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Trusts & Estates Client Alert

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JOINT COMMITTEE ON TAXATION ISSUES REPORT ON ESTATE AND GIFT TAX PROVISIONS IN PRESIDENT OBAMA'S FISCAL 2010 BUDGET PROPOSAL

In a September 2009 report, the Senate-House Joint Committee on Taxation presented certain tax provisions included in President Obama's fiscal 2010 Federal budget proposal (the "Proposal"). The Proposal contains several provisions that would affect estate planning for individuals, some of which could reduce the benefits of planning strategies currently in use.

First, the Proposal addresses uncertainties under current law as to the exemptions available for purposes of Federal estate, gift and generation-skipping transfer ("GST") taxes and the estate, gift and GST tax rates that are applicable. The Proposal would make permanent the \$3.5 million estate tax exemption, the \$1 million gift tax exemption and the \$3.5 million GST tax exemption. The Proposal would also make permanent the current maximum gift and estate tax rate of 45%. As under current law, any estate or other death taxes paid to the state where the decedent was domiciled at death would no longer be allowed as a credit in determining the Federal estate tax payable, but would instead be allowed as a deduction. The Proposal would retain the current rules that, under most circumstances, provide a "stepped-up" income tax basis for assets inherited from a decedent.

In addition, the Proposal would impose a "duty of consistency." It would generally require (i) the income tax basis of property received by a beneficiary by reason of the decedent's death to equal the value of the same property claimed by the decedent's estate for estate tax purposes and (ii) the income tax basis of property received by a donee by lifetime gift to equal the donor's basis in the gifted property. The Proposal sets forth specific reporting requirements to maintain consistency in values, including the requirement that the executor of an estate and the donor of a lifetime gift report information regarding tax basis to both the recipient of property and the IRS.

Further, the Proposal seeks to eliminate the "discounts" available on transfers of interests in family-controlled entities, such as family limited partnerships and family limited liability companies, by requiring that certain restrictions be disregarded when valuing interests in such entities. Currently, section 2704(b) of the Internal Revenue Code provides that certain restrictions may be disregarded unless they are (i) commercially reasonable and arise as part of any financing with non-family members or (ii) imposed by Federal or State law. The Proposal seeks to strengthen section 2704(b) by modifying it to create a new class of "disregarded restrictions," including (i) limitations on a holder's right to liquidate the holder's interest in the family-controlled entity (if such limitations are more restrictive than a standard to be set forth in the Treasury Regulations), (ii) restrictions on the ability of a transferee to be admitted as a full partner or holder of an equity interest in the entity and (iii) the ability of certain parties (e.g., charities) to remove restrictions. These provisions would apply to post-enactment transfers of property subject to restrictions created after October 8, 1990 (the effective date of section 2704).

Please read the important information relating to U.S. tax advice at the end of this Client Alert.

The attorneys listed below will be pleased to discuss the potential consequences of these proposed changes with you.

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Finally, under the Proposal the requirements for grantor retained annuity trusts (“GRATs”) would be changed to require a minimum trust term of ten years. The provision would be effective for GRATs created after the date of enactment. A GRAT can be an efficient technique to transfer wealth without gift tax, as long as the grantor survives the trust term and the trust assets appreciate in value in excess of IRS interest rate assumptions. A shorter trust term can be preferable for planning purposes because it reduces the risk of the grantor’s death during the trust term. Conversely, mandating a longer trust term may increase the risk and reduce the effectiveness of using a GRAT in some (but not all) situations.

NEW YORK ENACTS NEW POWER OF ATTORNEY STATUTE

New York recently passed new legislation, effective September 1, 2009, which made significant changes to the New York General Obligations Law regarding powers of attorney. All powers of attorney executed in New York on or after September 1, 2009 must comply with the new law in order to be valid. However, powers of attorney executed prior to September 1, 2009 in accordance with New York law will continue to be valid. While this new legislation made many changes to the law, below are some of the more significant changes of which you should be aware:

1. Pursuant to the new law, a power of attorney executed in New York on or after September 1, 2009 must be signed by the principal executing the power of attorney *and* the agent to whom authority is given pursuant to the power of attorney. The signatures of both the agent and the principal must be notarized. While a power of attorney is not effective until signed by the agent, a lapse of time between the date of the principal’s signature and the date of the agent’s signature will not cause the power of attorney to be invalid.
2. A power of attorney executed after September 1, 2009 automatically revokes all prior powers of attorney executed by the principal unless otherwise specified in the new power of attorney.
3. The agent designated in a power of attorney executed in New York on or after September 1, 2009 cannot make gifts in excess of \$500 annually on behalf of the principal unless a Statutory Major Gifts Rider is executed simultaneously with the power of attorney.
4. In any transaction where an agent is acting pursuant to a power of attorney and the hand-written signature of the principal or agent is required, the agent is required to disclose the principal and agent relationship by signing “[*name of agent*] as agent for [*name of principal*]” or “[*name of principal*] by [*name of agent*], as agent,” or any similar written disclosure of the agency relationship.

STATEMENT ABOUT CIRCULAR 230

Recent amendments to a Treasury Department regulation, known as Circular 230, require lawyers and accountants to follow strict rules in issuing a written statement about a Federal tax issue. The most onerous rules of compliance under §10.35 of the Circular involve written advice about so-called Listed Transactions, arrangements that have tax avoidance as their principal purpose and what are called Marketed Opinions. We do not believe any issue discussed in this memorandum relates to a Listed Transaction. We believe the tax benefit sought is consistent with the Internal Revenue Code of 1986 as amended (Code) and Congressional purpose. That means the principal purpose is not tax avoidance. We also believe no issue discussed herein is a significant Federal tax issue – meaning that we believe the IRS does not have a reasonable basis for a successful challenge on the overall Federal tax treatment of the issues discussed in this memorandum. That means we do not think this memorandum must comply with §10.35 of the Circular. Nevertheless, we add the following statements to ensure compliance with said §10.35. Notwithstanding these statements, we believe the conclusions reached herein are correct.

1. The written advice contained in this memorandum is not intended or written by us to be used, and it cannot be used, by any taxpayer for the purpose of avoiding penalties.
2. No one may use any part of this memorandum in promoting, marketing or recommending an arrangement relating to any Federal tax issue to any taxpayer.
3. Nothing herein shall be construed to impose a limitation on disclosure by any person of the tax treatment or tax structure of any transaction that is addressed herein.