

Transcript: Estate and Generation-Skipping Transfer Taxes and Step-Up in Basis Rules

Speakers: Andrew Katzenstein - Partner, Personal Planning Department
David Pratt – Partner, Personal Planning Department
Jay Waxenberg – Partner, Personal Planning Department

Brandy: Good afternoon. My name is Brandy and I will be your conference operator today. At this time I would like to welcome everyone to the estate and generation skipping transfer taxes and step up in basic rules a decision of planning opportunities in the face of potential legislation conference call. All lines have been placed on mute to prevent any background noise. After the speaker's remarks there will be a question and answer session. If you would like to ask a question during this time then please press' star, then the number one on your telephone keypad. If you would like to withdraw your question, press the pound key. Thank you. Mr. Jay Waxenberg, you may begin your conference.

Waxenberg: Thank you. Good afternoon and welcome to Proskauer's dial-in presentation on the repeal of the estate and generation-skipping taxes. I am Jay Waxenberg, a member of the Firm and chair of our Personal Planning department. Joining me today from Washington, D.C. is Jeff Peterson, a lobbyist with U.S. Strategies; from Boca Raton Florida, David Pratt, a partner in our Personal Planning Department and head of our Boca Raton office; and from Los Angeles, Andrew Katzenstein, a Personal Planning partner resident in our Los Angeles office. We have a very diverse group of people calling in today. We have trust offices, bankers, investment advisors, insurance professionals, accountants and, of course, attorneys. Thank you for joining us. After our presentation, if there is time, we will look for questions.

As you know, in 2009, we had a estate tax exemption of 3.5 million dollars, a generation-skipping tax exemption of 3.5 million dollars and top rates for estate and gift generation-skipping taxes of 45 percent. In 2010 we have no estate tax, no generation-skipping tax and a maximum gift tax rate of 35 percent. No one ever expected Congress to drop the ball and not enact some extending legislation by the end of 2009. Personally, I'm glad that no client took me up on the many bets I made that, of course, the tax would be dealt with by the end of the year. At this point, we have a few possible alternatives. One is that the repeal stays effective for all of 2010, and in 2011 the changes presently scheduled to take effect in actuality do take effect, meaning we're down to a \$1 million estate and generation-skipping tax exemption and a return to 55 percent tax rates. Another possibility is that there is no tax for a short time in 2010, but then Congress reinstates the estate and generation-skipping taxes using the 2009 rules of a \$3.5 million exemption at a 45 percent tax rate or some other rate. And last, the

tax is reinstated retroactive to January 1, 2010 using the 2009 or possibly different rates.

This afternoon we're going to give you some insights into the legislative process and advice on what many of us should now be doing. There are lots of materials out there that go into the technicalities of the dilemma we find ourselves in and our clients in. So we're going to try to not be over-technical and hopefully present some practical action to take. The big question is whether Congress will enact any estate and gift tax legislation this year and if they do enact legislation, will it be applicable retroactively. Before we discuss retroactivity, I want to introduce Jeff Peterson. Jeff is an executive vice president with U.S. Strategies, a lobbying firm. He is a graduate of Harvard College and Georgetown Law School. He served as legislative assistant and then chief of staff to former senator Abe Ribicoff of Connecticut, who was a senior member of the Tax Writing Senate Finance Committee. He was counsel to the Senate Finance Committee before joining the Carter administration, first as an assistant at the Department of Health Education and Welfare and then as Deputy Assistant Secretary of the Treasury for Tax Legislation. Jeff, you're in the middle of it all. How did Congress let this happen?

Peterson:

Jay, it's amazing. I would have lost a lot of bets too because I thought something was going to happen last year. It's sort of a perfect storm and I'd like to give you the background on it. In the more than 35 years that I've been out here in government or in lobbying I've never seen worse partisanship in my entire life and that was certainly true last year after the Democrats strengthened their control on the House and the Senate and President Obama was elected. Everything that the Democrats wanted to do the Republicans said no to, so that created a major problem. The partisan politics I'd say was the worst in history. Secondly, Congress, in the first session, there was so much on their plate because President Obama put so much on that plate and we had all the economic distress. There were so many things to do and Congress really didn't get around to doing them. They had health care. They had the stimulus package to worry about. They had jobs. They had extending the tax credits which were going to expire at the end of the year. They had debt ceiling issues. They had financial regulation. And they put off all of that pretty much towards the end of the year and, then when it came time to move something they had to do it at the end of the year, so at the end of last year the House passed a permanent extension at 2009 rate – passed the House by 225 to 200 vote – and that's the easy part because the House has easier rules to get things by if you're the majority. Majority really does control. The problem is the U.S. Senate. In the U.S. Senate you have to do a lot by unanimous consent and if you don't get unanimous consent, you have to get 60 votes to overcome a filibuster, so everything would potentially filibusterable.

In the case of the estate tax, there was no consensus. Liberal Democrats didn't care about it at all. They would rather just have high rates and low exemptions. A lot of the conservatives wanted no tax at all and there was

an in-between group and they were going back and forth on those. There were – the only way you could actually get a bill passed was by adding it to some must-pass bill at the end of the year. We thought that they would add something, perhaps a one-year extension or a two-year extension to the tax extenders. These are extensions of the tax credits that were going to expire. They decided not to do that because the extenders were added to the really-must-pass Defense Appropriations Bill at the end of the year and the Democrats in the Senate were scared that the Republicans would object if a estate tax extension was added there. So we came down to the couple nights before Christmas and nothing was done. It was sort of a perfect storm of extreme partisanship and a heavy, heavy agenda.

