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ESTATE PLANNING TO COPE WITH THE CURRENT LEGISLATIVE UNCERTAINTY

Because of changes made by EGTRRA, planners face a confused, rapidly shifting landscape of (1) high exemptions and lower tax rates, (2) no estate tax, and (3) a potential return to higher tax rates and lower exemptions. This article explores planning in the event of a return to pre-EGTRRA rules.

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"With Mr. Bush almost certain to fight almost any effort to revisit his tax cuts, and Republicans in Congress unlikely to rebel against the president, Democrats are inclined to wait until after Mr. Bush is gone." [1]

When the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") [2] was enacted, most estate planners (and probably most Republicans and quite a few Democrats) expected that Congress would enact some form of permanent transfer tax legislation before 2011 to replace the provisions of EGTRRA which expire on 1/1/11. As the above quote notes, it is becoming increasingly possible that permanent transfer tax legislation will not occur anytime soon.

The unfortunate reality is that Republicans have had numerous opportunities to enact permanent legislation, but have often chosen political postures (e.g., elimination of the estate tax) instead of compromise legislation that could have adopted permanently higher federal estate tax exemptions and lower estate tax rates. Now it appears increasingly possible that Congress and the President may be unable to come to agreement on permanent provisions.

Consider this increasingly possible scenario regarding Washington's enactment of permanent transfer tax legislation:

• In 2007, with a new Congress and with permanent estate tax reform not being a high Democratic priority, it is likely that any new transfer tax legislation will not be seen until mid- to late-summer of 2007, at the earliest. Purposely or because of different political priorities, the Democrats may deliver to the President legislation that contains provisions that are unpalatable to him. The President must either sign the legislation or veto it, and hope Congress enacts a more responsive bill after the November 2008 congressional and Presidential elections.

• In 2008, based on past political history, it is unlikely that any significant compromise tax legislation will be enacted; compromise legislation tends not to happen during a Presidential election year.

• In 2009, it will take the new Congress and President some time to get their act together. Most likely, the earliest we might see any permanent legislation from Congress would be late summer of 2009—less than six months before the beginning of 2010. By the middle of 2009, the festering impact of the alternative minimum tax ("AMT") and the extent of the coming budgetary shortfall caused by entitlement programs for the baby boomers and their parents will be even more apparent. Could Congress decide that the revenue from an increased estate tax solves some of these problems?

The election on 11/7/06 effectively killed any serious possibility of a permanent elimination of the estate tax. Even the $3.5 million to $5 million exemptions that have been discussed are an increasingly unlikely event. It is the author's expectation that if a permanent estate tax exemption is enacted before 2011, it will be $3 million or less. Given the partisan wrangling that is tying up compromise legislation in Washington, it is increasingly possible that Washington will fail to enact any permanent legislation—resulting in a return to the pre-EGTRRA rules on 1/1/11. Some of the dynamics supporting this viewpoint are:

• The Democrats will control Congress at least through 2008. The House Democratic leadership has not shown any desire to enact permanent transfer tax legislation. Moreover, the pay-as-you-go budget plan means that enactment of permanent estate tax legislation will require countervailing reductions in expenditures or increases in other taxes. Could higher estate taxes help fund the new programs the Democrats want to fund?

• Even if the Republicans succeed in taking back total control of Congress in the 2008 election, the Democrats will probably retain filibuster control in the Senate, and it is unlikely that they will lose that control in the next election. No one reasonably expects the Republicans to control 60 Senate seats anytime in the near future. Therefore, any legislation will have to be palatable to the Democrats—unless Congress decides to adopt another ten-year sunset law.

• Effectively, the Democrats do not have to act. All they have to say is "No" or adopt legislation that will be vetoed, and 2001 will return in 2011.

• Some estate planners believe that Congress will not allow the elimination of estate taxes to occur in 2010. But with less than 1% of all decedents paying an estate tax from 2006-2009,[3] the loss of estate tax revenue in 2010 could be quickly recovered by the return of a $1 million estate exemption and higher transfer tax rates in 2011. The gift tax exemption will remain at $1 million, and clients will have to die to get the unlimited exemption; most will try to avoid that choice. Moreover, Congress might adopt a stop-gap one-year rule for 2010.

• Polls indicate that most Americans want to eliminate the estate tax. But, according to a number of studies, few estates are subject to estate tax. The estate tax has a limited impact on the general population, and potential permanent estate tax relief for the middle class could be traded away for broader-based tax reform, like an overdue reform of the AMT or the retention of broader-based provisions of EGTRRA like reduction of the marriage penalty. Because these provisions affect more Americans, their enactment will have broader support than will a permanent reduction of the estate tax.

