Steve Leimberg's Estate Planning Email Newsletter - Archive Message #2274

Date: 20-Jan-15
From: Steve Leimberg's Estate Planning Newsletter
Subject: FLASH: Jeff Baskies - Will the Federal Estate Tax Be Repealed?

"Having just returned from the annual University of Miami Heckerling Estate Planning Institute, and having heard many esteemed planners and professors state that 'estate tax reform doesn't seem likely in 2015, but who knows what could happen after the 2016 election,' we were rather ironically greeted with news that President Obama intends to call for the repeal of the 'step-up' in basis on death. Apparently, this push will be part of his State of the Union Address.

From this stand-point, doesn't such news sounds like President Obama is saying to a Republican Congress: 'I will trade you the estate tax for carry-over basis or a capital gains at death tax.'

Based on the commentaries to date, it does not appear that such a compromise has been offered; instead, the Obama proposal seems to be to eliminate carry-over basis without eliminating the federal estate tax. But who knows? Although tax compromise has not been easy to come by, there may just be estate tax repeal after all!?!"

In Estate Planning Newsletter #2273**, Bruce Steiner** provided members with a first look at the President's proposal for a Simpler, Fairer Tax Code that Responsibly Invests in Middle Class Families. Now, **Jeff Baskies** looks at an important question that is likely to be on the minds of many **LISI** members after the President's State of the Union address tonight: is the estate tax in play, and if so, where is it headed?

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Here is his commentary:

EXECUTIVE SUMMARY:

In news that's available virtually everywhere on the internet, reports are that President Obama will use his January 20 State of the Union address to call on Congress to not only increase the capital gains tax rate (to 28%) but to eliminate stepped up basis at death. Currently there is not a proposal to simultaneously eliminate the estate tax. Perhaps the proposal will develop to trigger capital gains at death and make the taxes on such an estate tax deduction. However, while of course the path to real tax reform can twist and turn in many directions, if indeed elimination of the step-up in basis at death could become a reality (either in the form of carry-over basis or a capital gain at death regime), it seems more likely that such a change will be accompanied by repeal of the estate tax. That proposal might give the party seeking elimination of the tax a victory by eliminating a transfer tax that is perceived as "unfair" while giving the other party increased tax revenues, which it desires.

Indeed, given the "double taxation" arguments already hurled at the estate tax, it would seem untenable to imagine carry-over basis or capital gains at death without repeal of the estate tax. It might be politically useful for both parties to discuss such a concept, but the reality of both an estate tax and no step-up in basis (either capital gains at death or carry-over basis) seems remote and unlikely. Which either means, repeal of the step-up in basis is not likely, or is only likely if it is accompanied by a change in the estate tax.

However, having lived through 2010 (the year with no estate tax), it is fair to say anything is possible, but this commentary will focus on what the author believes to be the more politically tenably solution: a settlement that eliminates the estate tax in exchange for elimination of step-up in basis).

For example, in a New York Times article (*"Obama Will Seek to Raise Taxes on Wealthy to Finance Cuts for Middle Class"*) dated January 17, 2015, **Julie Hirschfeld Davis** wrote:

> The centerpiece of the plan, described by administration officials on the condition of anonymity ahead of the president's

> speech, would eliminate what Mr. Obama's advisers call the "trust-fund loophole," a provision governing inherited assets that shields hundreds of billions of dollars from taxation each year. The plan would also increase the top capital-gains tax rate, to 28 percent from 23.8 percent, for couples with incomes above $500,000 annually.

This seems like a natural step in the progression of the estate tax repeal movement which has been around for perhaps 20 years now (see discussion of Professor Graetz' presentation below). And perhaps this next turn is a logical conclusion to that movement.

FACTS:

In an article in Forbes entitled "Why the Death Tax is the Dumb Tax" (7/30/12), **Charles Kadlec** wrote convincingly why the estate tax is just "dumb" because it costs the government so much. He argued (as have others, of course) that the estate tax is actually a net tax loser for the government, which intuitively seems absolutely correct.

First, in and of itself, we know the estate tax raises very nominal revenue (estimated at 0.2% of projected budget revenues this decade). Looking backward, he says, the most tax the estate tax ever collected (in constant, 2010 dollars) was $36.7 billion (in 2000); however, he says the average annual revenue collected in the 1980s and 1990s was about $20 billion (when top rates ranged from 55-70%). Based on current exemption levels and estate tax rates, he notes that the Joint Committee on Taxation estimated that repeal of the death tax would reduce the Treasury's revenues by less than $7 billion per year.

In his article, Kadlec points to "Cost and Consequences of the Federal Estate Tax" published in July of 2012 by the Republican Staff of the Joint Economic Committee. That staff study cites to a few ways in which the current estate tax structure costs the government billions in tax revenues.

First, the staff study notes that many clients make substantial charitable gifts to avoid estate tax. They use an example of a wealthy client leaving $100 million to charity on death to avoid a $40 million estate tax. But the charity will invest the funds and earn income which won't be taxed. On the other hand, if the family retained the $100 million and invested, they'd generate a few million in tax every year. The study assumes that if they reinvested the money, it will take only about 10 years before the increased income tax will offset the lost estate tax, and of course, the consequences compound over time. The staff study estimates the lost income tax payments might exceed $100 million over 20 years. This argument seems logical.

