

Estate Reform Looms Ahead

With the current estate tax regime set to expire in 2010, it's time to consider what comes next.

With that sunset date fast approaching, the Tax Division of the American Institute of CPAs has taken its comprehensive reform proposal and boiled it down to a top-seven priority list of suggested reforms that it urged Congress to pass prior to the expiration date.

In developing these suggestions, the AICPA focused on the complexity of the current system, taxpayer and compliance burdens, ease of administration, and revenue constraints.

Permanent changes to the estate tax should be made prior to the current law expiring in 2010 in order to provide certainty to taxpayers.

A top priority is that Congress should increase the applicable exemption amount in order to eliminate filing and tax burdens for 90 to 95 percent of estates, as well as indexing the exemption for inflation.

Congress should create a uniform exemption amount for estate, gift and generation-skipping transfer tax purposes. Historically, there was a uniform exemption for both generation-skipping transfer tax and estate tax purposes

Until the phase-out of the estate tax, the uniform exemption amount reduced the tax impact of making either a gratuitous transfer during life or a bequest at death. In the last several years that has not been the case. The estate tax exemption amount increased to \$3.5 million in 2009, while the gift tax exemption has remained at \$1 million. I would like to see those amounts reunified. It would simplify planning for individuals, by taking out of the equation the issue of whether to give money away in the present, or transfer it at death.

The gift tax exemption was frozen at \$1 million on the theory that the estate tax would be repealed. The thought was that once it was repealed there would be a lot of

income shifting and income avoidance, but if the estate tax stays there=s not as much need to keep the gift tax exemption at a million. It=s logical that it should be the same for both estate tax and gift tax purposes. The million-dollar exemption limits the amount of lifetime planning that can be done.

The AICPA task force recommended that Congress make permanent the technical modifications to the generation-skipping transfer tax rule enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001. These technical modifications provide relief from several GSTT traps@ that existed under previous law. However, as with other provisions of EGTRRA, these changes will sunset on December. 31, 2010.

Congress should also reinstate the full state estate tax credit that would allow states to uniformly piggyback@ on the federal estate tax.

This is primarily a simplification device. A state estate tax system that differs from state to state adds complexity for taxpayers, such as where to live or how to deal with assets in more than one state. This would simplify the state estate tax system dramatically.

To avoid diminishing tax revenues, many states have decoupled from the federal estate tax and enacted their own estate tax regimes. This is important enough that I believe that there should be a surtax on top of what you would normally pay in federal estate tax in order for the states to not have to develop their own separate state death tax.

It is a good system for the states, because in effect it is free money. The federal government was footing the bill. When the states decoupled and many passed their own estate tax, it led to greater complexity in planning.

The full step-up in basis to fair market value for inherited assets should be retained, so that the complexities of carryover basis can be avoided.

The repeal of the estate tax was partially paid for by doing away with the step-up in basis. The issue here is simply that carryover basis is complex. People don't know what dad or granddad paid back in 1942. With a step-up in basis, you don't need to know.

The issue is controversial in the sense that it costs the government revenue. In part it depends on how big the exemption amount is. Carryover basis means, ultimately, the government receives its tax revenue through the income tax, rather estate taxes. There's nothing wrong with that from a fairness perspective, but it's complex, since many taxpayers simply don't know.

Among the proposals is broad-based liquidity relief, rather than targeted relief provisions.

It's not just closely held businesses and farms that are hit with the liquidity problem. Many taxpayers die with illiquid assets. It may be something as simple as an IRA. To the extent that relief is provided for closely held businesses, I believe that we should broaden it to other taxpayers. Some deferral of estate tax with interest paid would provide a bit easier way for taxpayers to pay the estate tax.

This kind of relief should be more broadly based. It creates an unfair burden on beneficiaries to have to sell an asset and pay income tax on it in order to pay the estate tax generated by including an IRA in the estate.

Finally, the AICPA recommended that the top estate rate be no higher than the maximum individual income tax rate.

Some proposals in the past have included a rate structure with a limited number of tax brackets.

Such a system might provide for only two brackets say, 15 percent rate and 25 or 30 percent rate with estates over a certain size paying the higher bracket and estates below

that number paying the lower rate. In this example, there may be significant uncertainty in the planning process for married couples with significant estates, according to the proposal.

For example, taxpayers may have to consider if estate tax should be paid at the death of the first spouse to die at a 15 percent rate, compared to an alternative of paying the tax in the future but a higher rate. In addition, this type of >cliff= taxation leaves too much room for disparity among similarly situated taxpayers, where one receives estate planning advice and pays significantly less tax when compared to the individual who does not receive such advice.