

MAJOR FEDERAL TAX POLICY DECISIONS, MANY OF GREAT INTEREST TO OUR CLIENTS, REMAIN ON HOLD IN CONGRESS.

**A Tax
Department
Publication**

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July 23, 2010

Transfer tax in 2010. The state of transfer tax law in 2010 remains unclear. Yes, federal estate and generation-skipping transfer taxes are currently suspended, with modified carry-over basis rules applying to 2010 decedents. However, dozens of pending legislative proposals could, if enacted, alter the status quo, either by retroactively reinstating 2009 law (as President Obama has proposed) or by enacting some new variation of the 2009 regime. This uncertainty, coupled with a complete absence of guidance from the IRS on current issues such as modified carryover basis, has made the administration of 2010 estates extraordinarily difficult. Three recent estate tax proposals illustrate the fluidity of the current transfer tax scene.

On July 21, 2010, the U.S. Senate defeated a motion by Senator Jim DeMint (Republican-SC) that would have required consideration of permanent estate tax repeal. Although Senator DeMint did not provide a list of revenue raisers with his proposal, the Congressional Budget Office has estimated its 10 year cost at \$502 billion.

On July 14, 2010, Senators Jon Kyl (Republican - AZ) and Blanche Lincoln (Democrat - AR) unveiled the summary of a plan that would permanently extend the estate tax, but with a \$5 million exemption, indexed for inflation, and a maximum tax rate of 35%, both phased in over 10 years. Under the plan, which would be effective retroactive to January 1, 2010, executors for 2010 decedents could elect to take a modified carry-over basis in a decedent's assets and pay no estate tax. The non-partisan Tax Policy Center estimates that the Kyl-Lincoln plan would raise \$11.6 billion in 2011, about one-third of the revenue provided by the \$1 million exemption and maximum 55% tax rate otherwise in effect for that year. Under the proposal, this revenue shortfall would be partially offset by as yet undetermined revenue raisers.

Full legislative language for a third plan was unveiled by Senator Bernie Sanders (Independent-VT) on June 24. This proposal, the "Responsible Estate Tax Act" (S. 3533), would reinstate the \$3.5 million estate tax exemption of 2009 law, but would modify the 2009 graduated estate tax rate schedule, which imposed a maximum 45% rate on estates in excess of \$3.5 million. Under the Sanders proposal, which would be effective retroactive to January 1, 2010, the tax on estates up to \$3.5 million would be no more than 39%; from \$3.5 million up to \$10 million, 45%; from \$10 million up to \$50 million, 50%; and, over \$50 million, 55%. In addition, a 10% surtax would apply



to any portion of an estate exceeding \$500 million. In other words, the top estate tax rate would be 65%.

Unlike the Kyl-Lincoln and DeMint proposals, the Sanders plan includes specific revenue raisers—which would bar minority discounts for family-held entities, limit the permitted term for grantor retained annuity trusts (“GRATs”), and require consistent basis reporting for transferred assets for estate, gift and income tax purposes.

Given the defeat of the DeMint proposal, permanent repeal of the estate tax appears unlikely in the near future. On the other hand, the contours of a potential estate tax compromise among Republicans, Democrats and Independents also remain unclear. If all sides cannot reach agreement, current law will remain in place. This would mean complete suspension of the estate and generation-skipping transfer taxes for all of 2010. In 2011, current law would give us a \$1 million estate tax exemption and maximum 55% rate; a \$1.34 million generation-skipping tax exemption and a flat 55% rate; and a \$1 million gift tax exemption and a maximum 55% rate.

Income tax for 2011. Yesterday, Treasury Secretary Timothy Geithner reiterated the Administration’s support for legislation that would extend income tax relief for lower and middle-class taxpayers. Earlier this week, White House Press Secretary Robert Gibbs noted that Congress needs to consider carefully the cost of whatever income tax legislation it chooses to enact. But with only a few weeks left on the legislative calendar, Congress has not yet turned its attention to possible extension, in part or in whole, of the Bush income tax rate cuts, which are set to expire at year-end.

With an election looming in November, will legislators duck this issue altogether and let pre-2002 law go into effect? If so, rates would rise for all taxpayers: a top 39.6% rate would apply to ordinary income as well as to short-term capital gains and qualified dividends, while long-term capital gains would be taxed at a maximum 20% rate. A complicating factor: some legislators, including most Republicans (and at least a few Democrats), worry about the effects of an income tax increase on the nascent economic recovery. Meanwhile, the Congressional Budget Office estimates that even a temporary one-year extension of the Bush tax cuts would cost \$115 billion.

Alternative minimum tax. The current alternative minimum tax exemption for marrieds filing jointly is \$45,000, down from \$70,950 in 2009. To date, however, there has been no movement in Congress to increase this exemption before year-end.

IRA charitable rollover. In 2009, a temporary “extenders” provision allowed those over 70 ½ to make tax-free distributions from their Traditional IRAs to qualified charities. Legislation to extend the IRA charitable rollover provision through 2010 is pending—but is currently mired in the Senate. Many advisers are suggesting that clients consider directing a charitable distribution from their IRAs while the legislation is pending. Then, if the legislation passes, the distribution will be tax-free; if it does not pass, the distribution will be taxable, but partially offset by an income tax charitable deduction.



Grantor retained annuity trust limitations. To date, six legislative proposals—including the Responsible Estate Tax Act—would require GRATs to have a term of at least 10 years. Five out of the six bills would affect “transfers made after the date of enactment,” while the sixth would apply to transfers made after December 31, 2010. In this environment, those planning to fund a short-term GRAT are well-advised to move quickly.

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