

The Future of Federal Estate Tax: Proposed Legislation

By Salvatore M. Di Costanzo and Kathryn Trinh

With only two months remaining in 2009, there is much uncertainty over the future of the estate tax. The 2001 Economic Growth and Tax Relief Reconciliation Act (“EGTRRA” or “Act”) has gradually increased the exemption amount, or the amount not subject to estate tax, from the pre-2001 level of \$1 million to the current \$3.5 million exemption, and reduced the maximum estate tax rate from 55% to 45%. However, with no further action by Congress, the EGTRRA provides that the estate tax will temporarily expire in 2010, leaving all estates free of federal estate taxation for one year. Then in 2011, a sunset provision in the Act reinstates the pre-2001 \$1 million exemption and maximum tax rate of 55%.

In January of this year, the *Wall Street Journal* reported that Democrats were determined to move quickly to pass legislation establishing the estate tax permanently and to avoid the 2010 repeal. Several Democrat-sponsored bills introduced between January and June propose reinstating a permanent estate tax with exemption levels varying from \$2 million–\$5 million and a tax rate between 40–55%. The Obama administration’s proposed budget would maintain the estate tax in its current 2009 form, with a \$3.5 million exemption and a 45% rate. However, with less and less time left in 2009 to pass any permanent estate tax legislation, there is speculation that Congress will likely pass a one-year extension of the existing law through 2010 to prevent the one-year repeal and postpone passing a more comprehensive estate tax bill until next year. Regardless of whether a permanent bill is passed this year or next, it is almost certain that the estate tax will be maintained, as the Treasury cannot afford to lose the revenue it brings in.

The various House and Senate bills currently under consideration by the House Committee on Ways and Means and the Senate Committee on Finance are outlined below. In addition to the main considerations of exemption amounts and tax rates, other key issues in play include portability of exemptions between spouses, unification of the gift and estate taxes, and the reinstatement of the state death tax credit.

Proposed Legislation

H.R. 436 (“Certain Estate Tax Relief Act of 2009”): Sponsored by Bill Pomeroy (D-ND) in January, it would permanently establish the estate tax at the current 2009 rates, with a \$3.5 million exclusion (or \$7 million for married couples utilizing bypass trusts) and a maximum rate of 45%. There would be a phase-out of the \$3.5 million exclusion by increasing tax rates on estates larger than \$10 million. The “Pomeroy Bill” would

prevent the 2010 estate tax repeal, becoming effective January 1, 2010.

H.R. 498 (“Capital Gains and Estate Tax Relief Act of 2009”): Sponsored by Harry Mitchell (D-AZ), it would raise the exemption between 2010 and 2015 to a permanent exclusion of \$5 million, with an inflation adjustment thereafter. It would reduce estate tax rate brackets, and would allow a surviving spouse to use his or her deceased spouse’s unused unified estate tax credit. This “portability” provision, seen in a few other bills as well, would simplify estate planning for married couples by making the use of a bypass trust or the re-titling of assets unnecessary.

S. 722 (“Taxpayer Certainty and Relief Act of 2009”): Sponsored by Max Baucus (D-MT), it includes a slightly more complex “portability” provision that requires an election at the first spouse’s death to allow the surviving spouse to use the unused exclusion amount, and a Form 706 to be filed by the executor, regardless of estate size. This provision also places a limit on exemptions from multiple marriages to a basic exemption amount. The downside to these additional requirements is that it loses the simplicity of an automatic credit and requires sophisticated estate administration to ensure proper election and timely form filing.

Another notable feature of S. 722 is its proposal to reunify the gift tax and estate tax credits. The EGTRRA dis-unified the estate and gift tax by gradually increasing the estate tax exemption to \$3.5 million while keeping the gift tax exemption at \$1 million. Reunifying the two would create one exemption amount for both gift tax and estate tax. This would allow individuals to make greater tax-free gifts during life, but also means that if a person used the entire credit against tax on gifts made during life, there would be no remaining credit to use against estate tax at death. Reunification of gift and estate tax credits, like the portability provision, is a beneficial clause that would simplify estate planning. However, because such a reunification might reduce gift tax collected, or at least defer some taxes collected until death, such a provision seems less likely to pass than a portability provision.