• There has been an explosion of wealth in this country. It is estimated that between $10 trillion[4] and 136 trillion[5] will pass in the United States from 2000 to 2050. Although estate taxes have composed only 1.1% to 1.3% of the federal revenue during the 1990s, this percentage could grow rapidly as the two wealthiest generations that have ever lived die and pass trillions of dollars to their heirs. Congress may look upon this wealth passage as a ready source of federal revenue.

• Given the concerns that many elderly Americans have taken more out of Social Security and Medicare than they put into these systems, some in Congress may view the estate tax as a generational repayment of these distributions.

• Warren Buffett, George Soros, William H. Gates, Sr., and over 300 of America's wealthiest citizens have publicly opposed the elimination of the estate tax. They believe that the primary purpose of the tax should not be the raising of revenue. Instead, they think the estate tax should be used to avoid creating a multi-generational class of perpetually wealthy individuals in America. Increasingly, the debate on estate taxes is shifting to the taxation of the super-wealthy as a societal issue. [6] Warren Buffett may have made the most poignant comment on this issue when he said: "I don't believe in dynastic wealth," calling those who grow up in wealthy circumstances "members of the lucky sperm club." [7]

Some of the results of the failure to adopt permanent transfer tax legislation

The unfortunate reality of this uncertain environment is that practitioners and their clients need to start planning now for the possibility of a return to 2001 in 2011. Planners need to consider the possibility that their clients will have become incapacitated by 2011 and so would be unable to revise an estate plan that assumed the availability of a much larger estate tax exemption. A return to the pre-EGTRRA rules creates a number of planning issues for estate planners and their clients. The remainder of this article will discuss some of those issues. The chart that accompanies this article contains a list of sources for more detailed planning ideas during this time of chaos.

Higher taxes. Without the adoption of permanent legislation by the end of 2010, the payment of federal estate taxes will skyrocket on 1/1/11. Not only will the exemption decrease, but the value of the 2011 estate tax exemption of $1 million [8] will have been seriously eroded by inflation. In 2001, the estate exemption was $675,000. At an annual growth rate of just over 3.64% (barely above inflation [9]), the 2001 exemption of $675,000 will roughly equal the value of the $1 million exemption in 2011. Because the estate tax exemption is not adjusted for inflation, each year after 2011 the effective value of the exemption decreases.

Wealthy decedents will also be subject to a higher overall tax rate. From 2007-2009, the estate tax rate will effectively be a flat 45%. The federal estate tax rate in 2001 capped out at 55% for estates above $3 million. To make matters worse, estates valued at over $10 million paid an additional 5% surtax designed to eliminate the benefit of the marginal tax rates below 55%. [10] The 5% surtax stopped once the estate's value exceeded $17,184,000.

The combination of a reduced estate tax exemption and a higher estate tax rate can have a significant impact on clients who have not planned on the higher cost. Let's look at three separate scenarios. First, assume a single taxpayer has a $1.5 million estate in 2007, growing at an annual rate of 5%. Exhibit 1 shows the federal estate tax cost to the client from 2007-2013.

Now, assume that the client had an estate of $3 million, growing at an annual rate of 5%. Exhibit 2 illustrates the combined impact of a lower exemption and higher tax bracket.

From 2008 to 2011, the estate taxes for this client will more than double. The combined effect of a lower exemption and higher tax rates can create a much higher tax burden than either planners or their clients may expect.

Last, suppose that the above client had an estate of $10 million. Exhibit 3 shows the impact of the 2007-2011 changes. In this case, the combined lower exemption and higher tax rate from 2009 to 2011 increased the estate taxes by over $2.7 million.

Perhaps the most important aspect of the above three scenarios is the declining percentage of the estate that will ultimately pass to heirs. For example, in the last two scenarios (in Exhibits 2 and 3), the combined impact of a higher tax and lower exemption causes a 19%-36% increase in the effective tax rate in the two years from 2009 to 2011.

If these higher tax rates come back in 2011, they will create significant liquidity problems for many clients. Planners need to start raising the liquidity issues with clients today. If a client wants to insure to cover the potential increased cost of taxes, the client needs to plan today in case he or she becomes uninsurable before 2011. The ability to plan away the estate tax requires that most clients start planning for the higher estate taxes as soon as possible.

