Now What? Congress Considers Another Revamp of Estate and Gift Taxes

By Charles Lowenhaupt

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LOWENHAUPT & CHASNOFF
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Congress is threatening major overhauls of the gift and estate tax, as well as generation-skipping rules. Also under consideration are some of the rules relating to trust taxation. All of them are intended to raise taxes on the wealthy and are likely to cause headaches.

As we have seen often over the years, rather than simply increasing (or reducing) rates, Congress complicates the matter and leaves the estate planning of wealthy individuals in disarray. Indeed, I am now getting calls from younger lawyers asking how to deal with all of the uncertainty.

My grandfather, my father and I have lived collectively through many of these threats. We have seen the gift tax enacted, subsequently repealed and later reenacted. More recently, we have seen a generation-skipping tax enacted and subsequently revised and reenacted before any return was filed under the new law. We have seen carry-over basis enacted and repealed. We have seen rates and exemptions modified with and without sunset provisions. And we have seen numerous proposals made and never enacted.

What To Do

Over 100 years, our firm has counseled individuals and families, as well as their lawyers, about what to do regarding these legislative gyrations. Through it all, we have found the following principles worth remembering:

- Historically, Congress has liked to make changes in the estate and gift tax laws either retroactive or effective as of the date of the original bill. There should be grandfathering provisions, but we cannot count on that. The equity of grandfather provisions rests on the fact that people often cannot change wills and trusts quickly. Or, in the case of irrevocable trusts, no changes at all may be permissible.

- On the other hand, increases in capital gains taxes are generally prospective. Congress likes to make increases in the tax prospective – that is, for sales after a certain date often months after enactment. The reason is that the prospective change encourages taxpayers to sell assets before the effective date to take advantage of low rates. That approach produces a nice bump in tax receipts. Of course, you cannot be certain of either of these "historical" trends. It's anybody's guess what this Congress may do.

- Always answer the question: What are you trying to make your wealth do that taxes impede? Don't take steps simply to save taxes, unless you are accomplishing substantive purposes.

- Never take irrevocable action if you may regret it later. Make sure you keep enough to live comfortably and can enjoy freedom from the burdens of wealth.

- During the 100 years of the estate tax and its affiliated taxes, gifts during lifetime have always been beneficial. With or without annual exclusions (which should be used in full) or a lifetime exemption (which should be used in full), the value of a gift during your life can increase many times before your death. That increase will not be subject to estate tax. Further, generally whatever gift tax you pay will not be subject to estate tax.

- It's important to note that the gift tax is tax "exclusive," and the estate tax is tax "inclusive." If you make a gift of $100 subject to gift tax, that gift tax is imposed on $100. If the tax rate is 50%, the tax is $50. In other words, the donee gets $100 and the government gets $50. You have used $150. If, on the other hand, you die with an estate of $150 and estate tax is also 50%, the government takes $75. The donee takes $75. The tax is imposed on the tax for estate tax purposes.

- Prepare to give up all rights for property you give away. There may always be certain schemes that allow you to retain interests in gifted property, but such schemes are likely targets of any legislation trying to cut back on tax benefits.

Any planning should account for the relative burdens of income and estate, gift and Generation Skipping Transfer taxes. Many income tax savings can ricochet into higher estate taxes or gift taxes. Estate and gift taxes are taxes on principal, while income taxes are taxes only on income. For tax purposes, income can be limited.

All of these principles require discussion with your advisors. I caution you, however, not to act before the law is actually passed. Many changes can occur in the final hours of a bill's deliberation. It is prudent to try some planning as you see a new law being considered. Anything you do should be consistent with your purposes for the wealth and should not result in anything you may someday regret.

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