# Estate Planning in a Politically Uncertain, Economically Turbulent and Interest Rate Environment

**© 2017 Diana S.C. Zeydel,[1] Martin Shenkman[2] & Jonathan G. Blattmachr.[3]** **All Rights Reserved.**

## Background and Introduction

Virtually, all estate planners are aware that the current "conditions" in the United States are quite different than they have been for several years. One critical condition is that the wealth that was eroded in 2009 and 2010 by the Great Recession has largely been restored while interest rates have remained low and that likely is reflected in part by the stock market reaching historic highs and very high price earnings ratios for publicly traded securities. Because, as indicated below, low interest rates can be used to achieve significant estate and other wealth transfer tax reduction (such as through installment sales to grantor trust and grantor retained annuity trusts commonly called "GRATs" and similar arrangements) and because individuals have significantly greater wealth than ever before, it should be anticipated that the wealthy would be engaging in tremendous amounts of wealth transfer planning. However, that does not seem to be the case. That hesitation to undertake significant estate and related planning seems to reflect that many anticipate a political matter: the potential and, for some, the anticipated repeal of the estate tax.

Indeed, since the election of Donald J. Trump as the 45th President of the United States, many planners and their clients have been wringing their hands

[1] Diana S. C. Zeydel is a member of the Alaska, Florida and New York bars. She is the national chair of the trusts & estates department at Greenberg Traurig, PA. She is a prolific writer and frequent lecturer on tax and estate planning topics. She also is a past Regent of the American College of Trust & Estate Counsel and a past chair of its estate and gift tax committee.

[2] Martin Shenkman, CPA, MBA, PFS, AEP, JD, is an attorney in private practice in Fort Lee, New Jersey and New York City who concentrates on estate and closely held business planning, tax planning, and estate administration. He is the author of 42 books and over 1,000 articles and has won many professional awards. His firm's website is www.shenkmanlaw.com where he posts a regular blog and where you can subscribe to his free quarterly newsletter Practical Planner.

[3] Jonathan G. Blattmachr is director of estate planning for Peak Trust Company (formerly Alaska Trust Company), a director at Pioneer Wealth Partners LLC, a boutique wealth management firm, and co-developer with Michael L. Graham, Esq., of Dallas, Texas of Wealth Transfer Planning, a software system for lawyers, published by Interactive Legal LLC.

on what type of planning they should undertake in light of proposals by both the Republican party that controls both the House and the Senate and by the President to repeal "death taxes." And so, the question arises on why anyone who is well informed would undertake any meaningful planning now (unless death is imminent and might occur before repeal does).

## A Little Political and Legislative Background

With a majority in the House, the Republican can easily push through tax changes, including estate tax repeal. But the rules are different in the Senate. There, a bill can be filibustered, which means the measure will not pass unless 60 Senators vote to end the filibuster and have a vote taken. All measures in the Senate are subject to being filibustered other than a budget reconciliation act.

A similar situation occurred in 2001 when the Republicans held a slim majority in the Senate with Republican President George W. Bush was in the White House. President Bush wanted tax changes including a repeal of the estate and gift taxes. Estate tax repeal became part of the budget reconciliation act passed that year and was enacted into law because the Democrats could not filibuster it.

However, there is another important provision that governs procedure in the Senate: the Byrd Rule. Under it, any Senator can object to any measure, even in a budget reconciliation bill, that would increase expenditures or decrease revenues. If the objection is made, it essentially causes the increase in expenditures or tax reduction to sunset in ten years and the law as it existed before the budget reconciliation act was enacted goes back into effect. It takes 60 Senate votes to block the objection and prevent the sunset. The objection was made in 2001 and the 2001 tax act was, accordingly, subject to sunset. The sunset period cannot exceed ten years but some politicians (such as House Majority Lead Paul Ryan) have proposed making it 20 years.

But there was one more important aspect of the 2001 tax provisions: the repeal of the estate tax was not immediate. The repeal was phased in and was not to become complete until 2010. However, immediately thereafter, all of the 2001 tax changes would sunset including the estate tax repeal.