Treatment of insurance. Clients who decide to buy additional life insurance should consider placing the insurance in an irrevocable life insurance trust ("ILIT") to keep the death proceeds outside their taxable estate. Because of the current legislative uncertainty, it may be appropriate to adopt contingency formulas in the insurance trust to provide for how the passage of assets will occur in various scenarios. [11] For example, if insurance is held in an ILIT, but is unnecessary to provide estate tax liquidity to the estate, a formula provision in the insurance trust or the client's will could pass assets on to the donor's favorite charity. Flexibility should also include the use of limited powers of appointment in virtually every insurance trust. The trust may provide mechanisms for the early termination of the trust and the distribution of the policy to someone other than the insured/grantor.

Many clients have estates in the range of $1 million to $2 million, including life insurance. Many planners have advised married couples that with a federal estate tax exemption of $2 million each ($4 million collectively for a couple), they did not need to place their life insurance in an ILIT, because the individual estate tax exemption and/or the joint exemption of the married couple would produce a non-taxable estate. However, a return to a $1 million estate tax exemption could mean that many clients will have a taxable estate, with the result that 41%-55% [12] of the insurance proceeds could be lost to federal estate tax.

If a client is going to move an existing life insurance policy out of his or her taxable estate by 2011, the three-year look-back provisions of Section 2035(a) mean that the transfer should occur at least three years before the beginning of 2011. Thus, by the end of 2007, clients who do not currently have a taxable estate (but who may have a taxable estate in 2011) will be forced to consider the use of life insurance trusts or the transfer of insurance policies directly to heirs.

Retirement planning. With the higher exemptions and new rules permitting heirs to make withdrawals from inherited IRAs over their lifetimes, many estate plans have provided that the retirement plan will pass to younger family members (to take advantage of the longer life expectancy) while passing other assets to a surviving spouse. These plans could create a number of problems if we return to the 2001 rules.

For example, assume a client in a second marriage had a $1.5 million IRA and $2 million in other assets. Under his current planning, the IRA passes to his children from a prior marriage while the $2 million is held in a QTIP trust for the second wife. At the current exemptions, no estate tax would be due at the client's death, assuming his spouse survives him. On the other hand, if the client dies after 2010, there could be a federal estate tax of approximately $210,000 on the transfer of the IRA to the children. If the children reach into the IRA to pay the $210,000 in estate taxes, they will create taxable income of $210,000. If the children then reach back into the IRA to pay the income taxes, they incur additional income taxes. Each withdrawal from the IRA to pay tax will create a new tax. The plan should be revised either to:

- reduce the IRA bequest to the available exemption,
- pass other assets (e.g., a life insurance policy) to the children to pay the estate tax liability, or
- pass non-IRA assets to the children, while passing the IRA to the surviving spouse, perhaps in trust. [13]

The reduction in 2011 of the available estate tax exemption and the increase in estate tax rates mean that clients with significant retirement accounts will have to reconsider the impact of the imposition of both income taxes and estate taxes on these IRD (i.e., income in respect of a decedent) assets. In many cases, rather then lose over 50% of the retirement plan to taxes, the clients will choose to pass all or a portion of their retirement plan to charity.

This area is characterized by an interesting conflict. For several years, Congress has been encouraging the growth and creditor protection of retirement plans, particularly for baby boomers. But the high level of estate taxes and income taxes on retirement plans in poorly planned estates after 2011 may create a tax windfall for the federal budget.

State death taxes. Prior to EGTRRA, the federal estate tax was offset by a credit for state death taxes. [14] Roughly 38 states used the amount of the credit as their state estate tax; these states effectively took a portion of the federal estate tax as their tax. The tax was often referred to as a “sop tax” or “sponge tax.” In 2005, as part of EGTRRA, the state death tax credit was fully phased out and replaced with a deduction. [15]

States were forced either to lose the revenue they had received from the credit or to “decouple” themselves from the federal estate tax and impose new state estate taxes. Today, roughly half the states have state estate taxes that are decoupled from the computation of the federal estate tax. [16] The return of the state estate tax credit in 2011 could create some confusion.

In decoupled states which impose their own state estate tax, there will be confusion because state death taxes will not relate directly to the federal estate tax credit and tax computations. Many decoupled states have lower estate exemptions than the federal exemption. For example, New Jersey has a $675,000 exemption. In many of these states, the combined state and federal estate taxes may exceed 60% because state estate taxes will exceed the federal state death tax credit.

Those states which have not enacted a new death tax (and which effectively lost any revenue from the estate tax in 2005), will suddenly see an unexpected return of previously lost revenue. This change will effectively return dollars to the states that did not revoke their state statutes that coupled the state estate tax to the federal credit. For example, according to one source, [17] Florida lost over $1.1 billion in revenue in 2006 from the elimination of the state estate tax credit. That lost revenue could now return to the state as an unexpected revenue windfall.

