The President's estate tax reform proposal

The Obama administration's 2013 budget documents included a mix of old and new proposals for changing estate and gift taxes. Key points:

- Return to the 2009 exemptions ($3.5 million for estate tax, $1.0 million for gift tax) and tax rates (top rate of 55%, and 60% for transfers in the "phase-out" range).
- Minimum 10-year term for Grantor Retained Annuity Trusts.
- Reduction in discounts for intra-family transfers.
- Consistent valuations for income and transfer tax purposes.
- Limit the generation-skipping tax exemption to 90 years.
- Extend the tax lien for estate tax deferrals for the full deferral period.
- Create an estate tax inclusion for grantor trusts.

The last point is the most radical proposal, with the greatest potential for disrupting estate plans. Certain types of irrevocable trusts are today treated as completed transfers for estate and gift tax purposes, but as the property of the grantor when it comes to income tax. That means the grantor must pay the taxes on the trust's income. Normally, one would not want to be taxed on income that one doesn't receive, but in this case it's the grantor's heirs who will benefit. The IRS has ruled that the payment of income taxes in this situation is *not* a taxable gift, even though the heirs benefit. What's more, if the income tax payments are substantial, they will remove assets from the grantor's future taxable estate, for additional savings.

Some tax specialists have warned that Irrevocable Life Insurance Trusts might also be adversely affected by the proposed change.

Few tax observers expect Congress to act on the President's tax proposals during this election year. If nothing is done, the estate and gift tax rules revert to the 2001 law come January 1, 2013. That means exemptions of just $1 million and top tax rates of 55% (60% in certain situations).

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