Waxenberg: Let me ask you a multi-part question: Now that Congress has caused all this chaos, at least among those of us in the trust and estates world, do you think it's likely that we're going to see legislation this year and, if so, what form do you think the legislation will take and, finally, no matter what happens, do you think Congress will try to make the changes retroactive to January 1?

Peterson: Well, the bottom line is that no one knows. Right now there are absolutely no plans. Members of Congress are just coming back into town. The Senate doesn't come in until next week and the House is in for some pro forma sessions today and they don't come in until next week and in fact then they go out on a recess for ten days for the President's Day recess, so they don't have a lot of time at the early part of the year. Let me put it in context though. If last year was partisan, this year will be mega-partisan. You've got an election year coming up and the Republicans sense that there's a movement against the Democrats so they don't want to give the Democrats any victories at all. Once again there's a huge agenda that's coming up. The health care bill continues to be the major thing that everybody wants to get done. The health care bill is a major part of Finance Committee jurisdiction so they are spending a lot of time behind closed doors working on the health care bill, leaving them little time for anything else. In fact, they haven't even had an opportunity to bring to the floor all the confirmations of Treasury, and HHS nominees were just piling up because they're working so hard, supposedly working hard on the health bill.

Secondly you've got a jobs bill. The House passed the jobs bill in December and right now with the new numbers on the economy showing that the numbers are bad, there's going to be increased impetus to pass the jobs bill, so that's going to be a major issue that people are going to want to take care of. There's a debt ceiling extension. The debt ceiling has to be increased by mid-February, and at the end of last year they extended it pretty much till mid-February. They also have to do the extenders tax credits. At the end of last year, everybody expected that they were going to extend tax credits, things like the R&B tax credit, the biofuel tax credits. They were going to extend them for at least one year. They ended up just extending everything but February 10th so they have to revisit that as well.

You've got financial regulations – all the stuff that Chris Dodd's been doing and Barney Frank has been doing in the Financial Services Committee. You've got unemployment extension. You've got COBRA issues. so it's sort of on a back burner now.

Right now the House is basically saying, "We passed a bill last year. It was the permanent extension of 2009. Let's watch and see what the Senate does." They say the Senate has no plans right now. Baucus and Grassley, the Chairman and ranking Republican on the Senate Finance Committee – the tax writing committee – late last year assured that they would extend the expiring tax credits and they gave a signal to the market and to the economic community they would do that. They did no such thing for estate tax. So they have not said that they have any consensus in the estate tax.

What we understand now, as I'm talking with tax staff, is that there are some negotiations going on principally involving Senator Blanche Lincoln of Arkansas, who faces a tough battle for reelection. Last year she got passed in the Senate a budget resolution amendment, an amendment which lowers the rate to 35 and increases the exemption to \$5 million. They are now working to see if they can get that accepted as a Senate position. But it turns out that the costs of doing that as opposed to last year's raise and exemptions is \$81 billion over 10 years. So they are now struggling to come up with money to pay for that because under PAYGO rules they have to come up with money to offset that.

Here's a couple of scenarios that could happen on this is that one, they meet and combine the extenders bill – which has to be done supposedly by February 10th – with estate tax bill. That gives the estate tax a train to ride on, sort of a must-pass train. However, the history of extenders bills in the last ten years has been that they don't mind letting those tax credits expire and they will make them retroactive, you know, going back a year. So there's no guarantee there. It's possible that they could – what I'd be looking for is to see if the Senate Finance Committee goes into a markup in late January to actually do something on estate taxes. I could be very doubtful that they would do that. I think this is going to be a bill that's going to be done on the Senate floor and to be done later in the year. Now as to retroactivity, Congress can do tax increases retroactively, I believe, and they do tax credits retroactively all the time. When talking to staff people and to a couple of members, I think the feeling is that the longer you go without enacting a tax the harder it is to go all the way back. So it would be easy if you passed a new tax in 2010 before, say, April 1st or March 1st, but if you get into May, June, July, it becomes tougher and sometimes when they make credits retroactive they've gone back to the previous quarter.

I think this is going to happen later rather than earlier. There's no real impetus on the part of anybody except a few people to do something. I mentioned to you folks on a conference call recently that there's no expertise in Congress on estate taxes. Aside from the staff in the Finance and the Ways and Means Committee, virtually no one in the House or

Senate knows anything about estate taxes except rates and exemptions. That's all they know about it so there's a very limited number of people who care about it, which also means that you're not going to be able to do a lot of technical changes. It's going to be something very simple. My gut tells me that if they do anything it will be perhaps in the October period but – and the Congress is now supposed to adjourn in October – generally when they adjourn for the elections they come back in December and do something again. If you also remember, the Bush tax cuts, which were enacted ten years ago, expire at the end of this year. So it will be a big battle to extend those tax cuts. If they do estate tax I think they would tie them – the estate taxes – to the Bush tax cuts, but members of Congress don't want to vote on taxes before the election. It's too big a battle. So my gut feeling is unless they do something by February 10th, it's not going to happen till the end of the year.

And as I say, there's no pressure to do anything. There's no – once you got past January 1st of this year, which is a real time pressure, there's now no time pressures as far as they're concerned. They don't know or appreciate the chaos that's out there.

Waxenberg: You know, Jeff, last year those of us in trust and estates who obsess about these things heard about proposed legislation that we were not thrilled with. Specifically there was talk about the elimination of discounts on entities in family transactions, minimum terms of GRATs – we heard ten years – and maybe worst of all, minimum gifts and GRAT transactions equal to ten percent of the value of the assets transferred to the GRAT. Do you have any idea if we're likely to see any of these proposals enacted?