Last, some states (e.g., Arizona, Oklahoma, and Virginia) have repealed any state estate tax. If we return to the federal state death tax credit, these states will receive no benefit from the credit, but estates will still be responsible for paying the full federal estate tax without an offsetting state death tax credit. It should not take long before these states re-enact a new sop tax.

Family business deduction. Planners and drafters of documents will have to deal with the return of the business deduction [18] for businesses that pass to family members. Perhaps one of the most complicated pieces of federal estate tax legislation ever enacted, the deduction for qualified family-owned business interests ("QFOBI") could be restored in 2011, albeit at a total deduction of approximately $300,000 per decedent. Therefore, clients with closely held businesses should make sure their estate plans contemplate the potential restoration of the QFOBI deduction. [19]

Generation-skipping transfer (`GST') tax. EGTRRA tied the lifetime and estate GST exemption to the estate tax exemption. On 1/1/11, the pre-EGTRRA rules may return and the GST exemption could become $1.1 million, plus the post-2002 adjustments. While the GST exemption remains high, clients should consider making lifetime generation-skipping transfers using lifetime unified credit trusts and reverse QTIP trusts to maximize the available GST exemption.

In 2010, there is no GST tax. Clients (especially those who expect to die in 2010) should consider creating an unlimited GST trust in 2010. If a GST trust is created before 2010, consider having a limited power of appointment in a party to allow the trust to make unlimited distributions to a skip person.

Other provisions. While most of us are vaguely aware of the major changes that comprised other parts of EGTRRA, there are some additional provisions that we may have forgotten about, including:

- The expanded estate tax exclusion for conservation easements. [20]
- Liberalized rules for deferred payment of estate taxes. [21]
- Rules governing automatic allocations of GST exemption to lifetime indirect skips. [22]
- Retroactive allocations of GST exemption. [23]

It is hoped that Congress will at least extend these transfer tax provisions. Although the transfer tax portions of EGTRRA may sunset in 2011, the IRA, retirement plan, and Section 529 plan provisions of EGTRRA were made permanent by the Pension Protection Act of 2006. [24]

Shifting fundamental goals. With so few estates being taxable after 2001, many planners [25] have noted that estate tax avoidance is no longer a driving force of most estate planning decisions. Unfortunately, the combination of the return of lower exemptions and higher tax rates and the accumulation of assets since 2001 will mean that clients will be increasingly driven back to the necessity of planning their estates to minimize the imposition of a confiscatory federal estate tax. Such planning may limit a client's non-tax planning approaches.

IRS estate and gift staff. In July 2006, the IRS announced that it was laying off roughly half the attorneys (157 out of 345) who worked in the Estate and Gift Tax

Division of the IRS. The primary reason was that the number of taxable estates was decreasing dramatically and the need for auditors was concomitantly reduced.

However, with the return of the 2001 rules and especially given the expected significant increase in the number of taxable estates (e.g., see the previous appreciation impact on $675,000 from 2001), it should be expected that the IRS will be back in a hiring and auditing mode, particularly when the top tax bracket could equal 60%. One has to wonder how long will it take the IRS to gear up and train so many new hires.

Planning in this chaotic environment

Planning from 2007-2011 is going to require not only flexibility, but also a continuous review of how the client's estate plan interacts with the changing tax rules. Some of the approaches include the following:

Flexible planning before 2010. Flexibility is the key to planning in this chaotic environment. [26] Among the flexible approaches that need to be considered are:

• The expanded use of limited powers of appointment. [27] Such powers of appointment will permit changes in the estate plan to account for changes in the family and in the law.

• Planning that considers the impact on family asset allocations of first an increasing exemption, then no estate tax, followed by a drastic reduction in the exemption. For example, if the intent is to pass the estate tax exemption amount to children from a first marriage and the remainder of the estate to a spouse from a second marriage, the client must be advised how the changing exemption amounts will affect the passage of assets to each of the client's heirs. Suppose a client in a second marriage has $5 million in assets. Does he want $2 million (2007-2008), 3.5 million (2009), $5 million (2010), or $1 million (2011) to flow to children from a prior marriage? What amount is the surviving spouse expecting to receive?

• Formula clauses that deal with various potential levels of estate and GST exemptions, depending on when the client dies. For example, in the above example, the client could create a formula that passes a set amount (e.g., $1 million) to his children, while any exemption amount in excess of the $1 million to the children passes to a credit shelter trust held solely for the benefit of the second spouse.