President Obama and the head Republicans made a deal, keeping in place many of the income tax changes (such as taxing dividends as long-term capital gain) and adopting $5 million (indexed for inflation which will be $5.6 million effective in

2018) estate, gift and GST exemptions and essentially a flat 40% tax bracket for each wealth transfer tax system. And estates of decedents who died in 2010 were given a choice: keep the estate in the estate tax system (which might not result in any or much estate tax on account of the $5 million exemption or the use of the marital deduction) and have the basis of the assets in the estate "stepped up" under Section[4] 1014 (other than for the right to income in respect of a decedent described in Section 691) or stay out of the estate tax system but have the basis of the assets "carried over" to the estate and inheritors.

It is obviously not possible to forecast exactly what the Congress and President Trump will do this year or next from infrastructure spending to tax changes. The "major" promise of both was to immediately "Repeal and Replace" the Affordable Care Act (commonly known as Obama Care). That has not (yet) been accomplished. And that is important for tax policy reasons. The repeal would reduce Federal health care expenditures by hundreds of millions of dollars. That is offset, to some degree by the elimination of the net investment income tax under Section 1411 but overall it would provide the Federal government with significant funds to use for tax reduction.

In any case, it is certain that some tax changes will be introduced and some likely will be adopted in 2017 or 2018 perhaps, as urged by Treasury Secretary Steve Mnuchin, made retroactive to the beginning of 2017. These proposal may include a reduction or elimination of the estate tax, plus many income tax changes including a lowering of income tax for US corporations and higher income taxpayers, except perhaps in a few cases (such as taxing so-called "carried interests" as ordinary income rather than as long-term capital gain). One significant potential change for individuals in high income tax states, such as California and New York, is the likely elimination of the income tax deduction under Section 164 for state (and local) income taxes.

Regardless of the faith of the estate tax, repeal of the gift tax probably will not occur, according to almost all commentators. And, again, what happened in 2001 may foreshadow that result. President Bush wanted the gift tax repealed. But the gift tax acts as a backstop, not just to the estate tax but also to the income tax. Without that lifetime transfer tax on gifts, taxpayers can shift income producing assets to other family members without cost, who are in lower income tax brackets and who can recognize the income (such as gain on the sale of the gifted property), pay a lower tax and gift the after tax proceeds back to the original

[4] Throughout this article, "Section" refers to a section of the Internal Revenue Code of 1986 as amended.

owner. For that reason, the repeal of the gift tax was taken off the table in 2001. See discussion in Dept. of Treas., Office of Tax Analysis, David Joulfaian, The Federal Gift Tax: History, Law, and Economics (2007), available at https://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/WP-100.pdf.

**Why Estate Tax Repeal May Not Occur (Immediately)**

Estate tax repeal is not the only significant tax change that the Republicans and the President have sought. Although the Republican party proposals and those of President Trump are not the same, many are the same or so similar that they likely could be adopted (if the Republicans alone get to decided). These include: (1) Reduction of individual rates to a 33% maximum, (2) elimination of AMT for individuals and corporations, (2) repeal of the 3.8% Net Investment Income Tax, (3) elimination of itemized deductions (other than the home mortgage interest deduction already limited to not more than the interest on $1 million of debt and possible limiting the charitable contribution deduction to $100,000 for a single taxpayer and $200,000 for married taxpayers filing a joint return), (4) taxation of carried interest at prevailing ordinary income rates, (5) corporate tax rate reduction (down to, perhaps, 15%), (6) repatriation of untaxed foreign income at a reduced rate, (7) continuation of low rates for investment income including interest income.

But there does not seem to be a complete consensus among all Republicans on all points. Republicans Congressmen and Senators in states with high income tax (e.g., New York) have spoken against eliminate the deduction under Section 164 for state and local income taxes. Some have indicated that they oppose taxing carried interests at ordinary rates. Many oppose a limitation the charitable deduction any more than it now is. Even House Majority Lead Paul Ryan has indicated that a 15% corporate tax rate may be impossible to achieve.

