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2010 In Review: Year of the Ginormous Loophole

Plus: The New Estate Tax Law Arrives

And: Inglorious, Ignoble, and Ignominius Estates

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Did you just hear something?

Was that the sound of another volcanic eruption from Eyjafjallajokull? Was it a lingering echo of vuvuzelas from the World Cup of 2010? Or was it an enthusiastic cheer from the Bronx at the news that no estate tax would apply to the estate of billionaire George Steinbrenner?

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No, that "thud" was the sound of Congress closing the book on its experiment with estate tax repeal. The estate tax is back, thanks to HR 4853, the Middle Class Tax Relief Act of 2010.

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But the estate tax repeal did take effect in 2010, and an enormous rift in the transfer tax system opened just long enough for the estates of several billionaires to pass through.

Let's take a look back at 2010.

Angry Birds, et al.

The cacophonous gridlock from our nation's Capital in 2010 may have been reflected in microcosm by the phenomenon of Angry Birds, a game played on iPhones by Americans for an estimated 65 million minutes per day in 2010. Even author Salman Rushdie confessed to playing it. An estimated 2.3 million people watched an attorney trying (on YouTube) to broker a peace treaty between the birds and their mortal enemies, the pigs. (See, "Angry Birds Peace Treaty.")

The year gone by was not all fun and games, however. "Austerity" was chosen as the word of the year by Merriam-Webster. Bankruptcies were filed for Blockbuster, Hummer, A&P, and numerous publishers of newspapers and magazines. Several car brands such as Pontiac, Mercury, and Saturn went extinct.

It was the year of many natural disasters, including an earthquake in Haiti and a heat wave in Russia that hit 111 degrees. There was the British Petroleum oil spill in the Gulf of Mexico after the explosion of the Deepwater Horizon platform. Government documents were posted on WikiLeaks. Greece needed a bailout from the International Monetary Fund. And LeBron James made a fateful "Decision."

Looking back, there were a number of developments relating to estates.

The New Estate Tax Law

Having waited nearly a decade for what many experts always felt was inevitable, it is too distracting to think of any other news besides the return of the Federal estate tax.

Effective for the estates of decedents dying in 2011, the estate tax has been reinstated by the Middle Class Tax Relief Act of 2010. The top tax rate will be 35%, and estates will have an exemption of $5 million to work with.

The gift tax is reunified with the estate tax, and up to $5 million in lifetime gifts will be exempt (over and above the annual gift tax exclusion of $13,000 per donor for every donee each year). Taxable gifts would be taxed at a top rate of 35%. One would certainly have to make a very large gift to fall into the taxable range. Generation-skipping transfers are taxed at the top rate for estates and gifts, i.e., 35%. So the tax code is now rocking that sweet transfer tax system that applied in the 1990s.

Note: The new estate and gift tax rules apply for the next two years. There is no guarantee that the rules will remain in place permanently. Among the range of possibilities is another complete repeal (highly unlikely) or a tightening of the rules. However, Congress has shown that it has a difficult time generating a consensus on tax issues, so the status quo could continue beyond the next two years.

State Death Tax Credit

Another blast from the past may soon be back. When the state death tax credit was abolished under EGTRRA (and replaced by a deduction) it was supposed to return if Congress failed to make tax repeal permanent. The estate tax is back, but the state death tax deduction will remain for the next two years. With the rest of the transfer tax system in place, a return to a full state death tax credit appears justified.

Every state once had an estate or inheritance tax that absorbed the state death tax credit permitted against the federal estate tax. Only a minority of states currently have their own freestanding death taxes. It remains to be seen which states will re-implement their own death taxes.

A Modest Surprise

Instead of the modified carryover basis that enabled only $1.3 million of stepped-up basis on estates for 2010, the new law returns to the stepped-up basis.

The new law contains a surprisingly reasonable option for the estates of decedents dying during 2010. These estates may elect to apply the 2010 rules with no estate tax but only the limited stepped-up basis of $1.3 million, or they may apply the 2011 rules with a $5 million exemption and a stepped-up basis.

This avoids the unfair result that someone with a relatively modest estate of $5 million who died in 2010 might leave highly appreciated assets to his family, which would then be severely taxed when the assets are sold due to the carryover basis. Instead, these estates will be able to elect 2011 treatment and obtain the benefit of the stepped-up basis.

Spousal Portability

Another surprise is the inclusion of a "portability" provision that allows a surviving spouse to utilize the unused portion of a spouse's estate tax exemption. This means that a married couple can fully utilize each spouse's estate tax exemption for a total exemption of $10 million.

