



Current Events in Estate and Gift Taxes (December 2011)

by Chris Hamilton, CPA, CFE, CVA, DABFA

Current law exempts estates with a value under \$5,000,000 from estate tax. This current state of affairs represents the latest in a series of changes in the law that, in recent past, has included a year of no estate taxes on any estates regardless of size. Additionally the economy has affected small businesses rather severely. Both of these factors have reduced or altogether eliminated the need for business valuations in the context of estate and gift taxes. However, events are unfolding that are causing enormous uncertainty for legal, tax, and financial advisors.

Many estates are dominated by three assets: the family home, retirement accounts, and/or a small business. In contemplation of gifts or at death, all of the assets must be valued. The estate and gift tax is assessed on the fair market value of the estate's net assets. The most difficult asset to value for estate and gift tax purposes is the small closely-held business. This is true when valuing the entire enterprise. When a non-control interest is being valued the difficulty increases as does the potential for controversy with the Internal Revenue Service.

In recent years, two factors have dramatically reduced the need for business valuations. The increase in exemption would have excluded many small businesses by itself. However, the difficult economy since 2008 has further depressed business values. Even without the increase in tax exemption it is likely that the number of estates subject to the estate tax, and the number of estates requiring a business appraisal, would have dramatically decreased.

Two factors indicate that the trend is about to reverse just as dramatically. First, there is wide expectation that the economy will begin to improve. There is pent up demand and accumulated cash that, at some point, will be the driving factors of an economic recovery. The new concern will be the impact of inflation. There is little doubt that the economy will respond to the extraordinary amount of debt and currency in the financial system with increasing interest rates and, depending on the strength of the recovery, inflation. This will drive up the price of most assets and will eventually cause more estates to fall into the estate tax trap.

The second development is the need by the US Government to increase tax receipts. Not only are annual operating deficits currently at the extraordinary level, the implementation of the health care legislation in 2013 will increase government spending to levels that have never been seen before. The political battle is joined to either cut spending in other areas, raise taxes, or both. Congress recently passed legislation to appoint a "super" committee to agree on how to close the current budget deficits.

The early favorite is a reduction in the estate tax exemption to \$1,000,000. In fact, there is speculation that this change could be imminent. The exemption amount is already scheduled to be reduced at the end of 2012. In the midst of all the speculation is a tremendous amount of uncertainty as to amounts and timing. What is probable is that the exemption amount will be reduced. Lawyers and financial planners will once again be required to contemplate the value of the closely held business for planning and compliance purposes. What has been an extended lull in the valuation business for estate and gift tax purposes looks to be coming to a close.

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