Thought Leadership Interview

Trusts & Estates Guest Expert Interview

Timothy J. Meinhart

With the estate and gift tax discipline being in such a state of flux, we looked for a legal expert (1) to help navigate current developments in this complex area and (2) to offer insights into what may be coming down the road.

Charles A. ("Clary") Redd, St. Louis, Missouri, partner in the Trusts & Estates Practice Group of SNR Denton, graciously offered to share his expertise with our readers. Clary, a nationally known expert in trusts and estates, has spoken at the Heckerling Institute, one of the premier national trusts and estates events.

He is also the immediate past editor of *The American College of Trust and Estate Counsel (ACTEC) Journal*. ACTEC is one of the leading organizations for trusts and estates lawyers.

The *Insights* editorial team brainstormed to come up with some questions in the trusts and estates arena that may be on everyone's mind, and we put these questions to Clary. We hope that you will find his insights as informative as we did.

Meinhart: How do you see estate tax legislation unfolding? When do you anticipate there will be changes in the law?

Redd: Were we to reach 2011 without any changes in federal estate tax law (meaning pre-2001 tax act transfer tax law automatically returns), federal revenue results may be mixed. On the one hand, estates having a value of between $1,000,000 and $3,500,000 would become subject to federal estate tax, thereby serving as a new revenue source.

On the other hand, a large majority of estates having a value greater than $3,500,000 (the estates that generate the most estate tax dollars for the U.S. Treasury) would actually generate smaller federal estate tax revenues than under 2009 tax law because the federal credit for state death taxes would be restored, and, as a direct result, the "pick-up" estate tax systems of many states, now dormant, would be revived.

A political reality, as has been eloquently articulated by others, is that, the longer members of Congress can drag out estate tax reform, the more campaign contributions they can extract from those who seek to influence the outcome. If Congress extends the debate into 2011, those campaign contributions will continue to flow.

Another consideration is that, by today's economic standards, having an estate of between $1,000,000 and $3,500,000 does not necessarily place an individual in the category of "rich." Indeed, after taking into consideration life insurance death benefits, retirement assets and home values (even in the current residential real estate market), a lot of "middle class" individuals have estates in that size category.

Congress probably does not relish the prospect of being seen as doing nothing and thereby allowing the "death" tax to extend its tentacles to those who cannot derisively be referred to as "wealthy" Americans.

The bottom line? I think 2010 will pass with no changes in federal transfer tax law. Political paralysis and the lure of additional campaign funds will prevail for the rest of this year and into the next. Eventually (sometime in 2011), I believe we will end up with a federal estate tax applicable exclusion amount somewhere between $3,500,000 and $5,000,000 and a federal estate tax rate of between 35 percent and 45 percent.

I believe retroactive reinstatement of federal estate tax and GST tax will not occur. My reasons are as follows:

First, the developed law does not clearly establish that retroactive reinstatement would pass muster under the Due Process Clause. Those who believe retroactive reinstatement would be constitutional often cite *U.S. v. Carlton*, 512 U.S. 26 (1994), to support their position.

I believe the facts of Carlton are so far distinguishable from what would be a Congressional attempt to resurrect an entire tax system from the ashes that *Carlton*, although undeniably relevant, would by no means be controlling precedent.

Second, as a practical matter, Congress has waited too long to implement retroactive reinstatement. The longer Congress dithers, the less likely the courts would sanction retroactive reinstatement and the more pressure members of Congress will feel (particularly from the anti-"death" tax crowd) just to turn the page and make any transfer tax changes prospective only.

In this connection, it is noteworthy that, as I compose this piece, there is no indication of Congressional will (to be contrasted with isolated remarks by a few individual members) to reinstate federal estate tax and GST tax retroactively.

Third, upon calm reflection (if that is possible inside the Beltway), Congress will see that, on balance, there is less to gain than to lose with retroactive reinstatement. Already in 2010, several citizens of astounding wealth (e.g., George Steinbrenner and Dan Duncan) have died.

The fiduciaries and beneficiaries of the estates of these decedents have both the economic incentive and ability to carry on a years-long fight against retroactive reinstatement. I believe Congress understands it would invite further scorn and ridicule were it to enact a law that would be certain to extend significantly the hiatus of 2010.

Meinhart: How are estate planners currently dealing with the sunset provision of The Economic Growth and Tax Relief Reconciliation Act of 2001?

Redd: In my practice, there is a small universe of clients who are keenly aware of their mortality and understand that there are, during this unprecedented period of transfer tax uncertainty, opportunities to be considered (e.g., outright, direct skip "formula" gifts) and pitfalls to be avoided (e.g., implementation of word formulas in existing documents in an unintended and disadvantageous way if death occurs when federal estate tax does not apply).