Moreover, historically, Republicans have opposed increases in the national debt. And it is virtually certain that, at least for many years, adopting many if not all of the Republicans' tax "wish list" will increase the debt. In addition, there are other expenditures that Republicans (and many Democrats) contend they want such as infrastructure spending. But that too will be expensive. The Pew Charitable Trusts reports that "The American Society of Civil Engineers estimates that fixing all the roads, bridges, public transit, railroads, energy systems, schools, public parks, ports, airports, waste systems, levees, dams, drinking water facilities and hazardous waste installations in the 50 states and

the District of Columbia would take $3.6 trillion by 2020. That's a little over three years from now, not the 10 years Trump is touting." Bloomberg Global Business Forum (December 12, 2016) contends: "[Senate Majority Leader Mitch] McConnell, Warns of 'Dangerous' Debt, Wants Tax Cut Offsets."

The bottom line, so to speak, is that there likely will be a limit on how much tax "reform" can be "purchased." Whether the price of estate tax repeal can be accommodated is uncertain just as it was under President George W. Bush's tax proposals in 2001.

## Why Political Uncertainty Should Not Retard Planning

Because of the significant political uncertainty, many taxpayers and their advisors are adopting a "wait and see" strategy, deferring current estate tax planning. Many clients have determined to simply not proceed with planning in process, and even more not to undertake new planning. That may not be the wisest choice. It seems that a rational case can be made that planning should continue for the balance of this year and into next year as long as the risk of significant gift or income tax is tolerable, and the cost of implementation is reasonable relative to the circumstances. This conclusion is based upon any of the following likely results of the possible changes to the transfer tax system.

**Estate Tax Is Not Repealed.** Although there has been so much talk of repeal, it remains possible that the estate tax will not be repealed. As pointed out earlier, the estate tax was never really repealed under the George W. Bush regime. Part of the reason was cost— the focus was on immediate income tax cuts because, unless a person is about to die, he or she probably would rather have income tax reduction now and have death tax repeal implemented later.

In light of the possibility of no repeal, estate planning should, in many cases, continue now.

**Estate Tax Is Repealed But Sunsetted.** Even if the estate tax is repealed (whether implemented immediately or delayed or phased out), there seems to be a significant chance it will come back on account of the Bryd Rule. In that case, taxpayers, and their advisors, need to continue to engage in estate planning, unless they are confident the taxpayer will die while the estate tax is not in effect. Again, if the potential costs of planning versus not are weighed, in most circumstances it is difficult to imagine that it would be prudent to cease planning or even defer it. It should be noted that it seems that the estate tax possibly could be retroactively implemented— cf. United States v. Carlton, 512 US 26 (1994).

**Estate Tax Is Repealed But Reenacted.** If the political history of the United States repeats itself, the Democrats will regain control of the Federal government at some point and the estate tax may be reenacted (whether retroactively in part or not). That could happen in four years. And those who have foregone planning in the meantime may have lost opportunities they should have taken. In fact, many of the proposals made by the Obama administration (e.g., limit on the use of the GST exemption, reduction in the estate tax exemption, increase in wealth transfer tax rates, elimination of valuation discounts) could be enacted as part of the return of the estate tax. In that case, failure to have planned in the meantime will have been costly.

**Estate Tax Is Repealed But Capital Gains Tax at Death Enacted.** The President has proposed the elimination of "death taxes" but also seemed to propose the enactment of a capital gains tax at death. That is the Canadian system. For some, this will be a less expensive system than the estate tax would have been, but for others it will be more costly. For example, the ultimate winners of the step-up in basis at death are the inheritors of negative basis property with huge debt on the property even if in excess of the net or gross fair market value of the asset. (A negative basis means that debt against the property exceeds the income tax basis of the property.)

