Montecito Bank & Trust®

estate planning BULLETIN

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Regs. on intrafamily transfers proposed

In August the IRS proposed new Regulations under IRC §2704 on intrafamily transfers. Certain restrictions and lapsing rights are ignored for transfer tax purposes in certain circumstances. The Proposed Regs. appear to be an attempt to reverse the result of the Tax Court's decision in *Kerr v. Commissioner,* 113 T.C. 449 (1999). Some observers believe that job belongs to the Congress, not the executive branch.

In a blog post, Mark Mazur, the Treasury assistant secretary for tax policy argued: "It is common for wealthy taxpayers and their advisors to use certain aggressive tax planning tactics to artificially lower the taxable value of their transferred assets. By taking advantage of these tactics, certain taxpayers or their estates owning closely held businesses or other entities can end up paying less than they should in estate or gift taxes. Treasury's action will significantly reduce the ability of these taxpayers and their estates to use such techniques solely for the purpose of lowering their estate and gift taxes."

A hearing on the proposal is scheduled for December 1, and comments are due by November 2, 2016.

Clinton v. Trump on estate taxes

The ideas for the federal estate tax from the Presidential candidates could not be more opposed. Hillary Clinton essentially has endorsed the position that President Obama took in each of his budget proposals, a reduction of the federal exemption to $3.5 million, coupled with an increase in the tax rate to 45%. Bernie Sanders would have increased the tax rate to 65%. Donald Trump has proposed eliminating the federal estate tax entirely.

The Tax Foundation has modeled the economic consequences of these proposals [http://taxfoundation.org/article/modeling-estate-tax-proposals-2016]. They find that the estate tax is among the most harmful of taxes for every dollar of revenue raised. With today's large estate tax exemption, the average tax rate is far lower than the marginal tax rate, which is 40% for all taxable estates. A $6 million estate would have an average tax rate of just 3.7%, the study notes. A high marginal rate creates disincentives for savings above the exemption level.

The study observed that, with a static analysis, eliminating the estate tax would reduce federal revenue by some $240 billion over the period from 2016 to 2025.

A dynamic analysis finds that the economy would grow by an additional 2.3%, an additional 159,000 full-time jobs would be created, and the net revenue loss would be only $19 billion over the period.

The Clinton plan would increase revenue (static analysis) by $107 billion, but at the cost of a loss of 0.1% of GDP and 14,000 full-time jobs. Dynamically, the net gain would be $82 billion. The Sanders plan would raise far more money (static analysis) at $310 billion. Dynamically, it would reduce GDP by a full percentage point and cost a projected 194,000 full-time jobs, for a net gain of just $28 billion.

Estate tax repeal would not mean the end of planning for death taxes, however. During the year that the federal estate tax was suspended, 2010, executors and heirs had to learn the intricacies of carryover basis, which took the place of the estate tax. (Current law permits a tax-free step-up in the basis of inherited assets, a very valuable tax privilege.) In effect, the capital gains tax was substituted for the estate tax.

Many estate planning strategies have both tax and nontax objectives. Should Trump succeed and then persuade the Congress to accept his ideas for the estate tax, the tax planning benefit of many strategies would be reduced or eliminated.

Should Clinton win the Presidency, a reversion to the 2009 estate tax regime is unlikely unless Democrats take the House and Senate as well. Should that happen, history suggests that there might be a frenzy of major gift giving. Back in 2012, when the federal exemption was scheduled by law to be reduced, many wealthy families tried to "lock in" the higher exemptions with intrafamily transfers. That phenomenon would be likely to recur.

Top talent fleeing the IRS?

The IRS has to compete with the private sector for talent, and there are some critical areas where private sector pay beats IRS salary plus benefits. The IRS had a special hiring program with "critical pay authority" in order to compete better for top talent, but the program was not renewed in 2013. The assignments were for four years, and they have been expiring.

One result, according to Commissioner Koskinen, is that Chief Technology Officer Terence Milholland decided to accept an offer outside the IRS in June. Earlier the IRS lost its chief cybersecurity officer. Koskinen has asked that critical pay authority be restored.

National Taxpayer Advocate Nina Olson is in accord. She said, "If you want the IRS to bring itself into the 21st century, you have to have people from the private sector who've done it there," many of whom cannot realistically accept "the hit on their pay, even if they are motivated for public service."

Impact of Prince's intestacy

The controversy over the estate of pop star Prince Rogers Nelson continues. No will has been produced to date, and DNA tests have been used to disqualify some who claimed to be his illegitimate and unacknowledged children. DNA tests also may be needed to determine whether certain half-siblings actually had the same father as Prince did to support their claim to a portion of his estate, variously estimated at between $100 million and $300 million.

According to the Private Wealth Web site, all the publicity about Prince's intestacy has had a salutary effect upon the general public. More people are attending to their estate planning, or at least taking first steps in the process on the Internet [http://www.fa-mag.com/news/dearly-beloved--prince-s-death-prompts-uptick-in-wills-27071.html].

• LegalZoom.com had a 46% increase in estate planning volume after April 21, the day that Prince died.

• Nolo.com saw sales of its downloadable Willmaker service jump 24%, and its Nolo Online Living Trust Service rose 41%.

• RocketLawyer.com had a 57% increase in estate planning activity.

• Completed wills at USLegalWills.com grew by 61% in the three weeks following Prince's death.

LegalZoom also reported a 20% increase in requests for consultation with an attorney.