• Plans that contemplate the use of disclaimers and Clayton QTIP marital trusts to maximize the tax avoidance possibilities in this unusual tax environment. [28]

• Finding creative ways to move appreciating assets out of estates that are expected to be taxable after 2010. Particularly for clients with estates between $2 million and $5 million, the combination of the lack of an inflation adjustment for the estate tax exemption and the increase in tax rates as the estate grows can create an incentive to avoid the high estate tax cost by moving appreciating assets out of the estate as early as possible.

Spouse dying before 2010. Given a possibility not only that the estate tax could return to 60% on the top side, but also that the state estate tax in decoupled states would push it above 60%, planners should evaluate how to most effectively use the estate of a spouse dying before 2010. Some of the approaches may include the following:

• Make sure to use the full estate tax exemption of the first spouse to die. For example, assume an elderly couple has a $5 million combined estate and one of them is in poor health. Consider moving assets into the unhealthy spouse's estate before death. For instance, suppose a client's wife is terminally ill, but owns no assets. In 2009, the client transfers $3.5 million in low-basis assets to the ill spouse, who revises her will to provide that those specific assets pass into a bypass trust. [29]

However, if the asset is acquired by the decedent within one year of death and is bequeathed to the donor or the donor's spouse, the decedent's basis in the asset does not receive a step-up to fair market value. [30] Instead, the beneficiary takes the decedent's basis. There are at least three ways to cure this problem. First, if the wife dies within one year of the gift, the donor/spouse can disclaim his interest in the trust and the assets will be stepped up to their fair market value, saving income taxes for the heirs. If the wife survives the transfer by one year, the step-up occurs and the disclaimer is unnecessary. Second, if the husband is worried about needing a portion of the $3.5 million, the gifted assets could be placed in two separate trusts. If the wife died within one year of the gift, the husband could disclaim one of the trusts, but retain beneficial rights in the other trust. Third, the husband could create a trust over which the wife has a general power of appointment. Arguably, the general power of appointment is not a gift and, therefore, Section 1014(e) would not apply. [31]

• Having assets taxable in the estate of the first spouse to die could potentially reduce the top estate tax bracket, and remove future appreciation on those assets from being taxed at the higher rate for deaths after 2010. For example, assume a married couple has a combined estate of $15 million, with each spouse having $7.5 million in his or her estate. Both spouses are in their 80s and their assets grow at 5% per year. One of the clients dies in 2009, while the other dies in 2011. Purposely paying an estate tax in 2009 on the entire estate of the first spouse to die could save the family over $500,000.

The negatives can include:

(1) The long-term economic cost of prepaying the estate tax,
(2) The possibility that the surviving spouse could die in 2010 when there is no estate tax,
(3) If Congress ultimately provides a higher estate tax exemption, the benefit of pre-paying any estate tax may be lost, and
(4) If appreciating assets are held in the name of the second spouse to die, a higher step-up in basis could be provided at the second death.

Income tax planning. While the significant estate tax exemptions last and fewer estates are taxable, much of the tax planning may shift to trying to avoid income taxes rather than estate taxes. [32] For instance, instead of lowering the value of assets to reduce estate taxes, clients with estates below the available exemption may actually want to increase the value of assets to obtain a higher basis step-up at death. [33] The higher basis will reduce the income taxes paid by heirs on the sale of inherited assets and will create new depreciable values for depreciable assets. [34]

Try to die in 2010? Roughly 2.3 million Americans die each year. For those Americans who die in 2010, they and their heirs will have to deal with some unique opportunities and traps. For example:

• In 2010, there may be no federal estate tax. Assume that an incapacitated parent has a $4 million estate. Dying in 2010 means no estate tax is due. Dying in 2011 could create an estate tax of over $1.4 million. What happens if the disabled parent is lingering too long as he or she nears 2011? Be careful who holds that medical power of attorney.

• In 2010, the GST tax is eliminated. For the appropriate client who dies in 2010, it would be possible to create a dynasty trust without regard to the limited GST exemptions and rules that existed before 2010. An unlimited generation-skipping transfer to a flexible dynasty trust, which exists in perpetuity, could be the ultimate planning tool.

