

The Life of the Death Tax: Prepare for the Resurrection

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Last I heard, the cost of the new health care bill is projected to be close to \$1,000,000,000,000 (that's a trillion). The wars in Afghanistan and Iraq, just this year, another \$617,000,000,000 (billion) and the US National Debt has skyrocketed to an almost incomprehensible \$12,000,000,000,000 (trillion), that's over \$110,000 per taxpayer. But wait – there's more; years of raiding the Social Security and Medicare coffers instead of segregating the monies, has left us and our children with an unfunded liability of, brace yourself, \$120,000,000,000 – that's \$120 trillion. When are these hens coming home to roost?

The double whammy of course is that such costs and liabilities come at a time when US Treasury receipts from individual and corporate income taxes are likely to plummet this year by 35%. With these realities in mind, I'm troubled by a cycle which includes printing more money, selling more debt to China and increasing spending - all predicated on new cost cutting programs and projected revenues that haven't been enacted or realized. I'm further troubled that in the midst of debates over funding for the health care reform, the Senate Republicans and Democrats alike, locked in partisan politics and worried about the next election, have forced a wealth transfer nightmare upon us.

The Senate could have easily followed the House's lead in making permanent the current estate and gift tax rates. Instead, the Senate opted for prescribed chaos. With your legacy in hand, and your children's possible inheritance at stake, the Senate fumbled, in shaping the wealth transfer tax system - again.

Not long ago (though the last year the Mets won the World Series), the estate and gift tax system was easy to understand, though onerous. Upon one's demise, the first \$600,000 was exempt from the 55% estate tax, but every dollar thereafter not passing for the benefit of a spouse - bang - subject to estate tax. The tax was brutal, and with prosperity in the air during the Clinton administration The Tax Payer Relief Act of 1997 softened the estate tax bite by increasing the exemption from \$600,000 to \$1,000,000.

Though the exempt amount was indeed rising over time, the rate of tax was still onerous. Less than four years after the passage of the Taxpayer Relief Act, George W. Bush took office, and acting on a perceived mandate, Congress passed and President Bush signed new tax legislation called The Economic Growth and Tax Reconciliation Act of 2001.

Affectionately known as EGTRA, this new act gradually increased the exemption from estate tax to \$3,500,000, an action well received by taxpayers. Better yet, the rate of tax gradually decreased from 55% down to 45% - no problem there either. But at the time, Senate Republicans wanted full estate tax repeal by 2010, while the Democrats sought to make permanent the 09' exemptions and rates. So the ill conceived EGTRA compromise provided meaningful relief for those subject to the estate tax from 2002 to 2009, a temporary repeal of the estate tax for a year commencing on January 1, 2010, and but the estate tax will re-emerge on January 1, 2011. When it does - the estate tax exemption will be only \$1,000,000 and rate of tax - 55%. Ouch!

Tax attorneys, financial planners, accountants, bankers, financial planners, and those knowingly affected by the estate tax, almost universally shrugged off the likelihood of estate tax repeal on December 31, 2009. Their reasoning was sound – the Treasury needs predictable revenue, taxpayers need clarity so reason would prevail. But, reason didn't prevail. The Senate didn't act. Instead, estate tax has been repealed, gift taxation remains in effect plus, we now have a new capital gains tax that provides a spouse of a decedent with a \$3,000,000 basis step-up, and other heirs another \$1,300,000 basis step-up. No gains – no tax. Gains, but no sales – no tax. Gains of \$4,300,000 and a sale by

spouse and heirs - no tax. Congress actually tried a similar system in 1977 - it was deemed a disaster and quickly abolished. Why? In part, because few individuals actually know the basis of their assets. Ask yourself, what's the basis of your home, mutual funds, stocks, dividend reinvestment plans or art collections and perhaps you wouldn't be surprised to learn - you're not alone, few truly know. Next problem, if you're wearing the hat of the Treasury and you're trying to predict revenue from capital gains tax - you've got a tough assignment. You'd have to predict; a) how much gain is held, b) how much of the gain will be sold and recognized each year, c) how much would be offset by losses and d) how much would be stepped up at death.

The chaos prescribed by repeal, then reversion in 2011 to an onerous estate tax leaves a families potential estate tax liability to chance, all dependent on the year of their death, and the tax system then in effect. If Wilma, an infirmed widow worth \$3,500,000 asks her advisors to approximate her projected estate tax liability based - here's the response, a) if you die this year - no estate tax, b) but possible capital tax if you die having gains over \$1,300,000 c) but if you live to 2011 - then estate tax of \$1,250,000 and no capitals tax. Strictly from an estate tax point of view, Wilma should die before December 31, 2010. If she's unwilling to cooperate, she should check the agents on her health care proxy carefully.

Why should Americans hard earned family wealth be subjected to such volatile and unpredictable swings? From a macro policy point of view, the Treasury is no better off. The days of relative peace and budget surpluses are long gone. War and budget deficits necessitate predictable revenue to offset spending or to service debt, and taxpayers demand clarity and reasonability. We elected our representatives to deliver bipartisan, practical legislation in a challenging economic environment. Sure enough, on December 3rd, the House of Representatives passed a measure known as HR 4154 making the \$3.5 million dollar exemption permanent and locking in the 45% rate of tax. Finally, some certainty. The fly in the ointment is that we needed the Senate, to follow their lead. To be sure, the estate tax isn't perfect, some reform is needed and healthy debate merited. But for now, some certainty with reasonable parameters would be acceptable to most. To quote my mother, "is that too much to ask"?

But our Senators, dead locked in partisan politics and worried about the next election, didn't take action. Instead, the Senate allowed our estate and gift tax system to fall into the abyss of confusion, conjecture and chaos. Several Senators promise retroactive estate tax legislation sometime in 2010. However, until such time, the Treasury is losing revenue and taxpayers are left dangling, And back in D.C., Congress has raised our nations debt ceiling - again. I have to go feed the hens.

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