Peterson: I would guess not. The only, as I say, members of Congress don't know about what they would call the underbrush of the estate taxes, not rates or exemptions. If they just do estate taxes as an amendment to some other bill they are not going to get into the weeds on any of this stuff so it won't happen. The only way any of those things could happen is if there was actually a committee markup which went to the estate tax and there's a very, very slight chance that that could happen. I don't expect it to happen and even then, unless some of those changes raise a heckuva lot of revenue, I don't think those are going to happen. I don't think you're going to see any of that.

If there's going to be any reforms, the House Ways and Means Committee is planning to start a series of hearings early this year as the sort of forerunner to major tax reform. Obviously that's not going to be on the plate this year. So I would think anything that would be considered major reform, would not be considered this year.

Waxenberg: And when do you think is the latest Congress could possibly act this year. Could we see something in December?

Peterson: Yeah. In December. My gut feeling tells me that after the, you know, when they go out for the elections which I think is October 8 – and sometimes

they extend that date by a week or two – they will come back, they will punt on a lot of different issues. They will, you know, and maybe they'll punt on appropriations which they often do, and they'll put off a lot of stuff. And I think they're going to put off any consideration of Bush tax cuts. I think the extenders will go to pretty much towards the end of the year. The interesting thing on the extenders is the extenders tax credits could be a nice vehicle and Senator Grassley, the ranking Republican on the Finance Committee, would love to attach estate tax to the extenders. Baucus has been saying, "No, I don't want to make that attachment." So the estate tax by itself cannot go through. It's got to be a part of some other train that has a stronger engine than just estate taxes. I see it as December, if at all. And I'm not sure that there's, it can happen even then.

Waxenberg: Well, thank you for that, Jeff, and if anybody wants to e-mail Jeff, his e-mail is Jpeterson@USStrategigies.com

Well, David, you know Jeff's indicated that while it's a hot-button topic, there certainly is a chance that Congress could enact legislation retroactively. Can they legally do that?

David: Jay, it's a great question. It's getting a lot of press. A lot of chatter, a lot of discussion. And when you think about it – at least instinctively – you would think that retroactive taxation is unfair and unconstitutional. Unfortunately, however, there is a significant amount of legal precedent that allows retroactive taxation. And this would not be the first time that Congress has retroactively imposed a tax. The Supreme Court has allowed it before and there's no reason to believe that they would not do so in this situation again.

So let me tell you a little bit about the law. Generally speaking, there is a very low threshold that must be met. The legal standard that's used to determine whether a retroactive tax law is constitutional is whether the law is rationally related to a legitimate legislative interest. In our opinion, retroactive transfer tax legislation would probably be held to be constitutional because as federal tax legislation is intended to raise revenue, it would probably be viewed as being rationally related to the legitimate legislative interest of raising revenue. Now, with that said, if there is retroactive tax legislation – and again, as Jeff mentioned, we don't know if there will be – there will undoubtedly be some taxpayers who will challenge the law. There always are. So what will their arguments be? Well, they will argue that any retroactive tax legislation is really considered to be a new tax. And why is this argument important? Well there are some very early cases from the late 1920s that involve the gift tax. And this is when the gift tax was first introduced into the Internal Revenue Code. And the cases that, from those years in the late 1920s, they held that when the gift tax was enacted for the first time on a retroactive basis, the tax was unconstitutional because the tax was new. Not the same here. Given the fact that the estate, generation-skipping transfer and gift taxes have been around for a very, very long time, coupled with the flurry of discussion last year regarding the taxes, it's hard to imagine a court holding that a

retroactive estate or generation-skipping transfer tax is really a new tax. Is it possible? Or impossible? We don't know. But the taxpayer making this challenge is going to need to understand that it is going to be an uphill battle. Very, very difficult to make that argument. We'd be happy to make it but as long as the client understands the challenge, that's the important part. We could probably spend hours talking about this very fascinating issue of retroactive taxation. We could probably spend days talking about it. If any of our listeners are interested, I wrote an article on the topic that was recently published in Steve Leimberg's newsletter which, by the way, is probably the best, single best way to keep abreast of the latest developments on the estate, generation-skipping transfer and gift tax laws. If any of our listeners are interested in seeing the article and receiving the newsletter, they can join Leimberg Information Services, they can go to Steve Leimberg's website at Weinberservices.com, that's Leimbergservices.com, to sign up and I'm pretty sure that he offers a ten day free subscription. So the article includes all the law that you need to address regarding the issue of retroactivity.

Waxenberg:

Assuming that it's going to be some time before this gets sorted out, we really have to take some practical action. And one thing that's clear it's whether you're an attorney, banker, accountant, investment advisor or insurance specialist, we all need to contact our clients in writing and we probably need to do it as soon as possible. The harder question is, you know, once we notify them, what do we tell them they should do? And we're going to try to break down what we think we should do in the three broad categories which we're going to discuss. And first is, what do we do with existing client estate plans? Do they need to be changed immediately? Are some existing plans more vulnerable than others? And second, assuming that some of these plans do need to be modified, what do we do with those and also what about plans for new clients we take on now? Should we be doing different strategies? And, finally, there's been a lot of talk about special planning opportunities while there's no estate tax, no generation-skipping tax and a reduced gift tax of 35%. Are they really opportunities or is this really all speculation?

You know, David, you and I have been talking about this and there are a lot of people out there who feel paralyzed and, you know, what if anything should we be doing now with existing plans and let's talk about all those formula clauses out there.

