

eReport conversation with Ed Koren

On December 10, 2010, eReport Editor Robert Steele and eReport TE editor Anta Cissé-Green spoke at length with Ed Koren, former chair of the RPTE Section, and chair of the Section's Task Force on Transfer Tax reform, which wrote the Section's recent letter to Congress, by phone from Ed's firm's Atlanta office at 10:30 am, which was only two hours after the text of the bill was made public.

eReport: Good morning, Ed, and thank you very much for your time. Before we talk about the specifics of the Section's letter to Congress, can you update us on the latest developments?

Ed Koren: There is a lot going on – a whole lot has gone on since about 8:30 this morning. The text of Senator Reid's bill [introduced late on Thursday, December 9, 2010] has been released. We are trying to parse through it and we have six people from our firm going through the implications of this bill, assuming of course that it passes and becomes law.

eReport: So the [Senator] Baucus bill is dead. We don't have to look at it?

Ed Koren: The Baucus bill is dead. The Senate bill would give us an estate tax beginning this year with a \$5 million exemption, a unified system, an inflation index, and a 35% tax rate.

eReport: "Unified" -- meaning the estate tax and the gift tax will both have \$5 million exemption?

Ed Koren: Yes, after 12/31/10. We will have a top tax rate of 35% for all three [estate, gift, and generation skipping transfer tax], an election for 2010 estates to opt out of the estate tax and opt over to carry-over basis.

eReport: Right. That works for large estates, but it sounds like a lot of small estates will be going the other way and opting for the estate tax since they will be under the exemption and will get the step-up in basis.

Ed Koren: Absolutely. The decision to get stepped-up basis will be particularly important for many 2010 estates, so they will not elect out of the new law.

There is another major provision for 2010, however. That is a provision for a GSTT exemption of \$5 million and a 0% GST tax rate for 2010 transfers.

eReport: So somebody in the next few weeks can make a major gift and be free of any generation skipping transfer tax.

Ed Koren: Yes. There is a \$5 million exemption that can be used for current transfers to a multiple generation trust and make a 2010 GST allocation to make the trust permanently exempt.

Alternatively, if you have a really big transfer and it is direct skip, you could make a \$100 million direct skip, or make a taxable distribution from an existing non-exempt trust. Then the entire transfer would be at a 0% tax rate if made before 12/31/10.

eReport: Very interesting. What else is surprising in the bill?

Ed Koren: After 2010 we get portability.

eReport: So the new bill does have portability.

Ed Koren: Only for two years.

eReport: All of this is only for two years, right?

Ed Koren: Yes

eReport: Is this from the “framework” deal or is this new? Or we don’t know because the framework didn’t have any details?

Ed Koren: This is very different from the Baucus bill, so I must say that it is new, but as you say, the framework did not have details.

eReport: Is the bill widely seen as having a real shot at getting passed?

Ed Koren: It will pass the Senate. The issue is what happens in the House and whether Speaker Pelosi backs off her threat to not even bring it up. Either way, if it does not come up for a vote now, it will likely get passed in January with the new Congress. Whether everything in the bill remains the same or not, I don’t know.

eReport: The problem is that everyone’s income tax withholding is going to go up on January 1. That is the real trigger to get people to move.

Let’s discuss other specifics of the proposal, assuming that it, or something similar will pass – even if the dollar amounts change, perhaps the technical concepts will remain. The estate tax would be retroactive but it would be optional. An estate can opt out of the estate tax and have the modified carryover basis system. Or is it the other way around?

Ed Koren: I think it is the former – the estate tax is the default result. The actual language of the bill is very cumbersome. We have to go back to the text

of EGTRRA and work through the references. We look at §301C of the bill. Then, notwithstanding A, the case where a decedent dies after 12/31/09 but before 1/1/11, the executor may elect to apply as if the amendments made by A do not apply with respect to chapter 11 and with respect to property acquired by the passing by such decedent in the meaning of 1014(b). What does that mean? We have to work through the provisions.

eReport: It is a triple negative and we have see if the result is automatic estate tax with opt out for carry over basis..

Ed Koren: I believe that it is an opt out of the estate tax. I also think that for 2010 the exemption is \$5 million. Beginning on January 1, 2011 the gift tax exemption also will be \$5 million, so we finally have achieved re-unification. In 2010 you can either have a \$5 million estate tax exemption or you can opt out of that and into the carry over basis provisions of §1022.

eReport: Which is the better thing to do. Then, people with smaller estates who don't do anything will get the step-up in basis automatically. We can assume that people with larger estates will be properly advised by counsel.

