Federal Legislative Outlook for Estate Planning 2008

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2008 will be an active year for federal elections, and for estate planning in the ways that federal law may affect how individuals and their advisors plan. Here is a brief discussion of several estate planning topics that may experience the winds of change in federal law. Whether for positive benefit or not remains to be seen.

1. The Uncertainty Continues Over Federal Estate Tax. As we inch (some would say gallop) closer and closer to 2010, the year when, under current federal law the estate tax is suspended for one year, the big news for 2008 may be no news. We currently may not learn anything more about the future of the federal estate tax in 2008 than we did in 2007. We have, and may end 2008 with, much uncertainty about the future of the federal estate tax.

It seems unlikely that the estate tax will be repealed, given budget constraints and the fact that 2008 is an election year. But 2009 may be the year when a new Congress and new President tackle the issues of: (a) the size of the "credit" against the estate tax each individual should have; (b) the maximum estate tax bracket; (c) whether the "step up" in tax basis at death will be retained; and (d) whether the "credit" will be indexed for inflation in the future.

These issues are weighty but estate planners should not allow uncertainty about them to immobilize clients from planning. Many planning techniques are beneficial for families regardless of estate taxes, and other techniques blend flexible estate tax planning with basic family estate planning.

2. The Flip-flop on the Non-Spouse Roll-Over from a Qualified Plan to an IRA. Uncertainty also plagues the provisions of the 2006 Pension Protection Act (the PPA 2006) that had appeared to require employers with qualified retirement plans to offer a non-spouse beneficiary of a deceased employee the choice of taking a lump sum distribution or making a roll-over to an IRA. Many estate planners think that the provisions of PPA 2006 require employers with qualified plans to offer a roll-over to an IRA for non-spouse beneficiaries.

Prior to this seemingly mandated choice, non-spouse beneficiaries were required to take the lump sum distribution and pay all the income tax on the entire sum, with no ability to retain the distribution in a tax-sheltered IRA. The beneficiary was precluded from "stretching out" the inherited distribution, taking annual life expectancy payouts while the remainder continues to grow in the "inherited" IRA tax-sheltered.

But early in 2007 the IRS issued a notice stating that qualified plans were not required to offer beneficiaries the roll-over option. In August 2007 a technical corrections draft bill for PPA 2006 was introduced in Congress. One proposed change was to mandate the roll-over option. In seeming response the IRA posted its list of PPA

2006 amendments, which included language requiring non-spouse beneficiary roll-overs beginning January 1, 2008.

But before the end of 2007, the August technical corrections draft disappeared, and a new draft bill makes no reference to mandated roll-overs in 2008. And the IRS issued a new guidance list of changes that makes reference to the early 2007 notice that states only that qualified plans would not be required to make roll-overs available to beneficiaries.

3. The Circular 230 Squeeze. In 2005 the IRS issued new rules for Circular 230 regarding the standards for advisors who practice before the IRS. But do not think this does not apply to you, because "practice before the IRS" is interpreted broadly to include any written tax advice, even though it may not involve contact with the IRS or preparation of any tax return. So if you ever provide written advice to clients about estate tax planning Circular 230 applies to you.

The IRS has proposed more rigorous standards for the Circular 230 rules, which it intends to apply in early 2008. Prior to the new standards, a practitioner needed to have a reasonable basis for his position and that test would be satisfied if the position had a one-in-three chance of being sustained by the IRS.

Now, a practitioner must meet one of two standards: (i) a reasonable belief that the tax treatment of a position taken is more likely than not the proper tax treatment (that is, a greater than a 50% likelihood that the position would be upheld by the IRS); or (ii) a position must have a reasonable basis and it must be adequately disclosed to the IRS.

Thus, if these proposed new standards become law, and if you give written tax advice to clients, be careful to satisfy the more stringent "more likely than not" test or make sure that the position has a reasonable basis and it will be disclosed on a tax return to the IRS.

Conclusions. Estate planners are advised to use caution this year as they advise clients in 2008. With federal laws and regulations in flux planners need to be ever mindful of new IRS positions. In particular written proposals of tax advice must be prudently prepared. But the uncertainty should not deter planners and clients from good estate planning --- for their spouses, their children and grandchildren, other dependents, and their favorite charities. Planning for favorite people and charities is always in vogue regardless of estate taxes.

When the rules and regulations are uncertain planning must be flexible. For example, there are many drafting techniques to build flexibility into trust agreements, such as disclaimers, general and limited powers of appointment, and use of trust protectors. Thus, while uncertainty has brought complexity to estate planning in 2008, clients and planners should not suspend planning; but they do need to plan more cautiously and more flexibly.