

# Estate Planning

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## Death and Taxes: Coping with Uncertainty

One of the most important considerations in any estate plan is the impact of the federal estate tax. The current status of our estate tax makes it impossible (not just difficult, but truly impossible) to know just how much estate tax, if any, is likely to be due on many estates.

### Estate Liquidity

One significant factor in estate planning is determining whether a person's estate will have sufficient liquidity. Cash will be needed to pay expenses, cash bequests, and taxes. An estate consisting primarily of illiquid assets, such as closely held business interests or other assets (such as real estate) that cannot be readily converted to cash, requires the estate planner to take steps that will assure the estate will be able to meet these needs.

The federal estate tax is typically one of the largest cash draws on an estate. Unlike some obligations, the federal estate tax is due on a certain date—normally nine months after the date of death, when the estate tax return is due—and cannot be put off or delayed indefinitely. The due date for filing a return can be automatically extended for six months, but this does not delay the due date for payment of the tax.

The Internal Revenue Code does provide relief for estate tax payments in some situations. For example, if closely-held business interests amount to more than 35 percent of the value of an estate, it may be possible for the executor to elect to pay the tax in installments over a period as long as 10 years. However, this election is subject to some conditions and limitations. For example, the business in question must be a “trade or business”

for tax purposes, and may not be a mere investment undertaking. Thus, an active real estate construction operation would normally qualify, but one which merely collects rental income might not. Numerous cases and rulings have addressed that point, and arguments with the IRS over this issue are quite common.

In addition, the IRS is authorized (but not required) to extend the time for payment in several circumstances. Such an extension can delay payment for as long as 10 years, provided the estate (through the executor or personal representative) is able to establish “reasonable cause” for an extension. While such an extension may be available, it is difficult to plan for because it is dependent upon the discretion of the IRS.

### The Estate Tax Is Changing Year-by-Year

The present state of the federal estate tax is very confusing, so much so that it is hard to believe that Congress could have intentionally come up with such a system. [We tend to blame the IRS for complications and complexity in our tax system, but the blame really belongs at the other end of Pennsylvania Avenue—with the U.S. Congress.]

Today, no estate tax is due on the first \$2 million of property in a decedent's estate. With basic planning, a married couple can escape paying tax on up to \$4 million. Next year, in 2009, those figures go up to \$3.5 million and \$7 million, respectively. Then in 2010, for one year only, the federal estate tax goes away entirely, with no estate tax due on a decedent's estate of any size.

*Note: There might be no estate tax, but the IRS does get a consolation prize—an heir receiving property from a decedent dying during 2010, while the estate tax is suspended, takes a basis in that property for tax purposes equal to the donor's basis. The standard rule, both before and after 2010, gives the heir a basis equal to the property's value at the time of the decedent's death.*

In 2011, the estate tax comes back to life with an exemption reduced to only \$1 million.

Of course, that system doesn't make any sense at all, but that's how Congress has it set up for now. It is almost inevitable that the new Congress that takes office next year will change this system. No one can predict exactly what those changes will involve, but we can guess. Efforts to repeal the estate tax permanently have continued since the present system was set up in 2001, but it now seems that even fervent proponents of repeal are ready to accept a compromise, so repeal seems unlikely for the foreseeable future.

The likely effect of that compromise will be to increase the exemption and lower the top rate. The final decisions on the estate tax will be made by Congress, probably in 2009, but here is the consensus on what is likely:

- The scheduled estate tax repeal in 2010 will not be allowed to take effect.
- Any estate tax legislation will probably come about as part of a larger tax bill presenting the new Administration's comprehensive tax plan.
- Final action is unlikely before next summer. The eventual estate tax exemption will probably be in the range of \$3.5 million to \$5 million, with a top tax rate in the range of 30 to 45 percent.
- There will probably be other reforms, such as a "portable exemption" system that would allow a surviving spouse's estate to use any part of the estate tax exemption not used in the first spouse's estate. For example, assume that the new estate tax exemption is \$4 million, and the husband died first, leaving a \$2 million estate. Under the portable system, his widow could leave as much as \$6 million free of estate tax (her own \$4 million plus the remaining \$2 million of her husband's exemption).

## What Can I Do Now?

Obviously, with the estate tax law in flux it is hard to know just how to prepare for whatever eventual changes are ultimately enacted. Despite this, there are some things one can do. First, and most important, it is never too early or too late to review your personal situation and determine whether any changes in your estate planning documents may be indicated. If you have gotten married or divorced, had a child, lost a spouse, or had other such major events in your life, you need to evaluate the estate planning implications of such changes. Does your Will need to be changed? Do you even have a Will? Far too many people think once their documents are signed, they need take no further action.

If you should die today, would your survivors face an estate tax liability? If your estate is under \$3.5 million, it would be free of federal estate tax. That is likely to be true should your death occur in 2009 as well. However, your state may impose a death tax, and this must be checked with your personal advisors. If you are married, you and your spouse together may leave your heirs a total of \$7 million free of federal estate tax, subject to the likely changes described above. At least under present law, your documents have to be in proper form to enable you to take advantage of the full \$7 million, so check this with your advisors.

If you have business interests, you should carefully think through how these are to be handled if you should not be here to manage them. Perhaps you should consider a buyout agreement with your colleagues in the business. Would the value of the business cause liquidity problems in your state? If so, you should take this issue up with your advisors.

Finally, while the estate tax is the principal focus of this column, it is only one of the factors you should take into account in planning your own estate. Tax savings are worthwhile only if accomplished without resorting to actions which distort your true intentions. The bottom line is you have to think about your estate planning situation, hire capable advisors, and meet with them often enough to keep your own estate plan up to date.