David:

Absolutely. This is a paralyzing time and there's a lot to address. Before I address the specifics, um, I want to make a statement that I think is absolutely critical. As we've gone through this over the last few days and talked about this it has become even more apparent. And that statement is the following: This is absolutely not a one-size-fits-all situation. Let me repeat it: This is not a one-size-fits-all situation. We must assume that every client has different circumstances and then we can go from there. I think we all know as lawyers that we start with our form documents and we have our standard formula clauses that we use. But we usually modify

them to fit our clients' particular circumstances and I think we have to take that into consideration and just assume that everybody is unique.

Here's the problem: since the estate and generation-skipping tax exemptions have been around, and they've been around for quite a long time, we've been drafting estate planning documents for our clients which refer to the estate tax exemption and the generation-skipping tax exemption. These are commonly known as formula clauses and they're designed to maximize the use of the estate tax exemption and the generation-skipping tax exemption. For example, it's typical for both spouses in their testamentary document – a will or a revocable trust – to have a provision that says something along the lines of "I leave the maximum amount that can pass free of federal estate tax to a trust for the surviving spouse and the children." This is the typical credit shelter or bypass trust. Or maybe an individual wants to take care of his or her grandchildren. And that individual may leave the maximum amount that can pass free of generation-skipping tax to a generation-skipping trust for his or her grandchildren. So we have them in our documents with respect to the formula clauses. We've also been using these terms that are in the Internal Revenue Code as references in estate planning documents we draft for clients. For example, one could leave ten percent of his gross estate as finally determined for federal estate tax purposes as a specific request to an individual or maybe a charity. Again, a reference to a term in the Internal Revenue Code. And of course who can forget about the references to percentages that may be used in a prenuptial agreement? For example, a spouse could be required to leave a percentage of her gross estate to her husband upon her death. I could go on and on and on with examples.

The problem is twofold. First, some of the formulas that have been written just don't work if there is no estate or generation-skipping tax when they have to be applied. In the last two examples regarding the bequest made on a percentage – or based on a percentage – of the gross estate, what happens in this case to the bequest if there is no estate tax when the individual dies? There's no term in the Internal Revenue Code during 2010 that is defined as the gross estate for federal estate tax purposes. We don't have an answer. Second, the formulas may work from a technical standpoint, but the assets may actually be disposed of in a manner that is completely contrary to the testator's intent. For example, let's say that an individual who assumes that the estate tax exemption will never exceed \$3.5 million dollars signs a will that leaves the maximum amount that will pass tax free to his children and the balance to his wife. In this case, the kids get everything and the wife gets nothing. And to make matters worse, what if this was a second wife who was not the mother of the children? I think the probate litigators will have a lot of fun with this type of case, and they're very, very common. So what do we do to avoid these problems? First, as Jay alluded to before, you must communicate with your clients. Clearly, you can not call every single client or write a personal letter to every client. You should reach out to your clients and alert them in general

of their situation and the potential problem. Our Personal Planning Department has drafted a letter that will be sent out shortly to all of our clients and this one should probably be in a letter, not in a global e-mail. Believe it or not, there are still some clients who don't use e-mail. If any of our listeners would like to see a copy you can certainly send me an e-mail and I'd be happy to send it to you, or you could visit our website, Proskauer.com, and if you go to the publication section from the homepage you can click on the document. It's dated January 11, 2010 and the title is "Temporary Estate Tax Repeal Congressional Inaction May Require Your Action."

So, we send the letter. We alert our clients. Once the clients start calling, and they already have started to call, you should analyze the formulas in a particular client's document to determine exactly how the assets will be distributed if the client died today, when there is no estate or generation-skipping tax. If the result is contrary to the client's intent, you obviously need to redraft the documents, and when you'd redraft the documents, you should probably do them in two separate scenarios. Scenario one: that's going to be the scenario where death occurs where there is no estate or generation-skipping tax. In other words, if the person dies before the law passes that Jeff was alluding to and perhaps may get passed later in the year. Scenario two would be, of course, if there is an estate or generation-skipping tax. I think the point is that you need to contemplate all scenarios that could take place.

Is this going to be cumbersome? Absolutely. But unfortunately I don't think we have a choice. Otherwise, if death occurs when there is no estate or generation-skipping tax, there are going to be some very peculiar results and perhaps, lots of litigation. I wanna give you some extra-sensitive situations to look for that may not be that apparent at first thought. First: second marriages with children from the first marriage. Very common for people to leave the estate tax exemption to children from the first marriage and the balance to a QTIP trust for the surviving spouse. Next, bequest the grandchildren of the generation-skipping transfer tax exemption. This could essentially leave everything to the grandchildren to the detriment of everybody else if the person dies when there is no generation-skipping tax. What about a bequest to a charity or individual based on the value of the gross estate as finally determined for estate tax purposes? This could potentially wipe out these types of bequest. Very often we use zeroed-out testamentary charitable leave trusts and these are tied to the estate tax exemption and they may be impossible to apply. Another example involving charity is a bequest for the maximum amount that can pass tax-free to individuals other than charity with the residue going to charity. In this situation, the charitable bequest could be completely wiped out.

Another not-so-common example that we need to give some thought to, particularly in this climate where people have significant IRAs, is that, in some cases, the beneficiary form actually contains the formula disposition. Many clients have large IRAs and these forms divide the IRA based on the

estate or generation-skipping tax exemptions. These are just a few. There are plenty of others. The bottom line, I think, is that you must review your client's documents and see how the assets would be distributed if the client dies when there's no estate tax and the current plan is followed.

Waxenberg: What about wills with QTIP trusts? Do we need to modify those if somebody's got a straightforward will where you've got a pecuniary credit shelter bequest and a residuary QTIP for example?

