

# Crystal Ball Gazing

## Legislation Expectations Post 2008

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Crystal ball gazing to predict legislation *always* is a fool's errand. Yet many estate planners are anxious for indications of how the end game of the Bush Administration's 2001 tax reform may play out. There are few realities (and thus plenty of guessing) involved, and no lack of seers and soothsayers willing to prognosticate. Herein are just a few facts, and proposals, from which we might garner a little truth.

Looking toward the 111th Congress, it is not likely that repeal of the estate and generation-skipping transfer taxes will become permanent in the midst of the economic meltdown, with anticipated budget deficits in the trillion dollar range, a Democrat in the White House and a Democratically controlled Congress. The interesting question is presented by the specter of a one year repeal, still slated for 2010, coupled with carry over of basis for that same year, and then sunset of the 2001 legislation in 2011, which will return the law to what it was in 2001. Both the revenue loss of the one year repeal and the angst that will attend to carryover make it likely that reversal of these two elements of current law will be on the 2009 legislative agenda.

Congress has many larger issues to confront, however, and any short term or targeted response may not occur until very late in 2009. Indeed, given the difficulty of Congress in the recent past to accomplish meaningful tax reform, or even to pass extenders until the very last minute, it seems possible that any response to these two aspects might not occur until sometime in 2010 (presumably before any tax returns for deaths in 2010 are due), with a retroactive effective date to the beginning of that year. Such a delayed response, applicable as if enacted before the beginning of 2010, would be constitutional, so we should not expect that “throwing Momma from the train” just after the singing of Auld Lang Syne on New Year 2010 will succeed for tax avoidance.

When Congress does undertake to address the most immediate issue the revenue situation may suggest an “extender” bill that would push off the effective date of each of these 2010 and 2011 events. Before Labor Day 2008 predictions about freezing the exclusion at the 2009 level were realistic, and a Senate budget resolution in late March 2008 garnered 99 votes to make permanent the 2009 45% rate and \$3.5 million applicable exclusion amount (AEA). A change to either alone — lowering the rate or raising the AEA — generated no more than 50 votes. Today the economy may predict a very different combination (such as returning to a \$2 million AEA — perhaps indexed for inflation — which might shelter as many estates now as \$3.5 million would have on Labor Day 2008).

The most intriguing wealth transfer tax legislation introduced in 2008 was H.R. 6499, labeled the Sensible Estate Tax Act of 2008, offered by Rep. Jim McDermott, D-Washington, a member of the House Ways and Means Committee. It’s principle provisions were:

- Repealing carryover basis, the 2010 repeal, and the 2011 sunset
- Making the estate and generation-skipping transfer tax AEA \$2 million (with an inflation adjustment)
- Re-unifying the gift tax AEA with the estate and generation-skipping transfer tax amounts, meaning a \$2 million exclusion for all (with an inflation adjustment)
- Restoring progressivity in the tax rates: 45% on the first \$5 million, 50% on the next \$5 million, and 55% on the excess over \$10 million (all with an inflation adjustment)
- Restoring the §2011 state death tax credit (and repealing the §2058 state death tax deduction)
- Portability of unified credits of married decedents

Other potential changes revealed in hearings conducted during summer 2005 or during late fall and early Spring 2007-2008 by Congressional tax committee staffs included:

- Precluding lapsing *Crummey* withdrawal rights (a §2642(c) “tax vesting” requirement would be easiest and most sensible — but was not one of the three options noted in 2005)
- Eliminating certain valuation discounts, perhaps by an aggregation rule
- Refining special interest provisions for farmers and small business owners
- Changing the generation-skipping transfer tax exemption provisions to preclude perpetual tax free dynasty trusts

A good “academic/theoretical” case can be made for the following added reforms — all of which probably are too extreme for the reform that we can expect in the near term:

- Codify the “diminution in net worth” principle in Treas. Reg. §25.2511-2: the value of a gift “is measured by the value of the property passing from the donor, and attaches regardless of the fact that the identity of the donee may not then be known or ascertainable” (which would negate Rev. Rul. 93-12)
- If the gift tax were thus amended, then repeal of §§2035 through 2038, 2040, and 2042
- Adopt “baby carryover” — no new basis to the extent a transfer qualifies for a marital or charitable deduction
- Improve §6166 to better target lack of liquidity circumstances

Finally, just as a reality check, the following chart shows the impact of a \$2 million AEA — it suggests the number of estates that would remain subject to wealth transfer taxation, by jurisdiction (Sources: IRS and Centers for Disease Control and Prevention)

Number of Estates Owing Federal Estate Taxes in 2006 and 2007 by State

	# of Estates Owing Tax		% of Estates Owing Tax	
	2006	2007	2006	2007
Total United States	22,798	17,416	0.9%	0.7%
Alabama	219	189	0.5%	0.4%
Alaska	*	*	*	*
Arizona	371	287	0.8%	0.6%
Arkansas	142	82	0.5%	0.3%
California	4,492	3,637	1.9%	1.5%
Colorado	210	180	0.7%	0.6%
Connecticut	399	393	1.4%	1.3%
Delaware	83	36	1.1%	0.5%
District of Columbia	44	76	0.8%	1.4%
Florida	2,482	1,667	1.5%	1.0%
Georgia	429	333	0.6%	0.5%
Hawaii	131	75	1.4%	0.8%
Idaho	48	76	0.5%	0.7%
Illinois	1,120	907	1.1%	0.9%
Indiana	270	196	0.5%	0.4%
Iowa	237	158	0.9%	0.6%
Kansas	191	102	0.8%	0.4%
Kentucky	160	78	0.4%	0.2%
Louisiana	198	162	0.4%	0.4%
Maine	116	93	0.9%	0.8%
Maryland	542	371	1.2%	0.9%
Massachusetts	606	455	1.1%	0.9%

Michigan	551	480	0.6%	0.6%
Minnesota	230	221	0.6%	0.6%
Mississippi	106	41	0.4%	0.1%
Missouri	371	222	0.7%	0.4%
Montana	92	80	1.1%	0.9%
Nebraska	62	58	0.4%	0.4%
Nevada	144	119	0.8%	0.6%
New Hampshire	131	96	1.3%	1.0%
New Jersey	739	569	1.0%	0.8%
New Mexico	75	101	0.5%	0.7%
New York	1,750	1,339	1.1%	0.9%
North Carolina	523	379	0.7%	0.5%
North Dakota	*	*	*	*
Ohio	790	425	0.7%	0.4%
Oklahoma	196	180	0.5%	0.5%
Oregon	290	111	0.9%	0.4%
Pennsylvania	732	578	0.6%	0.5%
Rhode Island	111	40	1.1%	0.4%
South Carolina	272	150	0.7%	0.4%
South Dakota	46	51	0.6%	0.7%
Tennessee	204	156	0.4%	0.3%
Texas	1,082	906	0.7%	0.6%
Utah	66	34	0.5%	0.2%
Vermont	47	65	0.9%	1.3%
Virginia	657	573	1.1%	1.0%
Washington	472	384	1.0%	0.8%
West Virginia	163	76	0.8%	0.4%
Wisconsin	232	291	0.5%	0.6%
Wyoming	*	39	*	0.9%

\* No estate tax figures are provided by IRS for these states in some years due to privacy concerns. These excluded figures are, however, included in the national totals.

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