Ed Koren: Right

eReport: Let's talk about the Section's letter to Congress. The most interesting proposal or suggestion in the letter was the very first one, which was fascinating. The letter is suggesting a reformation of estate plans of people who already died. How was the drafting committee thinking that would work?

Ed Koren: That dealt with the situation where somebody who died in 2010 made a transfer in a will or trust and the issue is the way it gets interpreted. There could be a credit shelter trust and depending on interpretation, either everything went to the kids under the credit shelter or nothing goes to the credit shelter and all goes to the marital residuary. I have heard of several major estates, some in the last two weeks. I am glad I am not a fiduciary in any of them. There could be very difficult choices. I really think that is going to be an issue if it is a non-family beneficiary, or a second marriage.

eReport: Yes, it can affect different people in different ways.

Ed Koren: I understand that. Assume your parent died, you have another parent still alive. Then, it depends on whether you are in one of the 18 states and DC that has legislation on the interpretation of the credit shelter language. Lets pick California, which does not have legislation. The parent dies and the document says "I give the maximum amount to the credit shelter trust – generation skipping trust" and you go in and say that is the whole estate.

eReport: If the estate tax applies then the bequest is capped at \$5 million, but if it does not apply then the bequest is unlimited.

Ed Koren: Right. The really interesting thing is that last minute enactment may create problems in states that do have legislation, for the question will be whether the estate tax “is applicable?” Does that reference refer to any estate in the particular state or just that estate, where the executor could opt out?

eReport: So your election there would affect the amount of the credit shelter trust.

Ed Koren: Right, so that is where there could be some issues. There is a whole host of things here.

eReport: They sure gave us a handful.

Another suggestion in the letter is to allow the re-structuring of 2010 gifts.

Ed Koren: Yes. Suppose you made a gift in June of \$20 million because you ran the numbers on how much benefit you get, assuming the 35% gift tax rate. Then, what if Congress came back and said no, it was 45%. We want to be able to unwind the transaction if it no longer makes sense. Now, with the new proposal, it looks like the rate is 35%, so that our suggestion is not applicable.

No doubt we have a lot of confusion now. It reminds me of the period in 1976 when there was a transition rule for transfers between September 1976 and December 1976. I know that most of the “younger” lawyers don’t remember this. Before the credit was unified, there were different rates and different exemptions. Making gifts during that period saved exemption. I was making tons of gifts for clients. I was a very young lawyer and this was before word processing. We had mag cards instead of computers. I had more secretaries than any other lawyer at the firm for about two and a half months because we were redoing so many trusts. I was running five secretaries! That is the closest I can think of to the situation now, but then at least we knew what the law was.

eReport: Right. Now we don’t know the law and the IRS doesn’t know the law. They come out with pronouncements saying we can’t even tell you what the law is. Also, the form [for stepped-up basis] and all of that was retracted -- they will have to start over again.

Ed Koren: That is another problem. You have to deal with your tax return.

eReport: Right

Ed Koren: This is another area where the bill is very helpful. It provides an extension of the time to file either the estate tax return if the default rule is used, or the carry-over basis return if there is an opt out, until at least nine months after the date of enactment. There is also a similar extension for GST returns. In addition, and most importantly, there is an extension of time to pay the estate tax if the default rule is allowed to operate. Finally, the bill extends the nine month period under §2518 for disclaimers until nine months after enactment, although there may be some problems with state statutes or an acceptance of benefits issue that would have to be looked at.

eReport: Is there anything in the letter that you want to discuss?

Ed Koren: I think the proposal kind of cleaned up the issues we address in point 3. I also think they addressed point 4. Point 5 may not be addressed and that may be a concern -- trying to find out the qualification severance and all of those provisions could be an issue. If so, we want to see if they can pull something together on that.

eReport: There will be technical corrections for sure.

Ed Koren: If my read on the proposal is correct, then you opt out of the \$5 million estate tax and this would mean that point 6 was addressed. Also, point 7 is addressed. The issues in point 8, if you opt for carry-over basis, have not been addressed at all. I think that covers our points in the letter.

eReport: Bottom line – we have confidence that if a bill passes, whether it is this year or next year, that Congress is taking into consideration the issues that the Section has raised concerning the technical problems.

Ed Koren: Yes

eReport: That is probably the best news of all.

Ed Koren: Right

eReport: This bill can totally crater [for political reasons] but we have confidence that when we have a new bill that they at least understand the issues because of the work the Section has done.

Ed Koren: Yes. I hope this helps

eReport: We greatly appreciate your time today.