David: Well, again, I think in those types of standard documents you have to see where the chips fall, Jay, and you have to ask the client. It's the client's choice. If there is a difference in how the assets will be distributed and is contrary to the intent of the client, then you may need to make some changes. We all know, for example, that credit shelter trusts typically have provisions that have discretionary distributions of income and it's possible under your scenario that that could be wiped out with everything going through a QTIP trust, which would force all the income out. So again, you've gotta look at the document.

Waxenberg: One of the things that I should point out is while you're in sunny Florida – in a ski coat I might add – there's no estate tax in Florida. For those of us in New York, if we want to take advantage of the no-tax era and have discretionary or credit shelter-type trusts with the entire estate, we could be faced with large New York estate taxes. So there are probably more options in Florida or California, for example, than we have.

Andy, I wanna move over to you a little bit. Over the last couple of days, you and I and David have been talking about all kinds of planning opportunities during this no-tax period and what happens is one day we start talking about it and then the next day one of us comes up with a reason why it doesn't work anymore and we end up rejecting it. There may or may not be retroactivity, but a lot of people feel if there is retroactivity, you may be worse off if you did something than if you had done nothing. But is there anything we can do here?

Andy: Well, just from an introductory point of view, I wanna say that there are two ways you can react when there's uncertainty and change in the tax law. One way is to freeze and do nothing and wait to see how things are sorted out, and that's certainly a logical way to proceed. But the other way to proceed is to look at this as an opportunity to see whether you might be able to get a better tax result than you could if the law changed or if the uncertainty is resolved. The important thing to remember here is that because there is uncertainty, the steps you take you want to take in such a way so that if the law is passed retroactively you can protect yourself from being in a worse position than if you'd done nothing. So let me give you a couple of examples.

I think the big play and the big things that people are talking about doing at this particular moment is to take advantage of the lower costs in making transfers to grandchildren. You know in 2009 with a 45% gift tax rate and a

45% generation-skipping tax rate, it cost about 65-70% to transfer funds to grandchildren in terms of tax. In 2010, if you're going to make a transfer to grandchildren, they're only going to pay a 35% gift tax. As the law currently stands, you won't pay any generation-skipping tax. And in 2011, if the law remains as it is, you'll pay both gift and generation-skipping tax starting at the 55% brackets and so the costs to get things to grandchildren can exceed 70%. Bottom line is making transfers to grandchildren this year can be done at about half the tax costs as it could have been done last year, or it can be done next year but only if they don't make a retroactive change to the law. If somebody decides "I want to take advantage of this opportunity and give a million dollars to my grandchild and pay \$350,000 of tax," they would not be happy if it turned out a law came in retroactively and the cost of giving that million dollars to the grandchildren was \$700,000 and tax. So the question is, what types of strategies can we design in order to let our clients have our cake and eat it too?

Let me give you an example of one of the strategies that we've thought about to accomplish this end. Let's assume that Grandpa wants to give a million dollars to his grandkids. In our plan, the grandpa would give a million dollars to a trust for Grandma, and the trust would say when Grandma dies the assets in the trust go to the grandchildren. Those trust provisions for Grandma look like and are a QTIP trust – all the income to grandma may be principle that she needs for her support. After that gift is made, we wait. And we wait to see what Congress does. If Congress passes a law that's retroactive and catches the gift of that trust, then next April 15 we file a gift tax return, make the QTIP election for that trust, the gift of the trust qualifies for the marital deduction and there's no gift tax consequence for Grandpa putting the million dollars into the trust. If Congress doesn't pass the law or they pass a law that isn't retroactive, Grandma can then disclaim her interest in the trust. When somebody disclaims an interest in the trust, they simply say, "I don't want it." And when they say "I don't want it," the assets in the trust pass to the next named beneficiary and, in this case, that would be the grandchildren. Because the disclaimer relates back to the dates that the money was put in the trust, the minute that Grandma says, "I don't want it," those assets are deemed to have gone directly from Grandpa to grandchild, predating any change in the law and, as a result, you get to take a look to see if it will work. And if it'll work, you let it happen.

One of the rules about a disclaimer is that it has to be made at 9 months, no later than 9 months from the date of the gift to the trust. And as we heard from Jeff, it might take longer than 9 months for Congress to sort this all out. So what do we do if we get to that 9-month period and we don't know what's going on? One of the things that we could do is have Grandma execute a formula disclaimer. She could say, "I disclaim any portion of the assets of this trust that could pass to the grandchildren without the imposition of generation-skipping tax." And then that way, once Congress sorts it out, we'll be able to know how much goes to the grandchildren and how much does not. One of the concerns that people have when they take

a look at this kind of planning is whether the assets have to pass outright to the grandchildren or whether they can be retained in trust for the grandchildren, and I think all I can say at this point is there are arguments both ways. But certainly the safest course of action would be to make sure that if the assets are disclaimed by Grandma in our example, they would pass to the grandchildren outright.

Now there are many people who have minor grandchildren who don't want them to get outright distributions. There are many people who have adult grandchildren that don't want them to get outright distributions. They want to continue to control those monies. And we have a strategy using a partnership that will enable our clients to accomplish those goals. So it's this type of generation-skipping planning, where we can transfer assets to grandchildren at half the tax costs yet protect our clients from a retroactive change in the law, that we're pursuing at this time. One of the things I wanna say is, you know, how do you figure out which of your clients, which of the people that you work with, should think about this plan. It really isn't for everybody. But the place that we started was, we looked to see people who were leaving significant sums to their grandchildren as part of their will or their living trust. Those would be natural candidates to try to make transfers to their grandchildren now at a cheap tax costs as opposed to waiting until they die, presumably in a number of years, when the tax costs would be much greater.

