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What You Should Do Now

The estate-tax uncertainty makes planning difficult. Here's what some advisers recommend for their clients.

By CHARLES PASSY

As the debate over the estate tax rages on, financial advisers and their clients face a more mundane problem: what to do in the meantime? It isn't easy, without having a clue where the law will end up.

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We asked a number of financial advisers what they are recommending for their clients. Here's what they said:

Marv Hills, partner, Crowe Horwath, South Bend, Ind.
Since clients expect that the estate tax is coming back in 2011, they are making plans now to implement taxable gifts this year. This way, they can pay gift tax at the 35% gift-tax rate applicable in 2010, in order to avoid paying estate tax later at a presumably higher rate in 2011 and after. Although it seems certain that an estate tax will exist beginning in 2011, it is impossible to know whether the rate will be 55% as currently scheduled, or a different rate if Congress changes the law before next year.

Even though the gift-tax rate is low in 2010, some clients are waiting to make the gifts very late in the year, between Dec. 26 and 31, because they are concerned about the risk of dying unexpectedly during 2010. These clients realize that if they make a taxable gift now but then die before Congress changes the laws, they will have paid gift tax at 35% when the assets could have passed through their estates in 2010 without being subject to estate tax.

However, the risk in waiting until the end of the year is that Congress might enact a gift tax at a rate higher than 35% before the client makes the gift. Therefore, some clients are considering making their taxable gifts now, but rather than gifting directly to family members, they are using trusts with those family members as beneficiaries. The trust has provisions, however, which allow the beneficiary or beneficiaries of the trust to disclaim the gift. This would have the effect of "reversing" the gift, and sending the property back to the donor as if the gift had never occurred. By using this type of flexible technique, it gives the family the opportunity to decide later (within nine months of the gift) whether the gift will be implemented as planned or reversed retroactively, based upon subsequent congressional changes.

Scott Winget, senior director of planning, Wells Fargo Family Wealth, Denver
Individuals with larger estates should consider some unique wealth-transfer opportunities that currently exist. First, consider making gifts outright to grandchildren to take advantage of the current low gift-tax rates and the suspension of the generation-skipping transfer (GST) tax. (The GST tax is a second layer of tax levied on gifts to grandchildren or more remote descendants. It is in "repeal" during 2010, along with the estate tax.) Also, for those with GST nonexempt trusts, begin to discuss whether a taxable termination or taxable distribution might make sense before the end of the year. Finally, consider taking advantage of a potentially vanishing opportunity with short term grantor-retained annuity trusts (GRATs). (A GRAT is an approved gifting structure using a trust, and is designed to reduce or eliminate the gift tax liability associated with the transfer by returning a portion of the gift to the grantor.) Proposals in several current bills would mandate a minimum term of 10 years for all GRATs, and interest rates are currently near historic lows, making the strategy all the more compelling.

Marvin E. Blum, lawyer and CPA, Blum Firm, Fort Worth, Texas
Although we don't know yet what form the estate tax will take in the future, we strongly believe that the estate tax is here to stay. Given this almost certainty, we are advising our clients to continue taking steps to reduce or eliminate estate taxes. Many estate-planning techniques are particularly effective in this current environment of historically low interest rates, depressed asset values, and the ability to take valuation discounts.

We are urging our clients to take advantage of this "perfect storm" to shift wealth to future generations, particularly to dynasty trusts benefitting future generations where wealth can be sheltered from estate taxes for multiple generations. Not only can dynasty trusts save massive amounts of estate tax, but in Texas, assets owned by dynasty trusts are also protected from the beneficiary's creditors and from the beneficiary's spouse in the event of divorce.

Kenneth P. Brier, lawyer, Brier & Geurden, Needham, Mass.
The year 2010 may be an especially advantageous one for making substantial gifts, particularly to grandchildren. Such gifting would make particular sense if you believe that the estate tax and GST tax are likely to be reinstated.

But you should not forget that Congress might decide to pass legislation reinstating the estate and GST tax this year, perhaps retroactive to Jan. 1 (even though that's looking increasingly remote at this late point in 2010). Moreover, if and when the old regime returns (in any form), assets still held in a multigenerational trust may again become subject to the GST tax, possibly without having benefited from any effective allocation of GST exemption or generational step-up. These risks should be weighed before deciding to embrace an aggressive gifting program. However, we believe that there are ways to structure the current gifts that will postpone the time when it is necessary to irrevocably decide how to treat such gifts for gift and GST

tax purposes. Hopefully, by that time, Congress and/or the IRS will have provided us with additional guidance.

