



## You and Your Clients May Be Rich!!!

by: Harlan Dodson and Tracy Kane

As you prepare for the upcoming holiday season, consider the good news that come January 1, you may be RICH! Really! And, no, this article is not about how to get a cut of the late Prince Ombutu's fortune out of some British bank. However, something just as magical may happen on December 31 – Congress will have turned back time and we will all be partying like its 2001.

### *1. PLANNING FOR CLIENTS TOO STUBBORN TO DIE IN 2010!!*

Assuming Congress does nothing surprising between now and the New Year's Eve party you and your client attend, if the client dies before the "stroke" of midnight, the federal estate tax and generation skipping transfer tax do not apply. But, if he is misguided, or unguideable, enough to survive the New Year's Eve party, by the time he awakes to watch bowl games, the federal tax law from 2001 applies! Talk about Retro uniforms.

Simply Put – if a couple has over \$1,000,000 between them including real estate, IRA's, 401(k)'s, savings, life insurance and any inheritance, and they happen to die in 2011, they are subject to both federal estate and Tennessee inheritance taxes, on any amount over \$1,000,000.

More Simply Put – almost everyone will need the same level of planning as a multi-millionaire needed in 2009!

"How could this be?!" you ask. "Surely Congress would not let such a crazy thing happen?!" This was precisely what people were saying last November when everyone thought, "Surely Congress won't allow the federal estate tax to expire?!" Congress, however, did just that and as it reconvenes in mid-November it has a plethora of leftover matters to address, of which the estate tax is only one.

Even if Congress does act before January 1, we all need to be prepared to react by then to whatever it does; or, in the event it does nothing this year, but gets around to business next year, any will written or plan developed today will be impacted and we must be prepared for that as well. The law could be changing while you are typing – or signing. So, what is a lawyer to do over the next few weeks?

At a minimum, clients will require us to be up to date on what the law would be if nothing changes, and what to do to plan for that. Those signing wills at the end of 2010, or in early 2011, will need to be aware of both the present and the possible.

**Practice Tip:** Perhaps the best thing to do is plan a New Years Day party and invite your clients to cook hamburgers and sign wills drafted for whatever happens to be the law that day.

## II. TIME-WARP – 2001 IN 2011

There may be a few who do not remember the details of the federal tax laws in effect in 2001 (there may even be a few who were not even practicing then). As a public service, here is a quick and incomplete summary of the laws in effect in 2001 and likely to be in 2011.

**Federal estate taxes.** There is an exemption for each estate of \$1,000,000 for those dying in 2011 or after. The rates are graduated based on the size of the taxable estate, and reach 50%, the highest marginal rate, for amounts over \$2,500,000. There is also a 5% surcharge on estates between \$10,000,000 and \$17,184,000.

**Federal gift taxes.** In 2011 or after, there is an annual per donee exclusion of \$13,000, or \$26,000 if splitting gifts with a spouse. There is also a lifetime exemption of \$1,000,000 per donor for gifts not otherwise excluded from tax. Note, however, that because of the gross up of any gifts not otherwise excluded, use of the lifetime donor exemption reduces the estate exemption mentioned above. Thus, the only advantage of gifts using the lifetime donor exemption is moving appreciation. The gift tax rates track the estate tax rates.

**Federal generation skipping transfer taxes.** Each person is allowed a \$1,350,000 exemption (it is indexed) for those making such gifts or dying in 2011 or after. There is also an annual exclusion which is similar to, but technically different from, the gift tax annual exclusion. Again, the rates track the estate tax rates.

**Tennessee inheritance tax.** This exemption has remained at \$1,000,000 and, now, again matches the federal estate exemption. The Tennessee inheritance tax is a progressive tax beginning at 5.5% and capping out at 9.5% on amounts over \$440,000.

A few other points to remember:

- Husbands and wives cannot share their estate or inheritance tax exemptions, meaning convoluted planning is required in order to not lose one exemption. Therefore, if, when you add up the equity in the house, the IRA's and 401(k)'s and such, the life insurance and any other investments, and anything they may inherit, your couple has over \$1,000,000, which is quite likely, you have to be doing estate planning – that is, the same estate planning you would do for rich folks, except your now newly “rich” clients will not likely want to pay for rich folks planning!
- The income tax rules for retirement accounts, such as IRA's and 401(k)'s, continue to be positively sadistic. They are, however, a significant portion of most clients' assets today, so we must be able to include these in our planning.
- On the bright side, for those dying in 2011 or after, Section 1014 of the Code provides a step up in basis to the date of death value for all assets passing through the estate, except for those pesky few excluded by Section 691.

In an effort to preserve your holiday cheer, we've provided a few tips on how to lessen the stress and limit the hours involved.

1. Basically, we have to accept that most estates are potentially taxable for federal and state purposes and, therefore, draft for that.

2. For our practice, we will still divide clients into categories with common aspects, such as your typical

“kids and cat” estate, [medium-liquid], [medium-business assets], [large], and then use a set of planning forms that fit that category.

3. Now, however, we also must look to techniques that help reduce the estate, such as irrevocable life insurance trusts, for a greater number of estates that we would have otherwise ignored in the last several years.

**Caveat:** There is still considerable uncertainty as to how events occurring in 2010 will be treated for tax purposes in 2011 and after because of the wording in the 2001 Tax Act, which provides that the laws in effect under the 2001 Tax Act “shall not apply” as to estates of decedents dying, gifts made, or generation skipping transfers, after December 31, 2010. The 2001 Tax Act goes on to say that the Code shall be applied and administered after December 31, 2010 as if the 2001 Tax Act “had never been enacted.” There is no precedent for how such language will be interpreted for tax purposes, so stay tuned..... ■



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