• Only a partial step-up in basis will be permitted in 2010. [35] Particularly in blended families and dysfunctional families, there are bound to be conflicts over the allocation of the partial step-up permitted by EGTRRA. [36]

• Without doubt, if Congress has not adopted new estate tax legislation by 2010, we will see a flurry of creative planning ideas designed to take maximum advantage of the unlimited tax avoidance opportunities available in 2010. Some commentators have started to speculate that the elimination of the estate tax in 2010 may create a surge in suicides. [37]

Given the elimination of the estate and GST tax in 2010, planners should consider the planning opportunities of having assets in the name of a chronically ill family member who may die in 2010. However, convincing a client that taxes should drive the timing of death is a particularly unpalatable process.

Conclusion

With the partisan wrangling that likely will continue as a result of the November 2006 election, we could be facing a confused, quickly changing landscape: 2-1/2 years of high exemptions and lower tax rates, one year of no estate tax (and generally a loss of step-up in basis), and then a potential return to higher tax rates and lower exemptions.

Anyone who says he knows what transfer tax legislation will be enacted in the next four years is either clairvoyant or deranged. Unfortunately, no one has any real idea what Congress is going to do with the transfer tax rules in the next four years. Planning in this time of uncertainty is going to require great flexibility and constant review and updating. Virtually every estate plan will have to be re-examined in the next three years either to account for Congress's failure to enact permanent transfer tax legislation or to deal with the terms of any permanent legislation that is passed.

Who benefits from this chaotic environment and the return to 2001? Seven groups will reap the greatest rewards: Roughly half the states which remain coupled to the federal estate tax will receive an unexpected revenue boost. Charities will see increased estate contributions (particularly of IRD assets) to avoid estate taxes. Fee-based planners who provide estate planning advice and estate attorneys will be inundated with work. CPAs will have more tax returns to file. The insurance industry should see substantial increases in life insurance sales to fund estate taxes. And politicians will see increased contributions to their campaigns from people on both sides of the debate. And the client/taxpayer? He'll be paying for all of it.

PRACTICE NOTES

In planning now for the possibility of a return to 2001 in 2011, advisors need to consider the possibility that clients will have become incapacitated by 2011 and so would be unable to revise their estate plans.

RESOURCES FOR PLANNING FROM 2007-2011

- Howard M. Zaritsky, *Waiting Out EGTRRA's Sunset Period* (WG&L 2004).
- Jerold I. Horn, *Flexible Trusts and Estates for Uncertain Times* (ALI-ABA 2004).
- Howard M. Zaritsky, "Estate Planning While You Wait for Congress to Decide on Estate Tax Repeal," 32 ETPL 56 (June 2005) .
- Stephan R. Leimberg and Albert E. Gibbons, "Life Insurance After the 2001 Tax Act: Lease, Buy, or Replace?," 29 ETPL 165 (Apr. 2002) .
- Sebastian V. Grassi, "Drafting Flexibility Into Trusts Helps Cope With Uncertainty," 29 ETPL 347 (July 2002) .
- Sebastian V. Grassi, *Drafting Flexibility into Estate Planning Documents After the 2001 Tax Act (with Sample Clauses)* (ALI-ABA 2003).
- Christopher P. Cline, "Some Post-Mortem Planning Ideas After EGTRRA," 43 BNA Tax Mgt. Memo. 9 (5/6/02).

Exhibit 1.Estate of $1.5 Million

	2007	2008	2009	2010
Estate	1,500,000	1,575,000	1,653,750	1,736,438
Exemption	2,000,000	2,000,000	3,500,000	ALL
Top Applicable Tax Rate	45%	45%	45%	0%
Federal Estate Taxes	0	0	0	0
Increase in Taxes	N/A	0	0	0
Net to Family	1,500,000	1,575,000	1,653,750	1,736,438
Family's % of Estate	100%	100%	100%	100%

	2011	2012	2013
Estate	1,823,259	1,914,422	2,010,143
Exemption	1,000,000	1,000,000	1,000,000
Top Applicable Tax Rate	45%	45%	49%
Federal Estate Taxes	355,467	396,490	439,970
Increase in Taxes	355,467	41,023	43,480
Net to Family	1,467,792	1,517,932	1,570,173
Family's % of Estate	81%	79%	78%

Exhibit 2.Estate of $3 Million

	2007	2008	2009	2010
Estate	3,000,000	3,150,000	3,307,500	3,472,875
Exemption	2,000,000	2,000,000	3,500,000	ALL
Top Applicable Tax Rate	45%	45%	45%	0%
Federal Estate Taxes	450,000	517,500	0	0
Increase in Taxes	N/A	67,500	-517,500	0
Net to Family	2,550,000	2,632,500	3,307,500	3,472,875
Family's % of Estate	85%	84%	100%	100%