Gain or income is not recognized by the transfer of property at death even if it has a negative basis. See CCA 200932024 (not precedent) and discussion in Blattmachr, Gans & Jacobson, "Income Tax Effects of Termination of Grantor Trust Status by Reason of the Grantor's Death," 97 Jl of Taxn 149 (Sept. 2002). Yet upon death, the entire debt is added to basis even if that puts basis above the property's gross fair market value. See Section 1014(a) and Reg. 1.742-1 ("The basis of a partnership interest acquired from a decedent is the fair market value of the interest at the date of his death or at the alternate valuation date, increased by his estate's or other successor's share of partnership liabilities, if any, on that date, and reduced to the extent that such value is attributable to items constituting income in respect of a decedent…under section 691.").

With a capital gains tax at death system, the inheritor of negative basis or highly leveraged assets may face immediate income tax with the debt presumably treated as an amount realized including any negative basis.

Some will be winners under capital gains tax at death and some will be losers. It will depend upon tax rates and the structure of the system. In Canada, for example, a capital gains tax is imposed on a trust every 21 years.

It is, of course, uncertain what assets will be subject to gains tax at death. It seems certain that merely putting assets into a revocable trust (or similar arrangement) will not avoid the tax. In Canada, gain is recognized by the transfer of an appreciated asset to a revocable trust. That seems unlikely in the United States as such trusts are so widely used. Rather, what seems logical is that any assets that would have been included in the decedent's estate under the US estate tax system will be subject to the gains tax upon death. But that indicates that making transfers now that would remove the assets from the owner's estate might avoid capital gains tax at death. When weighing whether to pursue or defer current planning, consider the possibility of current planning avoiding (or deferring) a future capital gains tax on death.

**Estate Tax Is Repealed But Carryover Basis Adopted.** Under the Tax Reform Act of 1976, a carryover basis for property received from a decedent was adopted under now repealed Section 1023 and the step-up in basis under Section 1014 eliminated. That system was itself repealed in the Windfall Profits Tax Act of 1980. Nonetheless, carryover basis (under now repealed Section 1022) was revived for estates of decedents who died in 2010 and choose not to elect into the estate tax system. Perhaps, this may portend that the Code might again include a carryover basis system if the estate tax is repealed. If so, it seems that there is no harm in doing planning—property transferred out of the estate would have a carryover basis under Section 1015 and would have a carryover basis if transmitted death. This seems to be a "no harm no foul" situation if it develops that way but it does mean protection against a later reenactment of estate tax (by sunsetting or otherwise) or capital gains tax at death.

**Estate Tax Is Repealed But Step-Up in Basis Continues.** Although based upon the history of the US tax system, it seems unlikely that the estate tax would be repealed but step-up in basis under Section 1014 would be retained. But in politics, nothing is impossible.

While it might appear that such a possibility might mean that no action should be taken to remove assets from what would be someone's gross estate, the property can be returned for inclusion with careful planning.

The first way to accomplish the return is where the assets are held in a grantor trust under which pursuant to Section 671 the income, deductions and credits of the trust are attributed to the grantor (or if Section 678 applies to a beneficiary who is not the grantor). It is the official position of the IRS that such a trust does not exist for

income tax purposes meaning the assets could be repurchased from the trust by the grantor without income tax recognition.  See Rev. Rul. 85-13, 1985-1 C.B. 184.

Another option might be for a new trust to be structured (or an old one "decanted") so a power of control over the beneficial enjoyment of the assets could be given to the grantor which, if given, will cause the property to be included in the grantor's estate under Section 2038.  If not granted, there would be no inclusion.  See Blattmachr & Rivlin, "Searching for Basis in Estate Planning: Less Tax for Heirs." 41 Est. Plan. 3 (August 2014).

This suggests that any transfer made in planning be made in trust, probably a grantor trust, but at least structured to give someone (perhaps, someone not acting in a fiduciary capacity) the power to grant a power of control to the grantor so estate tax inclusion could occur if that is beneficial.