Second, the authors of the staff study argue the estate tax discourages savings and accumulation of capital, and thus it actually impedes economic growth. The study also notes that the estate tax reduces the capital stock of the entire economy. Although potentially accurate, these arguments seem less compelling and logical.

A third argument against the estate tax presented by Kadlec, however, is that if the cost basis of assets were no longer stepped-up at death (on a tax-free basis for 99% of the nation) that would lead directly to higher capital gains tax revenues. To this author, this argument (that the capital gains tax lost by the step-up in basis vastly exceeds the revenue generated by the estate tax) seems irrefutable, but the issue is one of degree. How much capital gains tax revenues are actually believed to be lost? Although the numbers to support that analysis are not offered, the author concludes that the revenue generated by elimination of the estate tax exceeds the revenue lost by repeal by a substantial margin:

> According to a study by former Deputy Assistant Secretary for Economic Policy at the Department of the Treasury, Steven Entin, once these other sources of tax revenues are taken into account [increased revenue from capital gains and income tax raised by less passing to charity], repeal of the death tax would produce a net *increase* of $89 billion in tax revenues over that same 10-year period.

Indeed, even without the ability to prove it - as we don't have the actual numbers - the logic seems overwhelming that the tax revenue lost by the current estate tax regime (high exemption, low rate and stepped-up basis) exceeds the revenue generated by the federal estate tax by a significant multiple.

COMMENT:

In January of 2011 at the University of Miami Heckerling Institute, many of us heard Yale law **Professor Michael Graetz** (who presented the first Lloyd Leva Plaine Distinguished Lecture) address the history and fate of the estate tax. He discussed the history of the coalition that pushed for repeal of the estate tax in 2010 and concluded by suggesting this coalition would not cease its efforts just because the President and Congress adopted a $5 million exemption.

In his presentation and paper entitled "The Politics and Policy of the Estate Tax—Past, Present, and Future," Professor Graetz (in summary), addressed the early estate tax repeal advocates and the evolution of their attack on the estate tax. He cites the way they argued the estate tax was causing family businesses to be sold (even though he says their key "tree farm" story that was subsequently picked up by the Washington Post Magazine was subsequently debunked) and argued its repeal was a way to protect family businesses. And, he points to the change in rhetoric, and the philosophical impact. of calling the federal estate tax the "death tax."

It appeared from his presentation and materials that Professor Graetz believed the federal estate tax was on an inevitable march toward elimination. And his speech resonated with many. Moreover, little has happened since 2011 to change that impression.

Indeed, in his recent **LISI** commentary, noted estate planner **Ron Aucutt** wrote of his "Top 10 Estate Planning Developments of 2014" (see Estate Planning Newsletter #2266), and Number 1 on the list is the potential repeal of the federal estate tax. It is number 1 on this list, and obviously the most important issue in the trusts and estates world. And the issue is perhaps hotter now than it has been since 2012.

As the federal estate tax exemption continues to escalate ($5.43mil/person now) and less and less people are impacted by it (commentators at the Heckerling institute suggested either 99.6% or 99.8% of Americans are no longer impacted by the federal estate tax), will its very irrelevance lead to its repeal? Will the marginalization of the federal estate tax create the result the early advocates for reform/repeal have sought for decades?

It would certainly help if someone could do the tax math regarding the net costs of the current estate tax system (high exemptions, low rate and stepped up basis). While it seems the costs (lost revenue) must outweigh the benefits (collected revenue), the question might be "by how much?" Is there a net loss of $89 billion over 10 years? Or is the figure much more? Or much less?

Conclusion

While a proposal to have both a capital gains tax at death and an estate tax working side by side may seem intriguing, it would appear such proposals are very unlikely to succeed. Instead, a compromise or settlement might be more likely where the estate tax is repealed in exchange for either capital gains at death or carry-over basis. As the details of this proposal are still murky, and we are far from any real tax reform, it is also impossible to know the potential impact on and fate of the federal GST tax.

If the tax costs (lost revenue) caused by the current estate tax regime (high exemptions, low rates and stepped-up basis) exceed its benefits (tax dollars collected) by a high enough multiple, won't everyone agree the estate tax should be repealed?

If so, what is next? Will we go back to "carry-over" basis? Many of the arguments against carry-over basis (administrative burdens and record-keeping issues and such) which may have applied in the 1970s (when it was briefly tried) are no longer apt. Basis record keeping on many assets is not only simple but standard practice and required of all brokerages. The system is already there and likely easy enough to implement. Indeed, one can almost hear **Jonathan Blattmachr** preparing to re-print his carry-over basis books from the 1970s.

At this time, many wonder if the fate of the estate tax is sealed. Indeed, as Gaertz argued, are we on a slow but inexorable march toward its repeal? Ever since its opponents labeled the federal estate tax the "death tax," has its fate been sealed?

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

CITE AS:

CITES:

"Obama Will Seek to Raise Taxes on Wealthy to Finance Cuts for Middle Class" by Julie Hirschfeld Davis (New York Times, January 17, 2015); "Why the Death Tax is the Dumb Tax" by Charles Kadlec (Forbes, July 30, 2012); "Cost and Consequences of the Federal Estate Tax" (a Staff Study), published by the Joint Economic Committee Republicans (July 25, 2012); Fact Sheet: A Simpler, Fairer Tax Code That Responsibly Invests in Middle Class Families, The White House, Office of the Press Secretary (Jan. 17, 2015).