	2011	2012	2013
Estate	3,646,519	3,828,845	4,020,287
Exemption	1,000,000	1,000,000	1,000,000
Top Applicable Tax Rate	55%	55%	55%
Federal Estate Taxes	1,300,585	1,400,865	1,506,158
Increase in Taxes	1,300,585	100,280	105,293
Net to Family	2,345,934	2,427,980	2,514,129
Family's % of Estate	64%	63%	63%

Exhibit 3.Estate of $10 Million

	2007	2008	2009	2010
Estate	10,000,000	10,500,000	11,025,000	11,576,250
Exemption	2,000,000	2,000,000	3,500,000	ALL
Top Applicable Tax Rate	45%	45%	45%	0%
Federal Estate Taxes	3,600,000	3,825,000	3,386,2500	0
Increase in Taxes	N/A	225,000	-438,750	0
Net to Family	6,400,000	6,675,000	7,638,750	11,576,250
Family's % of Estate	64%	64%	69%	100%

	2011	2012	2013
Estate	12,155,063	12,762,816	13,400,956
Exemption	1,000,000	1,000,000	1,000,000
Top Applicable Tax Rate	60%	60%	60%
Federal Estate Taxes	6,088,038	6,452,689	6,835,574
Increase in Taxes	6,088,038	364,651	382,885
Net to Family	6,067,025	6,310,127	6,565,382
Family's % of Estate	50%	49%	49%

1

New York Times (1/4/07).

2

Pub. L. No. 107-16 (6/7/01).

3

Godfrey, “U.S. Senate Endorses Plan to Speed Cut of Estate Tax,” Wall Street Journal (3/21/03). This was confirmed in a 2/7/07 Congressional Research Service Report.

4

The lowest estimate came from a study by Avery and Rendall, “Inheritance and Wealth,” presented to the Philanthropy Roundtable, Nov. 1993, which estimated that $10.365 trillion would pass by the year 2040.

5

The newest estimate came in 1999 from Boston College researchers Paul Schervish and John Havens, and covers a larger period. The study estimates that, by 2050, between $41 trillion and $136 trillion will have passed. See Schervish and Havens, “Millionaires and the Millennium: New Estimates of the Forthcoming Wealth Transfer and the Prospects for the Golden Age of Philanthropy,” Social Welfare Research Institute, Boston College, Boston, MA (Oct. 1999). See the report at www.bc.edu/bc_org/avp/gsas/swri/. This study was updated in Havens and Schervish, “Why the $41 Trillion Wealth Transfer Estimate Is Still Valid,” J. Gift Plan. (Jan. 2003). A contrary argument can be found at: Gokhale and Kotlikoff, “The Baby Boomers' Mega-Inheritance Myth or Reality,” Economic Commentary, published by the Federal Reserve Bank of Cleveland in 2000.

6

For a detailed examination of this position, see Gates, Sr. and Collins, *Wealth and Our Commonwealth* (Beacon Press 2003).

7

Thomas, Jr., “A $31 Billion Gift Between Friends,” New York Times (6/27/06).

8

Although the estate tax exemption was $675,000 in 2001, it was phasing into a higher exemption which would have been $1 million by 2006 if EGTRRA had not been enacted.

9

According to the U.S. Government, inflation rates have been 2.83% in 2001, 1.59% in 2002, 2.27% in 2003, 2.68% in 2004, and 3.39% in 2005. As this article was completed, the annual inflation rate for 2006 was estimated to be approximately 3.3%.

10

Prior IRC Section 2001(c)(2) effectively made all estates above $17,184,000 taxable at a flat rate of 55%. Before 1998, the surtax was imposed on estates up to $21,040,000. This additional surtax was designed to eliminate any benefit of the unified tax credit for wealthier taxpayers.

11

For more information on ILIT planning in this environment, see Grassi, "Key Issues to Consider When Drafting Life Insurance Trusts," 31 ETPL 390 (Aug. 2004) .

12

I.e., the 2011 applicable tax brackets over $1 million, excluding the 5% surtax.

13

Lee, "Guidelines for Naming a Trust as the Beneficiary of an IRA," 30 ETPL 502 (Oct. 2003) .

14

Section 2011 .

15

Section 2058 .