The significance of this is dramatic in terms of estate planning. The entire concept of equalizing estates of husband and wife to the tax advantage of each spouse's unified credit has been made unnecessary. The use of a credit shelter trust to utilize the exemption of the first spouse to die has been made unnecessary.

Almost every estate plan in the United States needs to be rewritten immediately. This is not only true of very large estates, but also of those smaller estate plans that were drafted when the exemption was smaller and credit shelter trusts and outright bequests were drafted with maximum language.

The net result when such documents are interpreted under the new rules would be to pass entire estates into credit shelter trusts and not provide for other beneficiaries, perhaps not even for spouses.

The One-Year Repeal

Leave it to Congress to create a ginormous loophole, a historic rift in the entire time-space continuum through which several billionaires waltzed on their way out of this mortal coil, even while TSA agents were frisking, x-raying, and imaging elderly people boarding airplanes.

Along with the more notorious George Steinbrenner, who died in 2010 with an estate estimated at $1.1 billion, was Houston tycoon Dan Duncan, whose net worth was estimated at $8 billion. Not being subject to estate tax due to the timing of his death during the year of the estate tax repeal may have saved his family $4 billion.

Steinbrenner owned 55% of the New York Yankees at the time of his death. Had Steinbrenner died at another time when estate taxes applied, his estate may have been forced to sell shares of the team to pay taxes.

A Two-Year Reprieve

Although the estate tax was repealed by legislation in 2001, that law phased out the estate tax over time, and the full repeal did not arrive until 2010. But, because of the way the law was enacted, sunset provisions terminated the repeal after 2010 and would have sent the tax code back to 2001 rules in 2011, unless Congress took action. The same applied to the other "Bush tax cuts," as they have come to be known.

Congressional gridlock has impeded corrective action until now, but the new tax law maintains the current income tax and capital gains tax benefits without reverting to the higher tax rate schedule. It also avoids reverting to the $1 million estate tax exemption and 55% top estate tax rates of 2001.

Instead, the new law provides a two-year period in which estates will have a $5 million exemption and a top estate tax rate of 35%. Fortunately, estates may now be planned with some degree of assurance and stability for a 24-month period. Unfortunately, this set of rules expires in two years, and the transfer tax system may once again become a political pawn in two years' time.

Charitable Gifts

Johnny Carson's charitable trust received $156 million from his estate. Carson died in 2005, and the funds were transferred in 2009. The transfer was revealed in 2010.

Michael Bloomberg, Larry Ellison, T. Boone Pickens, and other billionaires have joined in the Giving Pledge initiated by Warren Buffet and Bill Gates. More than 30 billionaires have now pledged the majority of their fortunes to charity.

An anonymous donor gave $200 million to Baylor University. There were five other donors, including Mark Zuckerberg, Henry Kravis, and T. Boone Pickens, who donated $100 million or more to charitable causes.

Incredible Collectibles, 2010

Custer's last flag was auctioned for $2.2 million. John James Audubon's *Birds of America* was auctioned for $10.2 million. Winston Churchill's dentures were sold for $23,723.

Jewels once owned by Wallis Simpson, who married King Edward VIII, were auctioned for $12.5 million. They included an emerald-eyed panther bracelet that sold for $4.5 million.

A sculpture by Alberto Giocometti sold for $103.7 million, setting a record—until a Picasso sold for $106.5 million.

A copy of the Emancipation Proclamation printed in 1863, one of 48 that was signed by Abraham Lincoln, had been purchased by Robert F. Kennedy for $9,500 in 1964. It was sold by Ethel Kennedy to an anonymous bidder at a Sotheby's auction on December 10, 2010 for $3.77 million.

Miscellaneous

Who Dat?: An immigrant guitar-playing day trader named Marcos Esparza Bofill, in his twenties, borrowed some money, made some trades, and took some losses. Later he received an IRS bill for $172 million. "What's the IRS?" he asked.

Worst Tweet: Utah's Attorney General Mark Shurtleff gave the order to carry out a death sentence by firing squad…and then issued an announcement about it on Twitter to let everyone know that his press conference about the execution would be carried live on a website.

Virtual Real Estate: An imaginary asteroid from an online game was purchased for $100,000 in 2005…and sold for $625,000 in 2010. The owner had already recovered his investment by selling hunting rights to the Club NEVERDIE resort on the imaginary asteroid. Seriously.

Inglorious, Ignoble, and Ignominious Estates

Infamy knew no bounds in 2010. An assortment of unusual estate-related issues vied for the nadir of recognition.