In any event, we recommend that any generation-skipping gift this year be made directly to individuals and not to trusts, if feasible. Gifting interests in a family limited partnership or LLC can provide some trust-like protection for the beneficiaries. A donor might hedge his bets on designating the recipient through an appropriately structured formula gift.

The uncertainties related to the GST tax can have a direct effect on any ongoing gifting program, such as a program for making annual gifts to a life-insurance trust to provide funds for annual premium payments. If the trust is intended to be exempt from the GST tax, it is probably wise to refrain from making any gifts in 2010. With some insurance policies, one might be able to skip a year's payment without any real detrimental effect. In other cases, the trust might borrow the premium money against the policy or from the donor (or another party).

Jereme D. Brisco, wealth manager, USAA Wealth Management, San Antonio
When approaching the estate-tax conversation with members, I hear a lot of them say they do not want to make any changes until they know for certain what the exemption will be for 2011.

Since we do not know if the federal government is going to make any changes to the exemption for 2011, but we do know that it is scheduled to be $1 million, I am recommending that we plan accordingly. The most important thing is that we come up with a plan based on a $1 million exemption, and implement the plan. If the exemption is higher in 2011, then we can make any necessary adjustments.

The last thing we would want to see is someone with a $5 million net worth not create an estate plan, then see the exemption go to $1 million in 2011 and the member passes away on Jan. 1, 2011. What a huge tax bill they would be passing on to their heirs and potentially forcing them to liquidate assets, at an inopportune time, to pay the taxes due.

Douglas Freeman, senior managing director, First Foundation Advisors, Irvine, Calif.
The only thing certain about tax law is its uncertainty. We have been advising our clients for years to have alternative strategies in their estate-planning documents, one of which applies if there is a tax and the other if there is no tax. We also have encouraged long-range planning to continue as if there will be a significant tax on the estate. Better to be prepared than not, since the best planning requires many years for the benefits to be realized.

On the other hand, wealth owners should never make decisions merely because of the tax benefits or costs, but should always consider the impact of that decision on the individuals for whom the benefits are intended. In other words, if you could leave all your wealth to your child or other beneficiary, should you? What consequences will that wealth have on your beneficiary's life? Will it be helpful or harmful, motivate or demotivate, reinforce the values you hold most important or undermine those values? Is your beneficiary financially competent today, or will such beneficiary be ready, when the time comes, to handle either the income or the wealth responsibly? These are much more important questions than whether the amount of the wealth inherited will be subject to more or less tax.

Gary Altman, founder, Altman & Associates, Washington, D.C.
The biggest hurdle facing estate planners is, and always will be, procrastination. Estate planning is something that far too many people put off because it's uncomfortable, because they don't think they will die anytime soon, or because of the cost. With the federal estate tax in limbo, even more people are opting to hold off on creating an estate plan. They assume that the investment would have been a waste if and when the laws change again. As a veteran estate planner, I promise you: This is an extremely risky choice.

Patty Chantler, estate planning team leader, Sensiba San Filippo, San Francisco
The uncertainty of the estate-tax situation should not be cause for individuals to halt progress on the implementation of their estate plans. Other conditions make this an excellent time to transfer assets to the next generation through gifting or intra-family sales. Many commonly transferred assets are at suppressed values in this market, particularly real estate and businesses, and the AFR rate—the interest rate charged on an intra-family loan—is at historic lows. Gifting assets at these historically low values enables individuals to transfer/remove more assets out of their estates now then they could even a few years ago.

Specific current advice includes transferring assets at the lower current values via intra-family sales. This will freeze the estate value, since the asset (typically real estate or ownership in a business), which could increase in value in the future, is now replaced in the estate by an intra-family promissory note of a fixed and stated amount. Another key opportunity now is the transfer of partial interest in an asset to take advantage of discounts on the gift or sale, allowing even more value to be transferred. The discounts allowed can range from 10% to 40%, depending on the percentage of the asset being transferred.

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