Another area that we've looked at is a situation where children owe money to their parents and the parents have talked about forgiving all or part of that loan, because if they forgive the loan at a 35% gift tax rate, it will be much cheaper than last year's 45% rate or, perhaps, next year's 55% rate. Again, you face the same question. What happens if they forgive and they think they're going to pay 35% tax, and there's a retroactive change to the law where they're actually going to pay a much higher tax rate. And what we recommend to people there is that they use sort of a formula for forgiveness. They say, "I'm going to forgive that portion of this loan that can pass to my kids in the form of a forgiveness and not be subject to gift tax at more than 35%." That way if the law turns out to be retroactive and it would be taxed at 45%, nothing was forgiven. But if it turns out that that forgiveness done today isn't hit by any retroactive legislation, the transfer would be allowed to proceed because it would only be at a 35% rate. So those are the types of things that we're thinking about. Again, looking for opportunities to take advantage of the lower gift tax rate and the absence of the generation-skipping tax rate, but done in the type of a way that if it turns out to be as we don't want – with retroactivity – we can make it so it's no harm, no foul for our client.

Waxenberg: Andy, what about the planning, you know, that we all know and love and have been doing for years like, you know, GRATs and sales to defective grantor trusts. Is there any reason why they're not still viable options?

Andy: Well, you know, I listened to Jeff very carefully and I read the Internal Revenue Code before I came in today, and I haven't heard anything that

said that we're not going to have this tax law in some way, shape or form either this year or, certainly, next year. So as a result, I think that everyone should continue to do the planning that we've always done. Uh, if they don't pass away this year and they pass away next year or in years after where there is a tax, they're going to wish they'd taken opportunity, those planning – advantage of those opportunities, and particularly now when interest rates are low and when values are still low, I think that people should not stop doing what they've been doing but they should continue on.

Waxenberg: Alright. I want to bring up one last point before we go on to questions, and David, maybe you want to comment on this a little bit but we were talking earlier today – let's say you're an individual trustee or a corporate. And I'm sure there are a number of people who are on this call who are individuals serving as trustees, and I'm certain that there are a number of people who are for corporate trustees on the call with us. When we're in an environment right now where there's no generation-skipping tax, if you're the trustee of a trust that has skip persons as beneficiaries and that distributions to those beneficiaries would typically attract a tax, do you think there is a duty to make distributions now to take advantage of the lower tax rates and do you think that if you don't take advantage of that lower tax rate that perhaps if the rates go up, you might be faced with potential liability for not taking action?

David: I think, Jay, this is an area that is not getting any attention and I actually do think this is the most complicated area in this whole process. Whether there's a duty or not, is difficult to say. Certainly there's not time in history, when this has occurred, at least none that I can recall. I think the point is that if I were representing a trustee, I would probably want to address the possibility – the pros, the cons, maybe discuss it with the beneficiaries – and certainly my job in representing the trustee would be to make sure that the trustee is protected with respect to any decision that the trustee makes. There are going to be pros and cons. You're going to have to look at the document, understand what the intent is. Was the intent to keep this in trust for a long time or was the intent to save the maximum amount of taxes that you can? There certainly are ways that the distributions can be made with agreements in place so that the trustee is protected. So that's the approach that I would take. Address how to protect the trustee.

Taking the flip side, if I were a beneficiary, I suppose that I may want to ask the trustee for a distribution and start the dialogue, but certainly this is a new area and, um, there will be a lot to discuss about it. It's a fabulous – it's a fascinating and fabulous issue.

Waxenberg: I think this is one of those issues that trustees are going to have to focus on, and they probably should be looking at their trust documents to see if there are potential generation-skipping transfers that could be made without incurring any taxes and whether that's advisable to do so.

Peterson: can I just interpose here for one second just to...

Waxenberg: Sure, Jeff.

Peterson: As people are thinking about planning, I think – and we don't know whether they're going to do anything this year, but if they do, I think the parameters you ought to keep in your mind as to what they're going to do – it's going to be somewhere between 2009 levels and the levels that Senator Lincoln has proposed, which is the 35% and the \$5 million. In fact if I were sort of guessing I will bet she will try and cut some kind of deal somehow with the powers that be to, perhaps, have a phase-in over years to move from 45% and 3.5 million down to the 35% and up to the \$5 million level. So I think those are the parameters you ought to keep in mind, assuming they do something.

Waxenberg: And one of the things that we're concerned about: you keep saying "assuming they do something" and it's entirely possible that if they can't get their act together, we can go through all of 2010 with no legislation –

Peterson: Yep.

Waxenberg: – and start out 2011 with a million-dollar exemption for estate taxes and a million-dollar generation-skipping exemption with 55% tax rates. I guess the exemption for GST would be a little higher because of the indexing, but those rates may go up dramatically. So query whether people have some sort of duty to try to do something this year in case that happens.

I think that this is probably a good time for us to break and take some questions, if anybody who's listening has questions.

Brandy: At this time, I'd like to remind everyone in order to ask a question, please press "star," then the number one on your telephone keypad. We will pause for just a moment to compile the Q and A roster.

And again to ask a question, that is "star," then the number one on your telephone keypad.

Your first question comes from the line of Richard Sugar.

Sugar: Yes, the question is for carry-over basis rules. Uh, you didn't address the carry-over basis rules and what we should be doing about that, uh, in talking with our clients and perhaps modifying documents during 2010.

