

The Estate Analyst®

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The Year In Review, 2005

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For estate-planning purposes, 2005 was a continuation of 2004. The estate tax exemption remained at \$1.5 million. The estate tax was still inching its way out the door. Legislators were still offering proposals to help accelerate that departure.

FLP cases were still arriving, one of them being *Strangi*, and if all of that weren't enough to bring on a sense of déjà vu, Congress is gearing up for a new law: it's going to be called... "The Tax Relief Act."

But there were also many significant and noteworthy developments during 2005. There were legislative proposals, court rulings, a bankruptcy reform, and, as always, another year's worth of oddities, treasures, and celebrity estates.

Legislative Initiatives

Many important legislative efforts took place during 2005, including the following:

Presented With Our Compliments

The “Katrina Emergency Tax Relief Act” (KETRA) allowed increased charitable deductions through the end of 2005.

The Pension Protection Act of 2005 (H.R. 2830) was proposed. This law would affect defined benefit plan funding and increase premiums to stabilize the Pension Benefit Guarantee Corporation (PBGC).

The COLI Best Practices Act was proposed to address issues of company-owned life insurance. (A similar proposal was defeated last year.)

The Tax Relief Act: This is a \$60-billion package of changes that appears heading for passage in early 2006. A controversial one-year extension of tax breaks for capital gains and dividends had been dropped late in the year. Other expiring tax breaks would be continued, and one year of relief from the alternative minimum tax were included.

Bankruptcy Reforms & Homesteads

President Bush signed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 in April and the new provisions took effect on October 17, 2005, making it harder to wipe away all debts with a Chapter 7 filing and instead requiring the use of Chapter 13 filings with scheduled repayment plans.

Bankruptcy trustees will be able to utilize a two-year look-back rule to void transfers made within two years of filing for bankruptcy in general (doubling the previous one-year rule). In determining the domicile of the bankruptcy, the six-month look-back period is being extended to a two-year look-back.

Homesteads: A related provision prevents newly acquired homes from gaining homestead exemption status; homestead protection is limited to \$125,000 for debtors who have lived in a house and previous homesteads less than 40 months.

In addition, a 10-year look-back provision precludes a debtor from converting non-exempt property to a homestead with the intent of defrauding a creditor.

In an Arizona case (*In re McNabb*), a bankruptcy court ruled that the “Homestead Cap” of \$125,000 as reflected in Section 522(p) of the Bankruptcy Code as amended by Section 322 of the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) did not apply—Arizona had opted out of the federal bankruptcy exemptions. *In re McNabb*, 326 B.R. 785 (*Bankr. D. Ariz.* 2005).

But the opposite result was determined in a pair of recent Florida cases. It was found that the legislative history of the new law required a different interpretation of Section 522(p).

As a result, the \$125,000 homestead cap applies to the equity the debtor acquired in a home during the 1215 days prior to filing bankruptcy...even in Florida, a state which opted out of the federal exemptions. *In re Kaplan*, Chapter 7, Case No. 05-14491-BKC-RAM (*Bankr. S.D. Fla.* 2005).

An additional Florida case confirmed the result but involved a debtor who preserved the Florida exemption by rolling over equity from prior Florida homes. *In re Wayrynen*, Chapter 7, Case No. 05-32144-BKC-SHF (*Bankr. S.D. Fla.* 2005).

The Estate Tax, Still Leaving

Who wants to play Pictionary? Like a tiresome guest who won't leave after a long party, the repealed estate tax, now in the fourth year of its farewell tour, has basically settled into permanent departure mode.

Yet for the first half of 2005, there were numerous attempts to provide some certainty to the law. For example, Earl Pomeroy (D-N.Y.) proposed a compromise measure that involved retaining the estate tax, increasing the estate tax exemption to \$6 million, and retaining the stepped-up basis for property held at death. Other compromises pushed the exemption to \$10 million.

Some proposals sought immediate repeal of the tax. However, in April the House voted to repeal the tax permanently in 2011 by a vote of 272-162.

A vote was gearing up in September, but war expenses and Hurricane Katrina created the worst possible context for that vote, leading to its postponement. Nor has the estate tax repeal found its way into the Tax Relief Bills making their way through Congress.

