

The new math of tax relief

How Congress learned to tax less, spend more and help Americans give away the store

On December 17th President Obama, acting in concert with Democrats reacting in fear for their political lives, and Republicans willing to sell out their principals of fiscal responsibility, signed the mammoth "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010." While touted as an extension of the Bush Era law, the Tax Relief Act surprisingly accomplishes several things that President Bush and his Republican Congress only dreamed of.



TAMING YOUR TAXES

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There are a few drawbacks — like an \$850 Billion to \$1 Trillion pricetag. Nevertheless, the Tax Relief Act should help make this a "Happy New Year" for many, particularly those on the ends of the wealth spectrum — the unemployed and people of substantial wealth. In particular, the Act retains all the lower income tax brackets of the 2001 Tax Act, extends and increases estate and gift tax reductions for "wealthy Americans" and lowers payroll tax rates by 2% for a one year period. And (drum roll please) rather than actually creating jobs as the title of the act would imply (e.g., by offering work projects for the unemployed), the act extends unemployment benefits for thirteen months. To me this may help people remain more comfortably unemployed, but I don't see any direct "job creation."

The real surprise comes on the Estate and Gift Tax Side. The Estate

Tax Exemption for 2011 and 2012 is increased from the 2009 level of \$3.5 million exemption to \$5 Million per decedent (\$10 Million total for married couples with good planning). This change applies for 2011 and 2012 only, and then the law drops back to levels applicable before the 2001 Act.

Equally as beneficial to the wealthy is the new estate and gift tax rate. The top rate drops under the Act to 35% (the lowest it has been since 1931). Without passage of this new law, the Estate (and GST) Tax exemption would have dropped back to a \$1 million and the tax rate would have increased to 55%. To compare the difference this makes, consider that the family of a couple with a Ten Million Dollar estate dying in 2011 would have paid estate tax of \$4,400,000 under the old law, but will pay zero in estate tax under the new law. Wow!

Even more amazing, the new Tax Act does what the Bush Era tax law did not. Effective January 1, 2011 the gift tax exemption will be increased from \$1 million to \$5 Million. Some of you may recall the 2001 Tax Act retained a gift tax exemption cap of \$1 Million from 2001 through 2010. That meant the only way to take full advantage of the higher Estate (and GST) Tax exemption levels was to die. Not the preferred course of planning. I didn't have a single client voluntarily opt for that solution.

Come 2011 the Estate, GST, and Gift Tax is reunified (at the exemption level of \$5 Million per person)

and taxpayers won't need to "pull the plug" in order to capture the benefits of the estate tax exemption. Instead taxpayers can simply make taxable gifts, even leveraged taxable gifts, up to the full lifetime exemption equivalent of \$5 million (\$10 million per couple). This opportunity is available for the next two years only. Then the Bill for the Act may come due, depending in part on the willingness of foreigners to continue funding our debt.

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I have no doubt issues of our national debt, economic stimulus, spending for public programs, and the appropriate tax rates to apply to individuals, businesses, and estates will continue to be contentious ones in the 2012 elections. After all, we still have to figure out how we are going to fund our massive Federal Debt (or shrink our government programs to within our means). The level of fiscal irresponsibility being displayed by both parties is beginning to cause serious disruptions in the bond markets.

So starting next year a married couple can gift a full \$10 Million in assets without incurring any gift tax (or can gift at least an additional \$8 million if they had already used their \$1 million per person lifetime exemption under prior law). With the right strategies, using leveraged transactions and a little discounting for lack of marketability and control, it will be possible for married couples to transfer more like \$15 to \$18 million in total wealth estate and gift tax free over the next couple of years. Even better, with the

right trusts and gift tax reporting, this amount of wealth can be taken completely out of the estate and gift tax system for multiple generations through the use of long term Dynasty Trusts. That is where this new law becomes an estate planners dream, because massive amounts of wealth can and will be permanently taken out of the transfer tax system over the next two years.

The trick as always will come in the way such wealth transfers are handled. What amount of control will the donor(s) retain? Can the donor make a gift to younger generation family members "on paper" and with enough economic substance to pass muster, while not giving young beneficiaries so much access to cash and other liquid resources as to "spoil them rotten" or "ruin their work ethic?" And if donors can accomplish these things, can they set it up in a way that will keep the wealth in the hands of their family for generations to come? For those who want eat their cake and have it too, can this be done without seriously damaging the donor's own cash flow needs?

All these issues become magnified in light of the substantially increased Estate (GST) and Gift Tax exemption levels created by the Tax Relief Act of 2010. But for the moment anyway, where there is a will there is a way (or in this case where there is an Irrevocable Long Term Trust (ILTT) there is a way).

The politicians have figured out that they can raise more money on this one issue alone than on any other. So keeping us guessing is good for business. Both sides are positioning for 2012. So I guess we will be forced to keep planning based on the law as it exists today, expecting only that it will surely change in the not to distant future.

Happy New Year!

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