Estate Tax Debate Makes Planning For Death Even More Difficult

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"My wife and I are trying to do estate planning, but we don't know how Congress is going to change the law," lamented an elderly Kansas farmer during a recent meeting. "Do you have any idea of what they are going to do?"

Unfortunately, the estate tax picture, as well as the general tax picture in Congress, is about as clear as mud right now. As you may know, the federal estate tax expired December 31, 2009 after Congress was unable to reach an agreement on either a permanent or short-term extension. There is no federal tax on estates if you die this year, but then the death tax comes back with a vengeance.

The tax will be re-instated on January 1, 2011, with only a $1 million exemption and a 55 percent tax on amounts over that level – unless Congress takes action to change the law. As a result, even smaller farms and businesses could end up paying a bucketful of taxes when the owner dies next year.

Several lawmakers have introduced bills to raise the exemption and change the tax rates. But changing the law won't be easy. The Statuatory Pay-As-You-Go Act of 2010, enacted in February 2010, requires that any changes to the estate tax beyond a two-year extension of 2009 law must be fully offset by cuts in programs or revenue raisers. In 2009, there was a $3.5 million exemption on estate taxes with a 45 percent top tax rate. An estate tax bill was passed by the House last year that would basically reinstate the 2009 exemption and rates.

In addition to the estate tax, there are a multitude of tax issues that need to be tackled before year's end. The biodiesel tax incentive lapsed at the end of 2009 and has yet to be renewed. As a result, dozens of biodiesel plants are idling and investors are losing their confidence in renewable energy. Later this year, the Volumetric Ethanol Excise Tax Credit (VEETC), widely known as the "Blenders' Credit" is set to expire. Last, but certainly not least, are the "Bush" tax cuts that you hear about so often about in political debates. If these tax cuts are not renewed, you could see tax increases in individual rates, capital gains, and dividends.

Fiscal war?

Tax issues could brew into a fiscal war of sorts for the country. President Obama wants to allow the Bush tax cuts to expire for individuals making more than $200,000 a year and for couples making more than $250,000. Regarding the estate tax, Administration sources say the president's position is to restore the estate tax and extend it at the 2009 rates.

Several GOP lawmakers are fighting to reduce the estate tax and continue the previous tax cuts. They argue that, with the economy sagging and millions unemployed, it's exactly the wrong time to force small business owners to pay more taxes. Doing so will place an additional damper on economic recovery.

Yet, others say that continuing the current tax cuts will be fiscally irresponsible and add to an already alarming federal deficit. The Congressional Budget Office recently forecast that the federal deficit will reach $1.34 trillion for this fiscal year.

Even former Federal Reserve Chairman Alan Greenspan, an influential voice in favor of the first Bush tax cut in 2001, weighed in recently. On NBC's Meet the Press Aug. 1 he said that extending the cuts without making offsetting spending reductions could prove "disastrous."

"I'm very much in favor of tax cuts, but not with borrowed money," said Greenspan.

Tax package ahead?

When the Senate returns in mid-September, lawmakers are likely to consider a small business bill which could include a "fix" for the estate tax problem. The American Farm Bureau Federation is supporting an amendment to the small business bill that was introduced by Sens. Blanche Lincoln (D-AR) and John Kyl (R-AZ.). Their measure would set the estate tax exemption at $5 millionwith a 35 percent maximum rate.

Another bill, introduced by Sen. Diane Feinstein (D-CA), would defer estate taxes on farms and ranches if a number of conditions are met. Her "Family Farm Estate Tax Referral Act of 2010, includes provisions that the farm must be passed on to an individual or family member who has been materially engaged in its management and operation for at least five years, and the heirs must continue to use the land for farming purposes.

A "recapture tax" would be owed if the farm or ranch was subsequently sold outside the family or was no longer used for farming or ranching. The tax due would be based on the value of the estate at the time the property is sold or ceases to be used for farming or ranching.

Yet another measure has been introduced by Sen. Bernie Sanders (I-VT.). His bill is cosponsored by Sens. Tom Harkin (D-IA), Sheldon Whitehouse (D-R.I.), and Sherrod Brown (D-OH). The bill would exempt the first $3.5 million of an estate from federal taxation ($7 million for couples), the same exemption that existed in 2009, and create a progressive rate so the so called "super wealthy" pay more. The tax rate for estates valued between $3.5 million and $10 million would be 45 percent, the rate on estates worth more than $10 million and below $50 million would be 50 percent; and the rate on estates worth more than $50 million would be 55 percent.

The AFBF supports the Lincoln/Kyl amendment because it seeks a permanent forgiveness of estate taxes while the Feinstein bill is a deferral with taxes owed if property were ever sold outside the family or ceased to be used for agriculture.

The National Farmers Union sent a letter of support for the Lincoln/Kyl bill, but their policy actually calls for a $4 million individual exemption. Chandler Goule, NFU's VP for Government Relations says the Lincoln/Kyl measure is preferable to current law and says a conference between the two chambers could come close to what NFU has been supporting.

Failure to include estate tax reform in the Small Business bill increases the likelihood that estate tax reform will be included in a major tax package that is expected to be considered in a "lame duck" session after the mid-term election, says Patricia Wolff, Director, Public Policy for AFBF.

Where the offsets would come from to pay for estate tax reform or other changes in the tax code is still anyone's guess.

Sen. Maria Cantwell (D-WA) has circulated an idea that would allow individuals to prepay their estate tax, based on current value. Conceivably, the federal government would receive more money up-front, but could lose money if an individual's assets appreciate considerably between the time they pay and the time they die.

One relatively piece of good news for those of you trying to plan: There is little opposition to a stepped-up basis on asset values, says Wolff, so any of the proposed "fixes" will likely allow any appreciation of the affected property that occurred during a person's lifetime to never be taxed. Δ

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