Was this a near miss for estate tax repeal? Maybe not. The repealers still lacked adequate votes in the Senate anyway. And a “permanent” repeal enacted now but not changing anything until 2011 could certainly be revisited and undone.

And strategically, it may make sense for anti-estate tax advocates to wait until the \$3.5-million exemption arrives in 2009 or the complete repeal arrives in 2010 before entering a compromise deal. It is a classic game of chicken, to see which side will blink first and make the most concessions.

Taking Sides on Estate Tax

Writing in *The Wall Street Journal*, Senate Majority Leader Bill Frist offered arguments to proceed with permanent repeal:

“Imagine working your entire life to build a family business—a farm, store, motel or restaurant. Every hour you work and every decision you make is with the express goal of growing your business, so you can provide for your family and pass something on to your children. Dutifully, you pay your taxes owed, you weather the droughts, survive the downturns, and, in the end, you come out ahead. Now enter the death tax. The reality is that the business you’ve worked so hard to pass on to your family may have to be sold. This may be the only recourse for your loved ones to pay the burdensome taxes on your estate.”

By The Numbers: The nonpartisan Congressional Budget Office offered numbers that no farms or small businesses are overly burdened. Based on current exemptions, only 300 farms would have faced any estate tax in 2000 and 273 of those would have taxes less than liquid assets. The Joint Committee on Taxation estimated that permanent estate tax repeal would cost \$55 billion in 2011 alone and \$290 billion by 2015. Based on the Joint Committee’s estimates, repeal is expected to cost \$800 billion over the following decade, from 2012 through 2021.

Newspaper Editorials: In a July editorial, *The Wall Street Journal* cast some doubt on the “unelected number crunchers” of the Joint Committee on Taxation who provide the revenue loss projections from the estate tax repeal. *The New York Times* addressed the proposed repeal in an editorial: “The Senate should put a stop to this silliness. The only thing driving the push for repealing the estate tax is ideology. It sure isn’t sound tax policy.” (“Long live the estate tax,” April 15, 2005.)

Recruiting Greenspan: Estate tax opponent, Senator Charles Schumer, focusing on the \$1 trillion of revenues lost by the repeal, tried very hard to get indirect support for the estate tax from then-Federal Reserve Chairman Alan Greenspan at a committee hearing last July, but Greenspan, cagey to the end, provided only qualified responses:

Schumer: Is it fair to say that you would advise not to repeal the estate tax if there are no offsets, if there is no PAYGO? [PAYGO stands for “pay as you go.”]

Greenspan: That is correct. I think that PAYGO is an essential ingredient going forward and that all

programs, both spending and revenue programs, come under that.

Schumer: There is a proposal for a compromise which would cost about 80-90% of the full cost [of estate tax repeal]....I take it again, without PAYGO, without an offset, you would think we should not do that at this point?

Greenspan: That is correct.

Bongard, Strangi, et al.

Don’t you just hate when you plan an estate carefully based on other cases and the IRS comes along and assesses a \$52-million tax deficiency?

The IRS included various interests in the estate of Mr. Bongard under Sections 2035(a) and 2036(a) and Tax Court partially agreed with the reasoning. *The Wall Street Journal* reported on the case and before long, warnings about the case appeared on accounting and insurance websites. *Estate of Bongard v. Commissioner, 124 T.C. No. 8 (2005)*. Other FLP cases arrived during the year with the same end result. See, e.g., *Estate of Austin Korby et al. v. Commissioner, T.C. Memo. 2005-103*.

And *Strangi*, the most prominent FLP case of all paid us all another visit. Not to be confused with Dr. Steven Strange, a neurosurgeon who is trained by an ancient sorcerer in the Himalayas to become a Master of the Mystic Arts in Marvel comics, the FLP case of Dr. Strangi has continued to reappear through IRS sorcery.

In, *Strangi* (part IV), the Fifth Circuit Court of Appeals agreed with the Tax Court’s conclusion that §2036(a)(1) applied because of an “implicit understanding” among the parties that Mr. Strangi would continue to have access to his assets.

Supreme Court

Justices John Paul Stevens, Anthony M. Kennedy, David H. Souter, Ruth Bader Ginsburg, and Stephen G. Breyer formed a five-member majority that backed eminent-domain rights of a government to force property owners to sell their land and property for economic development purposes. *Kelo v. New London, 125 S. Ct. 2655; 2005 U.S. LEXIS 5011*.