Waxenberg: Well, I think there's a few things. First of all, I think that you do need to get basis information on assets if you don't have it right now. Uh, we are modifying the number of our documents to provide that we set aside a qualified spousal bequest to take advantage of the three million-dollar step-up that's allowed with a spouse. One of the nice things is that if you have a QTIP trust in an existing will, you should be able to get the spousal basis step-up with that. If you don't have qualified bequest to a spouse, you probably should be adding that in. Uh, David talked before about modifying documents under two conditions: if the tax is in effect and if the tax is not in

effect. I think you have to provide if the tax is not in effect, you have to make sure that the entire estate does not go to a credit shelter-type bequest because a credit shelter-type bequest would not qualify for the spousal basis increase. So you really do have to take care of that.

Any other questions?

Brandy: Your next questions comes from the line of Kim Bebour.

Bebour: Hi. I'm an estate attorney out in Los Angeles and sort of just formulating this on the fly, but if someone, if we have a decedent who dies this year, say in the next couple months before there's any legislation and there's a what otherwise would be a taxable estate, if there was estate tax in play, the trustee is the beneficiary's going to be looking for their assets for distribution and the trustee needs to protect themselves as far as paying estate tax if, in fact, there is retroactive legislation. So how are you going to advise your trustees in those situations and I guess how long would they – obviously, they'd hold some type of reserve – but how are you going to deal with that issue?

Waxenberg: Andy, you want to take that?

Andy: Yeah, um, you know, somebody called me the other day and said "I had somebody who died this year, what return should I file?" And there is no 706 to file this year. There are regulations that talk about the basis step-up return that's supposed to be filed, but as far as I know there's no form that exists. So what I told him was to collect asset information that could be used either for a basis step-up return or for an estate tax return. It's kind of the same work that you have to do to start out with and so I think that was step one.

But step two is that when you file that – if it comes time to file that basis step-up return and Congress hasn't acted, I think at that point you have to file the basis step-up return. But I still think if you're worried about retroactivity that you're going to have to hold back that reserve.

Now often times it takes more than a year to gather information and ultimately to make distributions to beneficiaries and many times, until estate taxes are paid, if you go on extension under the old rules, it might not be a year and a half until the taxes are paid and the beneficiaries might have to wait for distributions in any event. So I think that, as Jeff said, if we're going to see anything it's going to be this year. Um, I think that it might not mess up the timing for you too much. But one question I have – and this is for you, Jeff – is there any chance that we get to 2011 where they would tax something that would be retroactive to 2010 or do you think that once we get past 2010 with nothing, the ship has sailed and we just go from there?

Peterson: I think the ship has sailed and yes, if we get to next year, uh, they're not going to go back this year.

Andy: Right. So, Kim, I think that you'd only have to wait till the end of this year to know one way or the other for sure.

Bebour: Yeah.

Andy: In my mind that doesn't take us too far out of how long we'd make people wait in a typical case anyway.

Bebour: Good point, thank you.

Waxenberg: Well, the only thing that I would add, Andy, is if I was a fiduciary or representing the fiduciary, I would want to be very certain before I gave that money out to make sure that there was not going to be a tax due and that might be having to wait for legislation to be enacted.

Should we take the next question?

Brandy: Your next question comes from the line of Paul Graze.

Graze: Yes, I'm here in So Cal as a financial advisor and I was looking at this three-year rule restricting deathbed planning techniques. Is that in a non-community state or nationwide?

Waxenberg: Andy, why don't you take that, since you're in a community property state?

Andy: The three-year rule applies all over the country. What's interesting to me is right now there is no three-year rule 'cause there is no tax. And, but it is a nationwide rule.

Graze: One other question, the, um, client of mine is got Alzheimer's and doctor's talking, you know, 2 or 3 months left and his beneficiaries are up in the air and their health care power of attorney documents during this interim period and general power of attorneys and you've got a second spouse and original siblings from the first spouse – uh, they're looking for some answers.

Andy: Answers concerning which particular topic?

Graze: I guess during the time that the client is still alive and then what do they do after, you know, death per se with this second spouse and the first mother and, uh, just, you know, the things that you've already touched on.

Andy: I think the situation that you're describing is definitely one that calls out for the type of review that David suggested. This is really the classic situation where you need to take a look at the documents and see where you go from there.

Graze: So, the person that's got full authority, I guess, with general power of attorney is going to be the primary decision

- Waxenberg:** I suggest that your question – you might want to call one of us off-line and we can go over the specific facts with you because we have a limited amount of time and I think we should move on to the next question. But feel free to call one of us off-line.
- Graze:** Thanks a lot.
- Waxenberg:** Can we get the next question?
- Brandy:** Your next question comes from the line of David Roberts.
Your line is open, sir.
- Roberts:** Oh, yes, my question was whether there was any prospect in the course of these amendments that Congress might be looking at of reunifying the estate and gift tax credits.
- Peterson:** Well, as I said, it depends on how the process works. If they're just sticking things on – uh, unrelated amendments – and not going through the committee markup process, there's virtually no chance of doing that. If they're going to go through a normal procedure there will be time to look at those sort of things, and if they had hearings and things like that, I'm not sure that they would even look at that this year.
- Waxenberg:** Alright, next question.
- Brandy:** Your next question comes from the line of Ronald Finklestein.
- Finklestein:** Oh, yeah, my question was what to do when October 1st, when the estate tax returns were due if Congress hadn't acted, but the question was answered already. Thank you.
- Brandy:** Your next question comes from the line of Zeb Ra.
- Ra:** Hi. I'm an estate attorney in Orange County, California, and, uh, um, I have two clients that both, um, the surviving spouse passed away last year, um, late last year in 2009. In both those situations, we have trusts previously established that allowed for income and discretionary principal to go to children and at the death of the last child to go to grandchildren. And the plan was back then was to wait for the children to die and then there would be a taxable termination subject to generation-skipping tax, and my question now is if we do some kind of a qualified disclaimer this year when there's no generation-skipping tax, would the disclaimer be effective this year and I could maybe make the disclaimer with no generation-skipping tax or does anyone think that it might relate back?
- Katzenstein:** I think the quick answer to your question is that if you're within the period for the disclaimer, will it relate back? You might want to think about modifying the trust due to changed circumstances under California law and that's something we could talk about off-line if you wanted to.