It also seems that there could be minimal downside, other than transaction costs, even if the "no estate tax/step-up in basis" regime does not occur. As noted above, the client will have still obtained the benefits of shifting assets to protective trusts. But with the flexibility noted above those trusts might provide a tax advantage under a number of possible tax change scenarios.

**Weighing the Costs of Planning Or Not Suggests Planning Continue**

For a client who might endeavor to transfer $10 million if he or she knew estate tax might not be repealed, with proper planning perhaps the only material risk is the cost of implementing the planning if repeal does in fact occur. So long as the cost of the planning is reasonable relative to the wealth involved, why should the planning be deferred?  Further, if the result of the planning is a shift of wealth into trusts that are protective and beneficial even if repeal occurred, the cost of planning would not have been wasted. See Blattmachr & Blattmachr, "Even Without Estate Tax the Right Answer Is Still the Same, Put It All in Trust," LISI Estate Planning Newsletter # 2489.  When weighing the many possible tax law changes and other considerations, how can one quantify the asset protection benefits of implementing transfers to protective trust structures currently versus the potential downside risk of deferring tax because of unknown tax changes? As most practitioners believe the gift that will remain, there may in fact be no cost savings from deferral, merely a deferral of asset protection benefits.  Further, as indicated above, flexible planning might well provide tax benefits whichever tax system is ultimately enacted.

Here are some planning steps that might be implemented as the costs and risks of doing so seem relatively low.

**Create Large GRATs**. A GRAT tends to be a "heads I win; tails I can't lose" estate tax planning opportunity. See, generally, Blattmachr, Graham & Zeydel, "Steeply Declining Rolling GRATs: Perhaps, the Best GRAT Ever," ILS Newsletter (January 2009); and Blattmachr & Zeydel, "Evaluating the Potential Success of a GRAT Against Competing Strategies to Transfer Wealth", *Tax Management Memorandum,* January 23, 2006, Vol. 47, No. 2; BNA Tax Management, March 16, 2006.

**Do a 99 Year GRAT.** This concept, developed by Kentucky lawyer Turney Berry, of having a property owner create a very long term GRAT will result in exclusion of a portion of the property transferred to a GRAT excluded from the grantor's estate if the Section 7520 rate (used to value interests in a GRAT) rises more than *de minimisly.* Although some part of the GRAT will be included in the grantor's estate upon death if he or she is still entitled to the annuity at that time, the amount may be only a small portion of the trust. See Reg. 20.2036-1(c)(2)(i).

**Consider a SPLAT[sm] Rather Than a GRAT.** There should be no risk of inclusion of a lifetime SPLAT[sm] (under which the client would purchase an annuity stream from a grantor trust and another grantor trust would buy the remainder), even though the arrangement will terminate with the client's death. Also, the client will have an interest in the property for life. And the remainder can be made GST exempt. See Blattmachr & Slade, "GRATs vs. SPLATs[sm]," The Chase Review (October 1994).

**Long Term Installment Sale.** Do very long term installment sales to grantor trusts structuring them in ways to diminish the risks present with other estate planning strategies. See Blattmachr & Graham, "Gift Tax Safety Nets for Installment Sales Redux," ILS Newsletter (December 2008).

**Do a "Reverse Freeze."** Rather than have the client create an entity (e.g., a partnership) in which the client obtains a preferred interest (which would tend to be frozen in value) and younger family members obtain the common interests (which may tend to grow in value over time), which could trigger the adverse effects under Section 2701, the client would take the common interests and younger family members the preferred which preferred interest which would carry a very high but fair market value coupon. See discussion

in Blattmachr, Hatcher, Weinrib, Weiss & Zeydel, Program Materials, ACTEC (Fall 2007).

**Consider a Qualified Personal Residence Trust**. There seems little downside if the client has adequate exemption to cover any gift made.

One might assume that when interest rates are low, a qualified personal residence trust ("QPRT") will not be beneficial because the income interest (or retained right to occupy the residence) will have a lesser value. Yet a QPRT involves another retained interest in addition to the right of use and that is a reversion if death occurs within the term.