The Court agreed to hear the appeal of former Playboy model Anna Nicole Smith, who had married 89-year-old Texas oil tycoon J. Howard Marshall II shortly before his death. At stake is whether Smith is to inherit \$474 million, \$89 million, or zero.

The Court also agreed to hear a euthanasia case from Oregon involving that state's "death with dignity" law.

Celebrity Estates

Elvis Rocks On: *Forbes'* annual list of top-earning dead celebrities is topped once again by Elvis Presley, followed by Charles Schultz, John Lennon, Andy Warhol, "Dr. Seuss," and Marlon Brando. Joining the top 10 this year is newly departed Johnny Cash.

Shakespeare: Experts taking note of the 657,000 Shakespearean titles sold privately, the number of plays performed, and the potential licensing rights for merchandise, concluded that the Bard's estate would now be bringing in at least \$15 million a year, putting him seventh on this year's list (between Marilyn Monroe and J.R.R. Tolkien).

Rosa Parks: The Will of civil rights icon Rosa Parks is being contested on grounds of undue influence and lack of mental capacity.

Lieutenant Scott: "I dunna know if we kin hold on much longa!" "I've giv'n her all she's got Captain, an' I canna give her no more." "A can't change the laws of physics. A've got to have thirty minutes!" —Actor James Doohan, from multiple episodes of *Star Trek*. Doohan's ashes are to be launched on a Falcon 1 rocket and then released into Earth's orbit.

Unreal Estate

Off World Realty: A Chinese business, "Lunar Embassy to China" sold 49 acres of the moon to 35 people in its first three days of business...before having its business license suspended by the authorities.

Virtual Land: Jon Jacobs has purchased a virtual space station for \$100,000 (real money) in an online game. He hopes to create a virtual theme park and collect revenues from other gamers.

Burial Down Under: Cremation uses fuel and coffins utilize resources. Palacom, an Australian company offering environmental burials, proposes accumulating bodies in a morgue, transporting them in groups to a cemetery 112 miles west of Melbourne, and disposing of them in body bags in individually drilled 10-foot-deep holes, all for a cost of \$1,000.

Best Literary Inheritance: An "unplotable" piece of real estate at Grimwald Place was inherited in Book VI of Harry Potter from his Godfather, Sirius

Black, who was killed off in the previous book. Even better news...unplotable real estate, with no lot and block number, has no property tax.

Estates In Brief

PHILANTHROPY REVISED: A Pennsylvania Court approved the move of the deficit-ridden Barnes Foundation collection of art despite the restrictions of the donor's bequest. The decision allows the collection to be housed in a more conventional, \$100-million showplace in downtown Philadelphia. Meanwhile, the J. Paul Getty Trust's Museum in Los Angeles, facing charges of acquiring stolen works, has returned several disputed works to Italy.

PROBATE FEES: A Nevada Court has overturned a customary 5% executor's fee amounting to \$392,429 for an estate of \$7 million because the fees were not reasonable based on the efforts required to settle the estate.

TOP CAT: David Harper, 79, had never married or had children. He spent most of his life working as a gardener. Yet he was able to amass a \$1.3-million estate which he left to Red, his cat. Incidentally, the State of Hawaii joined 20 other states that provide for trusts to maintain pets after death.

SAME SEX: The term "civil unions" has been recognized by Merriam-Webster's Collegiate Dictionary.

DECOUPLED JURISDICTIONS: The State of Illinois, which is currently decoupled from Federal Law and imposes a state estate tax, recently enacted legislation excluding real estate assets located in other jurisdictions from the Illinois estate tax calculation effective retroactively to January 1, 2003. Meanwhile, North Carolina extended its estate tax until the repeal of the Federal estate tax in 2010.

CIRCULAR 230: On December 20, 2004, the Treasury released Circular 230 that became effective June 20, 2005. The Treasury made additional revisions in May. Circular 230 imposes new practice requirements, including potential liability, censure, disbarment, and fines, for professionals offering tax advice. There are new rules for providing written tax advice and rules for Federal tax practice.

POPE'S ESCORT: A 1975 Ford Escort GL once owned by Pope John Paul II was sold for \$690,000 to John O. Quinn, a Texas lawyer who made a fortune in a tobacco settlement case and now has a collection of 600 cars.