- Pratt:** Or, another point is you perhaps could fund those trusts and make a distribution to grandchildren subject to the rules that we talked about before.
- Ra:** A similar question will arise, I think, in 2011 under current law. Let's say, because I can imagine people doing disclaimers in 2011 to relate it back to the 2010 no GST rule. I imagine there may be a letter ruling.
- Waxenberg:** I think that you know the disclaimer does relate back and you may see it. I'm not sure that they would rule on that. I think the rules there are pretty clear.
- Take the next question.
- Let's take the next question.
- Brandy:** The next question comes from the line of David Johnson.
- Johnson:** Thank you. This is a fee question. The document allows a trustee to retain agents, advisors and attorneys and compensate them from the trust and the document allows the trustee to charge reasonable fees. Do you believe in this unusual time and circumstance a trustee would be entitled to additional compensation and, to be able to take this from the trust funds? Charge it to income and principal. How would it be charged?
- Katzenstein:** I mean, from my point of view, I think that the trustee's doing more work and doing more sophisticated work, those would be grounds to increase their reasonable fee.
- Pratt:** Yeah, I would certainly add that this does not come under, uh, the normal circumstances that would be deemed to be reasonable and ordinary and I would certainly think that these are extraordinary services and presuming that there's law that allows for the compensation of extraordinary services, it should be paid by the trust.
- Johnson:** Thank you.
- Waxenberg:** Next question.
- Brandy:** The next question comes from the line of Joe Fial.
- Fial:** Hi, how are you? Thanks for the webinar today. I have a question where I have a husband/wife couple and we need, actually the husband, uh, for 754 reasons, we need a basis step-up. So we'd like to transfer certain partnership interests to his spouse and then, uh, we would get the basis increase, you know, uh, the basis increase when she dies, the step-up in basis increase and I know there's a three-year rule. But I was wondering if you could give me some details on that? A three year?

- Katzenstein:** Actually, it's a one-year rule. And the one-year rule applies under Section 1014e only if that if the person who made the transfer received that property back from the spouse to whom they transfer. And so, for example, what some people do is they transfer the asset to the spouse and the spouse doesn't leave it back to them, they leave it to a QTIP trust for them. And then some accountants take the position that they don't fall within 1014e because the spouse didn't get the asset back. They got an interest in a trust that held the asset back.
- Fial:** Ok, but I thought under the repeal there's a – so people don't swap basis increases – that there's a three-year look-back.
- Katzenstein:** Under 1014e it's a one-year rule.
- Fial:** I know that, I know that, under the – but you don't get a basis, I mean, you don't get a basis increase any more because there's no estate tax. But you get the allocation of – was it 1.3 million and then 2 million for the spouse?
- Katzenstein:** I'm sorry, now I understand what your question is. If somebody dies this year –
- Fial:** Yeah
- Katzenstein:** – there is no basis step-up.
- Fial:** Right. Except there's a basis allocation rule or there's the basis allocation: 1.3 for a non-spouse and, I think, 2 million for a spouse, correct?
- Katzenstein:** 3 for a spouse.
- Fial:** Excuse me, 3 for a spouse
- Katzenstein:** An additional 3.
- Fial:** Ok, so we want to take advantage of that.
- Katzenstein:** So you're –
- Fial:** Go ahead.
- Katzenstein:** So, uh, you have a partnership interest if somebody died this year and the law...
- Fial:** No, no, the one spouse is terminally ill. The wife is terminally ill but we need a basis increase under 754, we'd like to have a basis increase under 754 for the partnership so we can get an inside basis increase - so we want to give so the – and that's in the husband's name right now. We want to give it to the wife. And then if she dies this year, we could allocate the 3 million dollars of basis to those partnership interest under her that are now in her name.

- Pratt:** I believe that there is a 3 – yeah, if you take a look at the new rules, uh, dealing with the no longer with the we step-up in basis or repeal of the step-up and basis I think you are correct. There is a three-year rule that prevents exactly what you're trying to do.
- Fial:** Except for between spouses. I think there is a caveat, there's a carve-out for except between spouses, unless the spouse, the transferor spouse, received property via a gift.
- Pratt:** That is correct. There is a three-year. There is an exception for the spouse and you're absolutely correct in how you stated. Unless the transferor spouse receives the assets as a gift.
- Fial:** Ok, so that means you can do that planning, uh, between spouses, uh, as long as the one spouse didn't get the interest via gift, you know he purchase or whatever he contributed to the partnership, so he didn't get it via gift. He can then transfer those interests in the name of the spouse into the spouse's name that's on her deathbed and we should be able to get a basis increase or allocated 3 million dollars of basis to those pieces of property provided he gets those back.
- Pratt:** At least based on a little reading, it appears that that would be correct.
- Fial:** Ok
- Katzenstein:** The only thing that I would add is you have to take into account what happens if this law isn't in place at the time that she dies, and try to structure your planning so that it will work either way.
- Waxenberg:** Ok, I think we have time for one last question before we break. So is there, are there any other people on the line?
- Brandy:** You do have an additional question. Your next question comes from the line of David Virgin.
- Your line is open, sir.
- Waxenberg:** Ok, let's try one other person before we break.
- Brandy:** And there are no further questions at this time.
- Waxenberg:** Ok, thank you, thank you very much
- Brandy:** This concludes today's conference call. You may now disconnect.