

Memorandum

TO: *Clients and Friends*

FROM: *Richard Gregory*

RE: *The Federal Estate Tax Is Heating Up -- Again*

DATE: *May, 2008*

*Things are heating up in Washington regarding the federal Estate tax. In late March, Senate Finance Committee Chairman Max Baucus offered an amendment to the current Senate Budget Resolution. **The amendment would make permanent a federal Estate tax exemption of \$3.5 million per person (up to \$7.0 million for a married couple, with proper planning) and a top Estate tax rate of 45%. The amendment passed by a vote of 99-1!** Of course, an amendment to a Budget Resolution is not law, but it does give some indication of what members of Congress are thinking as we move toward elections in November.*

A little bit of History

A little bit of history may help put current developments in context. In 2001 a Republican Congress helped George Bush deliver on his campaign promise to "repeal" the federal Estate tax. The "Economic Growth and Tax Relief Reconciliation Act of 2001" (the "2001 Act") gradually raised the per person exemption amount, first to \$1.0 million for deaths occurring after 2001, then to \$1.5 million for deaths after 2003, then to \$2.0 million for deaths after 2006, then to \$3.5 million for deaths after 2008. Its crowning achievement was to eliminate the tax in its entirety for deaths occurring in 2010.

The word "repeal" sounds permanent and final, but the 2001 Act did not make the federal Estate tax go away. It takes 60 votes in the Senate to pass permanent tax legislation, and in 2001 the votes were lacking. Therefore, the 2001 Act will "sunset" after 2010, and the provisions of prior law will come back into effect starting in 2011. Unless Congress acts, the exemption amount will drop back down to \$1.0 million per person, and the top tax rate will again be set at 55%!

The Baucus Amendment to the Senate Budget Resolution

The 2001 Act generated and still generates a great deal of uncertainty. So it is not surprising that during the intervening years the Senate has made several attempts to find a permanent solution based on bi-partisan compromise. The Baucus amendment may be the first sign of an emerging consensus.

The Federal Estate Tax Is Heating Up — Again (p 2)

For those of us who enjoy reading tea leaves and gazing into crystal balls, it appears significant that Senator Baucus is the Chairman of the Senate Finance Committee and that his amendment passed by a vote of 99-1.

Equally significant is the fact that a number of competing amendments were offered and defeated. Each competing amendment would have extended more generous tax relief, but each failed to pass and, of course, fell well short of the 60 votes needed to enact a permanent change in the law.

On the other hand, it is easy to read too much into a preliminary vote. Since politics is always in the air in Washington, it is important to bear in mind that 1/3 of the Senators who voted for the Baucus Amendment were posing and preening for their re-election campaigns in the fall. Many on the Republican side of the aisle had already staked out less taxing positions by voting for one or more of the competing amendments which were defeated.

What Does It All Mean?

That remains to be seen. As a general rule President Bush and Republicans in Congress favor a higher exemption amount and lower tax rates, while Democrats lean in the opposite direction. The Baucus amendment may well reflect the present balance of power in Washington, but this is an election year and the balance may soon shift. The fact that the electorate is in a sour mood bodes ill for the Republican Party's prospects in November. If Democrats win more seats in the House of Representatives and the Senate, and certainly if a Democrat is in the White House, a compromise exemption amount may move lower and tax rates may move higher.

We do not see permanent Estate tax repeal as a realistic possibility. No matter who is elected President, Congress will have to establish a budget and then search for tax dollars to fund it. That will be a difficult task. After all the speeches about cutting spending, eliminating waste, etc., where will Congress turn?

Put the question to yourself: if you were a Member of Congress, where would you turn? Would you increase Social Security and Medicare taxes? Would you increase Income taxes, perhaps targeting dividend and capital gain income? Would you increase Estate and Gift taxes? A politician interested in being re-elected might take into account the fact that:

- Only on the order of 1% of all Estates pay any federal Estate or Gift tax; and*
- Dead people do not vote (at least not in great numbers, except in Chicago under the 1st Mayor Daley); but*
- Their children and heirs do vote; and*
- Rich people have the ability to make generous campaign contributions.*

The Federal Estate Tax Is Heating Up — Again (p 3)

The States Are Not in Sync

Whatever happens in Washington will have no immediate effect on state death taxes. After the 2001 Act, most states “decoupled” their tax systems from the federal system. The Rhode Island estate tax exemption amount will continue at \$675,000, and the Massachusetts exemption amount will continue at \$1.0 million.

Florida has no death tax, not through any generosity of its legislature but rather from the interaction of the 2001 Act with a provision of the Florida Constitution. But that is a story for another day.

We hope these thoughts regarding estate taxes are of interest.

Please call us if we can answer questions or be of service in any way.

Best regards,

Dick Gregory