Generally, however, I am finding clients are affirmatively resistant to working on their estate plans until I can give them reliable advice as to what the rules are. Many clients whom I serve anticipate an unpleasant estate planning experience if they proceed now.

They believe either I will give them an incredibly convoluted and complicated set of documents ("If federal estate tax does not apply to my estate, then Disposition ABC; if federal estate tax does apply to my estate, then Disposition XYZ"), or they will have to have two successive, independent estate plans (one for right now and another to be created for and at the time when the transfer tax laws have become clearer).

Lots of folks are unwilling to make the investment of time and money to go down either of these paths. Each of them, of course, has a crystal ball that assures them they will not die until the transfer tax laws have stabilized.

Meinhart: In what ways do you feel the anticipated changes in the estate and gift tax laws will create additional opportunities for estate planning practitioners to serve their clients?

Redd: There will undoubtedly be additional opportunities for estate planners because their clients' estate plans will have to be closely examined and, in many cases revised, to ensure that they make sense under—and take maximum advantage of—whatever the new law may permit.

That is not to say that there will likely be additional estate planning opportunities for clients. Indeed, it would appear that, when post-2010 law is finally settled, the opposite will be true; there will be fewer estate planning opportunities than apparently exist today.

Meinhart: What are some of the more challenging issues you see on the horizon for estate planning professionals?

Redd: Dealing with the carryover basis system imposed by Section 1022 with respect to 2010 decedents has already proven to be a train wreck. A couple of examples of problems illustrate the point.

Many of those who were old enough to have died a natural death this year owned some significant assets at death that they had held for decades. We have found, unsurprisingly, that assembling cost basis data for such assets is often impossible—a frustrating situation for us and for estate beneficiaries.

When to sell assets to raise needed cash in the estates of 2010 decedents is perplexing. Ordinarily, of course, the prudent approach for a fiduciary is to raise cash as soon as possible after cash requirements have been determined.

In the current environment, however, some fiduciaries are tempted to defer selling assets until after December 31, 2010, anticipating that they may be able after that date to claim a basis in estate assets equal to fair market value as of date of death. Waiting, however, subjects the fiduciary to potentially enormous investment risk.

Interpreting word formulas in some 2010 decedents' estate planning documents has presented challenges. What is meant by a marital deduction formula that refers to "the smallest amount necessary to reduce federal estate tax to zero"? We have observed that in some situations it depends on whom you ask!

The specter of possible retroactive reinstatement of federal estate tax is causing great consternation, both for fiduciaries and beneficiaries, in the administration of the estates of 2010 decedents because, until the state of 2010 law has crystallized, distributions to beneficiaries are risky.

Meinhart: What role does the valuation specialist play when creating an estate plan for a client?

Redd: Depending on the circumstance, a critical role.

There are several strategies and techniques that have formerly been used commonly by estate planners (e.g., GRITs, preferred stock freezes, annual exclusion gifts of equity in closely held enterprises) that are now no longer available or are severely constrained.

Further restrictions appear to be on the horizon (e.g., ten-year minimum term for GRATs). Thus, in today's world, establishing the fair market value of assets as low as reasonably possible in anticipation of engaging in estate-planning-motivated transfers involving such assets is as important as ever, if not more important.

Appraisal of difficult-to-value property is a highly specialized skill not to be undertaken lightly. An estate planning lawyer lacks the experience, expertise and credentials to ascribe a particular value to any asset.

For a lawyer to dabble in valuation is to play with fire, given the substantial monetary penalties and sanctions that can that result from valuation misstatements, valuation understatements, and underpayments of tax.

Accordingly, while the lawyer can provide invaluable technical knowledge, experience and judgment in the formulation of an appropriate estate plan, the lawyer must engage and work closely with experts in arriving at and documenting the true value of assets whose value cannot be determined objectively by reference to a financial institution's statements or *The Wall Street Journal*.

Finally, care should be exercised to select the right appraiser for the right task. For example, a firm with great ability to value stock in a family business likely has no expertise in valuing antique furniture, artwork or a ranch in Colorado.

Charles A. ("Clary") Redd is Vice Chairman of the Trusts & Estates Practice Group of SNR Denton. Clary concentrates his practice in estate planning, estate and trust administration and estate and trust-related litigation. He is a Fellow of the American College of Trust and Estate Counsel (Board of Regents, Estate and Gift Tax Committee, Fiduciary Litigation Committee, Communications Committee) and an Elected Member of The American Law Institute. Clary is also an Adjunct Professor of Law (Estate Planning) at Northwestern University School of Law.