The reversion is not nearly as interest rate sensitive as is the income interest, but the reversion is very age sensitive.[5] Accordingly, it is the value of the reversion, not the income interest, that increases significantly the aggregate value of the retained interest for an older transferor. A I 0-year QPRT for a 65 year old at a section 7520 rate of 8% will yield approximately the same taxable gift (35% of the contributed value) as a 10 year QPRT for a 75 year old at a section 7520 of 3.8% (36% of the contributed value). Therefore, when interest rates are low, QPRTs may still be a viable strategy for an older settlor.

The reversionary interest will return the trust estate to the settlor if the settlor dies within the term of the QPRT. Thus, the value of the reversion depends upon the probability of the settler's death within the fixed term. That probability is much higher for a 75 year old than for a 65 year old.

**Consider a Split Purchase Trust In Lieu of a QPRT.** This allows the client to live in the home for life with estate tax inclusion concerns upon death. The remainder can be made GST exempt. See, generally, Blattmachr & Painter, "When Should Planners Consider Using Split Interest Transfers?," 21 Estate Planning 20 (January/February 1994); and Blattmachr "Split Purchase Trusts[sm]," The Chase Review (January 1994)

---

[5] The reversionary interest will return the trust estate to the settler if the settler dies within the term of the QPRT. Thus, the value of the reversion depends upon the probability of the settler's death within the fixed term. That probability is much higher for a 75 year old than for a 65 year old.

**Consider a Charitable Lead Annuity Trust.** A charitable lead annuity trust ("CLAT") benefits from a low interest rate environment for the same reason that GRATs do, because the annuity will have a higher actuarial value. A CLAT is usually is a longer term strategy than is a GRAT. One reason for that is the GRAT will "fail," at least in part, if the grantor dies during the annuity term; a CLAT generally will not.9 A CLAT, therefore, has the potential to benefit from "locking in" a long-term low interest rate at inception.

Assume, for example, that a 20-year zeroed-out CLAT created every month from January 1926 to May 1988 were invested in an S&P 500 index fund. Assume also for this purpose (because we do not have section 7520 rates for that period) that the section 7520 rate is 6% for each CLAT and the annuity payment to charity were escalated annually by 50% (meaning each subsequent year's annuity payment would be one and half times the amount of the payment for the prior year). In simulations run by one financial institution[6], 92% of the CLATs would be successful, meaning at least $1 would be delivered to the remainder beneficiary. Indeed, the median remainder value would have been 557% of the starting value of the CLAT -- a very impressive result.

Many may not expect future market performance to be as robust as in the past. Suppose that we assume a hypothetical portfolio with an expected return of 8.6% with 15% volatility. In computations performed by one financial institution, a 25 year zeroed out grantor CLAT with 100% annual escalation (meaning the CLAT annuity payment doubles each year) commenced when the section 7520 rate is 3% is expected to deliver a tax free benefit to the remainder beneficiaries that is 468% of the original value contributed to the CLAT in the median case, still a very attractive result.[7]

## Summary and Conclusions

The estate tax has always been a political matter. Although prospects of immediate repeal may appear high at this time, just as they did after the election of George W. Bush, the repeal may not occur for several reasons, almost all of which are political in nature. Clients need to be advised that even if repeal occurs, it may come back (as it has three times, in our nation's

---

[6] Courtesy of JP Morgan.

[7] A risk principal premium is generally an additional sum, above the original amount borrowed, due at maturity. In general, the risk premium in a SCIN is the additional amount (above the amount borrowed plus).

history). This suggests that, even if the client is convinced repeal will occur, planning nonetheless should be considered unless the client is certain he or she will die while repeal is in effect. Planning must also consider for income tax purposes as certainly a carryover basis or gains tax at death will almost certainly be adopted. It is not appropriate to do or gains tax at death will almost certainly be adopted. It is not appropriate to do nothing. There are many opportunities to do planning with minimal gift and income tax risks.