16

Gans and Blattmachr, "Quadpartite Will: Decoupling and the Next Generation of Instruments," 32 ETPL 3 (Apr. 2005) ; Steiner, "Coping With the Decoupling of State Estate Taxes After EGTRRA," 30 ETPL 167 (Apr. 2003) ; Woods, "Decoupling Dilemma," 143 Tr. & Est. 50 (Apr. 2004); Godfrey, "The Phase-out of the Federal State Death Tax Credit," Part 1, 35 Tax Adviser 96 (Feb. 2004); Part 2, 35 Tax Adviser 148 (Mar. 2004); McNichol, "Assessing the Impact of State Estate Taxes," Center on Budget and Policy Priorities (2/18/04), available at www.cbpp.org/2-18-04sfp.htm.

17

See www.FloridaTaxWatch.org.

18

Section 2057 .

19

For more information on the use of the business deduction, see Bellatti, *Estate Planning for Farms and Other Family-Owned Businesses*, Ch. 10 (Warren, Gorham & Lamont 1999), and Stephens, Maxfield, Lind, and Calfee, *Federal Estate and Gift Taxation* ¶5.08 (Warren, Gorham & Lamont, 8th ed. 2002).

20

IRC Section 2031(c) as enacted by section 551 of EGTRRA.

21

IRC Section 6166(b) as enacted by section 571 of EGTRRA.

22

IRC Section 2632(c) as enacted by section 561(a) of EGTRRA.

23

IRC Section 2632(d) as enacted by section 561 of EGTRRA.

24

Pub. L. No. 109-280 (8/17/06).

25

Scroggin, "Protecting and Preserving the Family: The True Goal of Estate Planning," Part 1, 16 Prob. & Prop. 29 (May/June 2002); Part 2, 16 Prob. & Prop. 34 (July/Aug. 2002); Scroggin, "Influencing the Legacy," J. Prac. Est. Plan. (Dec. 2003); Hayes, "Leaving a Legacy: A Client's Search for Meaning," J. Prac. Est. Plan. (Sept. 2002); Gallo, "The Psychological Education of an Estate Planner," J. Financial Plan. (May 2001), found at www.fpanet.org/journal/articles/2001.

26

Nelson and Carr, "Drafting to Achieve Maximum Flexibility in the Estate Plan," 25 ETPL 252 (July 1998); Acker, "Every Drafter's Dream: The Flexible Irrevocable Trust," BNA Tax Mgt. Memo., 1998, at 295; McBryde and Keydel, "Building Flexibility in Estate Planning Documents," 135 Tr. & Est. 56 (Jan. 1996).

27

Forsberg, "Special Powers of Appointment: The Key to Flexibility in Planning," 27 ETPL 13 (Jan. 2000); Bove, Jr., "Powers of Appointment: More (Taxwise) Than Meets the Eye," 28 ETPL 496 (Oct. 2001); Bove, Jr., "Exercising Powers of Attorney—A Simple Task or Tricky Business," 28 ETPL 277 (June 2001).

28

Grassi, *Drafting Flexibility into Estate Planning Documents After the 2001 Tax Act (with Sample Clauses)* (ALI-ABA 2003).

29

In most cases, the wife will already own some assets in her name. If the husband gifts additional assets to the spouse to fully fund her $3.5 million exemption, it may be important to have a special allocation of those assets to a bypass trust in order to use the techniques discussed below to obtain a step-up in basis.

30

Section 1014(e). The legislative history of Section 1014(e) and IRS rulings (*cf*. Ltr. Ruls. 9321050 and 9026036) indicate that a bequest to a trust in which the original donor is also a beneficiary may be deemed an indirect transfer which would deny a basis step-up. For a detailed review of this issue, see Zaritsky, *Tax Planning for Family Wealth Transfers*, ¶8.07[5] (Warren, Gorham & Lamont).

31

Zaritsky, *Tax Planning for Family Wealth Transfers, supra* note 30, at ¶8.07[5].

32

See Scroggin, "Income Tax Planning Now That Estate Taxes Are Less Significant," 32 ETPL 33 (June 2005); Scroggin, "The New Importance of Basis Planning," 144 Tr. & Est. (Apr. 2005).

[33] Section 1014(a) and Reg. 1.1014-3 .

[34] For more information on basis planning techniques, see Scroggin, *supra* note 32.

[35] For an article that addresses drafting and planning for changes in basis planning, see Berall, Harrison, Blattmachr, and Detzel, “Planning for Carryover Basis That Can Be/Should Be/Must Be Done Now,” 29 ETPL 99 (Mar. 2002) .

[36] See Hodgman, “Carryover Basis: Planning and Drafting Issues,” 28 ETPL 611 (Dec. 2001) , for language that might be used to protect the fiduciary.

[37] *Cf*. Giannageli, “A Tax Break To Die For?,” available at www.welcomebusiness.com.