRAT, there is no real economic or tax downside. The assets would simply come back to you.
5. Use of an installment sale to a grantor trust. This technique would enable you to lock in the current low AFRs for up to nine years, or possibly even longer. By using a term of up to nine years, not only could you shift appreciation in value above a very low AFR hurdle rate (2.97% for a November 2008 nine-year loan) for the benefit of your designated beneficiaries (including grandchildren), but you presumably could also protect against unfavorable changes in the law that may be forthcoming, such as restrictions on discounts and limitations on GRATs.

## LAWYER CONTACTS

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