

What does the Obama Administration Mean for the Federal Estate Tax?

Under current law, in 2009 the Federal estate tax exemption will rise to \$3.5 million or essentially \$7 million per married couple, if they effectively split their combined wealth. The top rate in 2000 was 55 percent (and in some cases, 60 percent). It is now 45 percent. Under the current law the Federal estate tax and generation-skipping transfer taxes (but not the gift tax) are repealed for one year in 2010 but come back in 2011 with a \$1 million exemption and the 55 percent rate, where they are to remain.

The professed positions of the candidates with respect to the estate tax were not radically different. John McCain's platform called for a \$5 million exemption and a 15 percent rate. Barack Obama's platform called for a \$3.5 million exemption and a 45 percent rate. While Obama's proposal or something close to it is now likely to win out, it still must be approved by Congress.

The actual outcome will be largely driven by what happens with the income tax. The income tax raises far more than the estate, gift and generation skipping taxes combined. The big elephant in the room is the Alternative Minimum Tax or AMT. It was originally enacted to apply only to high-income taxpayers who had tax favored income or tax "write-offs" that most did not enjoy. But now it has become a middle class tax. Almost all politicians agree that it must be reduced. Nevertheless, the cost of doing that is so high that other taxes would have to be raised including possibly the estate tax. Jonathan Blattmachr, a nationally recognized estate tax attorney notes that raising taxes is still thought to be politically unfavorable, especially to Congressmen and Congresswomen who have to run again in two years. Not eliminating someone's tax problem is politically much safer (hence, the reason the estate tax was not and will not be repealed) than increasing someone's tax.

What else will happen to the estate tax? Blattmachr suggests that from an inheritor's perspective, some good things and some bad. Congress likely will make the estate tax exemptions between husband and wife "portable," meaning the spouse first to die will not have to create a separate so-called "estate tax exemption" or "credit shelter" trust. He or she can just leave the entire estate to the surviving spouse who would inherit the property and the unused exemption. Perhaps, even more important, if the first spouse to die does not have enough property to fully use his or her exemption, the full exemption would be inherited by the survivor. Although it may seem that such portability will simplify planning for a married couple, it likely will not. There are advantages for the first spouse to die to use his or her estate tax exemption - it provides asset protection and income tax planning opportunities for the surviving spouse, among other things.

All of these changes, especially a permanent \$3.5 million estate tax exemption, will likely reduce revenue and it seems likely some in Congress will try to come up with some offsets. Several proposals are being considered. One is to eliminate the grantor retained annuity trust or GRAT which permits appreciation above a relatively low earnings threshold to be transferred out of the owner's estate free of estate and gift tax. The GRAT has been a "Heads I win, tails I can't lose" estate tax planning strategy for the wealthy.

Another potential change is the elimination of discounts in valuation in all but interests in operating businesses. A leading planning strategy in estate tax planning is valuation reductions: the lower the value, the lower the tax. Although it might be more likely that an Obama administration would seek them than a McCain administration would, these proposals likely would take hold in the Congress and not in the White House.

Some things are certain. There will be a 2009 massive tax bill, retroactive to the beginning of the year. There will be winners and losers; the estate tax exemption will likely be about \$3.5 million and the rate way above 15 percent. Income tax revenue losers and gainers may ultimately determine other changes to the estate tax system.