The main features of S. 722 are its \$3.5 million exemption, indexed for inflation after 2010, and a 45% maximum rate. An amended version of S. 722, approved by the Senate, sets the individual exemption at \$5 million and the rate at 35%. This bill would override the EGTRRA’s temporary estate tax repeal, becoming effective January 1, 2010.

H.R. 2023 (“Sensible Estate Tax Act of 2009”): Sponsored by James McDermott (D-WA), it proposes

an estate tax exemption of a moderate \$2 million, indexed for inflation after 2010, and tax rates between 45–55%. The bill contains the same portability provisions as S. 722 and similarly proposes reunification of the estate and gift tax exemptions. It would also become effective January 1, 2010.

H.R. 2023 also proposes the elimination of the deduction for state estate taxes and the reinstatement of the state estate tax credit. Before the EGTRRA, the state estate tax credit was an amount carved out of the federal estate tax for the state where a decedent resided. Thus, many states only imposed a “pickup” tax equal to the amount of the credit. The EGTRRA phased out that credit and lowered the federal estate tax rate, thereby requiring many states to “decouple” from the federal tax to impose their own separate taxes in order to maintain their revenue stream. The credit was replaced by a deduction for state estate taxes paid. Bringing back the state estate tax credit would simplify estate administration and unify estate tax rates throughout the country. However, due to the cost to the federal government of such a provision, and in the current absence of any lobbying effort on the part of the states, it is unlikely to become part of any final legislation.

H.R. 1986: Sponsored by Travis Childers (D-MS), this bill repeals the EGTRRA estate tax provisions and sets the exemption at a higher \$4 million, with a maximum rate of 40%, becoming effective January 1, 2010.

H.R. 2658: Sponsored by Michael Capuano (D-MA) in June, this bill has the highest exemption amount of all proposed legislation at \$5 million, and would also repeal the EGTRRA estate tax provisions.

H.R. 3905 (“The Estate Tax Relief Act”): Sponsored by Kevin Brady (R-TX) and Devin Nunes (R-CA) on October 22, 2009, this bill proposes to extend the estate tax through 2010 and increase the exemption over ten (10) years. The exemption would gradually increase from \$3.5 million to \$5 million by 2019. The tax rate would be reduced over the same period from 45% to 35%.

The Rangel Bill: Rep. Rangel has indicated that he is working on legislation to make the current estate tax law permanent.

A number of Republican bills seek to repeal the estate tax entirely, such as H.R. 1763, the “Responsible Reinvestment Act of 2009,” sponsored by Robert Latta (OH). Many propose making the estate tax provisions of the EGTRRA permanent, which would result in a gift tax reduction as well. Such proposals include:

- **H.R. 533**, the “Opportunity for Family Farms and Small Businesses Act of 2009,” sponsored by Randy Neugebauer (TX)
- **H.R. 1960**, sponsored by Joseph Pitts (PA)

- **H.R. 664**, the “Economic Stimulus Enhancement and Tax Relief Permanency Act of 2009,” sponsored by Samuel Graves (MO)
- **H.R. 3463**, the “Death Tax Repeal Permanency Act of 2009,” sponsored by Kevin Brady (TX)

The following Republican bills further call for a total repeal of both estate and gift taxes:

- **S. 11240**, the “Roadmap for America’s Future Act of 2009,” sponsored by Jim DeMint (SC)
- **H.R. 99**, the “Fair and Simple Tax Act of 2009,” sponsored by David Dreier (CA)
- **H.R. 205**, the “Death Tax Repeal Act,” sponsored by William Thornberry (TX)

At the farthest end of the spectrum is Ronald Paul’s (TX) **H.S. Res. 48**, a proposed amendment to the Constitution which would prohibit Congress from levying taxes on personal income, estates, and gifts.

Taking into consideration the budget deficit, the Democratic majority in Congress, and the Obama administration’s stated position on maintaining the estate tax, many doubt that any proposals seeking to repeal the estate tax will have enough support to pass. It is much more probable that the estate tax will be maintained at or around the current levels. Whether permanent legislation will be passed this year or not remains to be seen, but becomes less likely as 2009 draws to a close.

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