The estate of Pablo Picasso has filed suit to recover 271 paintings from the artist's former electrician, who claimed they were gifts. Picasso must have appreciated fine electrical work.

The estate of an 87-year-old woman was permitted to sue a four-year-old for negligence after the woman was struck by the child's bicycle on East 52nd Street in New York.

Did a charming society man con the wealthiest woman in France out of paintings and artwork worth $1.2 billion? A butler's secret recordings of L'Oreal heiress Liliane Bettencourt were revealed at trial, creating a scandal.

The 1.4-acre parcel in Montana where Ted "Unabomber" Kaczynski once lived was listed at $154,500, but the price was dropped to $69,500. The infamous shack itself is now in the Newseum Museum in Washington, D.C.

Celebrity Estates

Gary Coleman's ex-wife and parents fought a battle for control over his estate based on who was the least estranged from him. His ex-wife was with him at the end…but sold photos of him on his death bed to Globe magazine.

In his final months, actor Dennis Hopper was trying to divorce his wife and rearrange his estate plan to exclude her. His wife barricaded herself in one of the family homes to prevent its sale. Hopper's 7-year-old daughter was not able to go to her father's funeral because her mother wasn't invited. After Hopper's death, his estate rejected his wife's claim for $45 million and is enforcing the terms of a prenuptial agreement.

Anna Nicole Smith's estate is appealing a ruling that gave her none of her late husband's oil-related fortune. Meanwhile, her companion Howard K. Stern was convicted of conspiring to provide her with prescription drugs. Former Judge Larry Seidlin called for additional police probes. "I think enablers should be punished," he wrote, and then "we won't have all this celebrity blood on our hands."

Bret Carr (46), the only surviving son of Gail Posner, the daughter of corporate raider Victor Posner, was awarded income from a $1 million trust fund, excluding him from what might be $100 million of trust funds established by Victor Posner for his grandchildren.

Instead, Gail Posner left $27 million to her maids, personal trainers, bodyguards, and permitted her Chihuahuas, Conchita, Lucia and April Marie to reside in her $8.3 million, seven-bedroom, Sunset Island mansion and be cared for using income from a $3-million trust.

Is Nothing Sacred?

Astronomer Tycho Brahe was buried in 1601, but his remains have been exhumed repeatedly (1901, 1996, 2010) to investigate his mysterious death. Most recently, his remains are being tested for mercury and traces of a piece of metal that was used to replace a portion of his nose that was snipped off in a duel.

Chess Champion Bobby Fischer was exhumed from its final resting place in Reykjavik, Iceland, the site of his greatest triumph over Boris Spassky in 1972 so that his DNA could be tested in a paternity case. It was claimed that he fathered Jinky Young, age 7, in the Philippines. The DNA refuted this claim.

The body of accused Kennedy assassin Lee Harvey Oswald was exhumed in 1992 to put to rest rumors that his body had been switched by a Russian spy. His original wooden casket then spent 18 years in a corner of the office of a funeral director, who decided that the time was right to see who wanted it. Translation: It was cashed in. The final sale was for $87,469 and the seller received $72,890 after commissions.

The only thing missing from this story: an eBay auction. For that we turn to a report about the deceased son of disgraced financier Bernard Madoff in the *New York Daily News:* "Meanwhile, fascination with Madoff's Greek tragedy-like demise found its most ghoulish expression in the sale of several purported Mark Madoff business cards on eBay for as much as $75."

The Bitter End

In 2008, Revlon chairman Ron Perelman went to court on behalf of the estate of his late-ex-wife to rewrite the will of a man who wasn't yet dead, his ex-father-in-law, Robert Cohen. Perelman was trying to arrange for half of Cohen's estate to go to Perelman's daughter from his marriage to Claudia Cohen, who divorced Perelman in 1994 and died in 2007.

Perelman claimed that Robert Cohen verbally promised half of his estate (worth about $500 million) to his daughter. Robert Cohen, who was 84, paralyzed, and terminally ill during the 2009 trial, reportedly had 27 attorneys working on this case, went personally to court out of sheer will power, and countersued for the return of a $10-million loan.

Perelman was warned by the Court that in New Jersey verbal promises of inheritances after 1978 are not valid. Perelman's claim was rejected but not before a bruising and unsuccessfulo attempt to have Cohen declared incompetent. Robert Cohen then won the counterclaim for $10 million.

In August, 2010, New Jersey's Chancery Division of Bergen County delivered its eighth decision in the case and, in a 34-page opinion, awarded the defendants $1.9 million in legal fees because of plaintiff's frivolous litigation.