

# Obama's 2009 Estate/Income Tax Proposal Outline

Presented by:  
**Robert S. Keebler, CPA, MST, DEP**  
**Virchow, Krause & Company, LLP**

## I. Current Estate Tax Proposals

### A. Grantor Retained Annuity Trust (GRAT)

1. Overview of technique
  - a. GRATs shift wealth to future generations estate and gift tax free to the extent that the growth rate of the transferred asset exceeds the government's mandatory interest rate (i.e. IRC Section 7520 rate)
    - i. The current IRC Section 7520 rate for May 2009 is 2.4%
  - b. If the grantor dies during the GRAT term, all (or nearly all) of the trust's assets are included in the grantor's taxable estate
    - i. Short-term "rolling" GRATs (i.e. GRATs with terms from two to five year) can be used to mitigate this estate inclusion problem
2. Issue
  - a. The Obama Administration sees short-term GRATs as being too effective in avoiding the estate tax
3. Proposal
  - a. Require that a GRAT must have a term that is not less than ten years
    - i. Proposal is designed to increase the likelihood of estate inclusion
    - ii. Proposal still allows GRATs to be "zeroed-out"
    - iii. Proposal will only be effective after the date of enactment (i.e. prospective)

### B. Valuation Discounts

1. Overview of technique
  - a. When closely-held interests are transferred to family members, there is usually a discount associated with the transfer due to certain provisions of the governing document
    - i. These discounts can range anywhere from 20% to over 50% depending on: (a) the type of assets involved, (b) the nature of the entity and (c) restrictions
2. Issue
  - a. The IRS and the Obama Administration have seen valuation discounts taken in the past as being abusive in an attempt to underreport tax
3. Proposal (see example)
  - a. Certain restrictive provisions of the governing instrument will be ignored for valuing a transferred interest between members of transferor's family
    - i. The disregard of certain restrictive provisions will increase the value of transferred interest, increasing estate and/or gift tax
    - ii. Regulatory authority will be granted (including the ability to create safe-harbors)
    - iii. These rules will apply to all entities created after 10/8/1990

## **II. Current Income Tax Proposals**

- A. Reinstate the 39.6% tax rate
  - 1. Will apply to taxpayers currently in the 35% tax bracket
  - 2. Will take effect on 1/1/2011
- B. Reinstate the 36% tax rate
  - 1. Will apply to taxpayers currently in the 33% tax bracket
  - 2. Will apply to married filing jointly taxpayers with taxable income above \$250,000 (\$200,000 if single)
  - 3. Will take effect 1/1/2011
- C. Reinstate 3% phase-out of itemized deductions
  - 1. Will apply to married filing jointly taxpayers whose AGI is above \$250,000 (\$200,000 if single)
  - 2. Will take effect 1/1/2011
- D. Reinstate 2% phase-out of personal exemptions
  - 1. Will apply to married filing jointly taxpayers whose AGI is above \$250,000 (\$200,000 if single)
  - 2. Will take effect 1/1/2011
- E. Impose 20% capital gains tax on qualified dividends and long-term capital gains
  - 1. Will apply to married filing jointly taxpayers whose taxable income is above \$250,000 (\$200,000 if single)
  - 2. Reduced capital gain tax rate on five-year long-term capital gains would be eliminated
  - 3. Will take effect 1/1/2011

## **III. Action Steps**

- A. Establish a series of GRATs today to lock-in future growth at historically low rates
- B. Transfer closely-held business assets to junior family members today to “freeze” estate tax value of assets at all-time low values
- C. Explore sale of highly-appreciated assets to lock in 15% capital gains tax rate
- D. Explore the possibility of converting to a Roth IRA
- E. Explore exercising Non-Qualified Stock Options (NQSOs) before increase in tax rates

## Appendix Valuation Discount Example

	<u>Current</u>	<u>Obama Proposal</u>	<u>Difference</u>
Closely-held business*	\$13,000,000	\$20,000,000	\$7,000,000
Other assets	<u>7,000,000</u>	<u>7,000,000</u>	<u>0</u>
Gross estate	\$20,000,000	\$27,000,000	\$7,000,000
Less: Exemption	<u>(3,500,000)</u>	<u>(3,500,000)</u>	<u>0</u>
Taxable estate	<u>\$16,500,000</u>	<u>\$23,500,000</u>	<u>\$7,000,000</u>
<b>Estate tax @ 45%</b>	<b>\$7,425,000</b>	<b>\$10,575,000</b>	<b>\$3,150,000</b>