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**HEADLINE:** Retroactive Law Could Be Estate Tax Remedy

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**BODY:**

Despite years of advance notice and plenty of political maneuvering, there is now a realistic chance that Congress will be unable to prevent the scheduled repeal of the estate tax before it disappears -- for one year -- on Jan. 1.

It's a nightmare for tax and estate planning that lawmakers have seen coming since 2001, and one that they have tried to avoid.

But while the arrival of the new year without estate tax legislation could constitute an embarrassing policy failure, it might not result in the debacle that lawmakers fear, notwithstanding gruesome predictions of greedy heirs pulling the plug on elderly and ailing parents.

That's because Congress has long passed tax laws that apply retroactively -- meaning that lawmakers may make a public promise this year to handle the issue in 2010, then come back and clean up the mess.

"Nobody wants to be responsible for a train wreck, and letting the estate tax expire by Dec. 31 is a train wreck," said Michael Graetz, a professor at Columbia Law School. "Whenever Congress behaves incredibly irresponsibly, it's a big deal, even if they can fix it."

Estate tax planners are assuming that, even if Jan. 1 arrives without congressional action, lawmakers will move in 2010 to retroactively "repeal the repeal" and extend the current estate tax rate of 45 percent and exemption level of \$3.5 million, said Michael Halloran, president-elect of the Ohio-based National Association of Estate Planners and Councils.

Yet a retroactive fix is not guaranteed, could be challenged in court and adds an element of complexity and confusion to the estate tax process.

"The complication is how to plan properly for your clients," said Halloran, a director with Northwestern Mutual Financial Network in Jacksonville, Fla.

Scenarios Weighed

The 2001 tax cut signed into law (PL 107-16) by President George W. Bush set into motion a gradual phase-out of

the estate tax -- termed, to great political effect, the "death tax" by Republican conservatives -- culminating in its total repeal in 2010.

But under the rules governing budget procedures, the law could not be extended more than 10 years into the future. As a result, on Jan. 1, 2011, the pre-2001 estate tax levels in effect will snap back into place, with lower exemptions and higher rates.

The Obama administration wants to extend the current estate tax structure indefinitely, and legislation passed by the House last week (HR 4154) would do just that. But Senate Democratic leaders, consumed by the health care debate, say it is unlikely that they will be able to take up the bill.

House Democrats have pondered a one- or two-year extension of current estate tax levels.

"We understand that it's better to do it this year than have it hold into next year," said Chris Van Hollen of Maryland, a member of the House Democratic leadership and the Ways and Means Committee. Any "patch," he said, should be as long as possible.

But whether lawmakers can jam such a provision into a year-end legislative package is uncertain. Moreover, Democratic moderates in the Senate are likely to press for a more generous approach than the one advocated by the House.

"I don't know how much controversy we can handle in one bill," said Senate Majority Whip Richard J. Durbin, an Illinois Democrat.

Even if Congress does not act by Jan. 1, the Democratic majority's intent is clear -- to keep the estate tax alive.

As a result, Halloran said, the industry "is planning on no change in working with their clients. We're not counting on [the rate] going back to zero."

Of course, that is easier said than done. There is always the possibility that as people die in 2010 and their estates are transferred to heirs, some of those assets will be sold and the money distributed. That will complicate the process of taxing the estates if Congress does act retroactively. However, heirs are liable for any taxes, and estates have nine months after a death to file returns.

#### Some Precedent

Over the years, Congress has changed tax law retroactively on provisions large and small. For instance, when President Bill Clinton signed into law the Revenue Reconciliation Act of 1993 (PL 103-66) on Aug. 10, 1993, it increased federal income tax rates on high-income taxpayers, retroactive to Jan. 1 of that year. It also hiked tax rates on the estates of people who died after Dec. 31, 1992, to the rates that had existed in 1992.

That law was challenged in court, as other retroactive tax laws have been.

The clearest precedent came in 1994, when the Supreme Court unanimously held in *United States v. Carlton* that a retroactive estate tax provision, unrelated to the law Clinton signed, did not violate a taxpayer's due process rights.

The court specifically cited statements by the chairmen of the Senate Finance and House Ways and Means committees. That precedent could encourage lawmakers to write a letter signaling their intentions and remove some of the perverse incentive for wealthy people to die during 2010.

"I do think the macabre stories give them an incentive to do something before the end of the year," Graetz said. "I don't think anyone in Congress wants to be thought responsible . . . for that if it did happen."

Any estate tax challenge could be different from previous cases, lawyers said, because it could be seen as imposing a new tax retroactively, not just changing the rate of an existing tax.

"The stakes are so high," said Ronald Aucutt, a partner in the trusts and estates practice at McGuireWoods LLP in McLean, Va. "We have seen challenges in the past over much smaller changes, much less significant changes."

If Congress does not act this year or next, the year of repeal could present significant estate planning opportunities.

Along with the estate tax, the generation-skipping transfer tax also disappears, creating the possibility for the super-wealthy to create dynastic trusts to get money to their grandchildren, said Beth Shapiro Kaufman, a tax policy and estates lawyer at Caplin & Drysdale in Washington.

Additionally, under existing law, the gift tax will drop to 35 percent for 2010 only. Since few viable estate tax compromises include a rate lower than that, wealthy people could make taxable gifts in 2010, eliminate most or all of their future estate tax liability and pay 35 percent, Aucutt said.

But estate planners generally prefer certainty to intriguing possibilities. "Interesting is not really what we want for our clients right now," Kaufman said.

It's hard for estate planners to know exactly what will happen, and many are urging clients to sit tight and wait for the retroactive law, if that is where the current impasse eventually leads.

"A lot of people will be intrigued about planning opportunities but will be very, very cautious about making a commitment," Aucutt said.

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