

EGTRRA UPDATE: Reform, Not Repeal

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EGTRRA, a tax cut signed into law by President George W. Bush in June 2002, made significant changes to the transfer tax system, raising the amount of allowable estate tax exclusions and lowering tax rates over the next eight years.

With an even steeper economic downturn looming on the horizon, Congress is speculating that it might be best to repeal EGTRRA. Proposed bills calling for repeal of the EGTRRA are floating around the House of Representatives and Senate, making estate planners and their clients nervous. The answer? Don't repeal EGTRRA—reform it.

EGTRRA: A Brief History

The Economic Growth and Tax Relief Reconciliation Act of 2001 (“EGTRRA”) calls for a cut in estate-tax rates by over 10% over the next eight years while increasing the applicable exclusion amount by over \$2 million. However, on January 1, 2011, the provisions “sunset,” reinstating estate, gift and generation-skipping transfer taxes as they existed immediately before EGTRRA was enacted. If Congress makes no change to the law, EGTRRA will revert back to 2001 estate-tax rates of up to 55% and tax exemptions of only \$1 million.

More Funds to Fight Terrorism

While EGTRRA seems a boon for estate-planning clients of all income brackets, reversion back to 2001 rates under a potentially tightened federal budget make this tax cut a probable trap for wealthier clients. Furthermore, extending the reduction in estate tax may cause less-wealthy clients to put off any estate-planning needs, leaving them vulnerable to future estate tax liability. However, the biggest threat to clients and estate planners alike is not the tax cut itself, but the threat of repealing it.

As the federal budget has lost substantial estate tax revenues to EGTRRA, a hike in income taxes seems a likely next step for our Republican Congress. In this light, repealing EGTRRA seems obvious: our federal government needs more income to fight economic downturn, threats of terrorism and imminent war. Repealing EGTRRA seems a sound decision.

Pending Legislation in 2003

Proposed bills in the House and the Senate would extend all of the EGTRRA provisions, including the estate tax repeal, beyond their expiration in 2010; other proposed bills

aim to extend only the estate-tax portion of EGTRRA. Current repeal proposals also include a carryover basis regime for assets passed at death, leaving life insurance as the sole asset receiving a step up in basis. Advocates of repealing this legislation are active in Congress; the possibility is extremely high that repeal legislation will be considered in the 108th Congress.

Repeal vs. Reform

If EGTRRA were completely repealed, approximately \$23 billion in funds paid by 50,000 estates would be eliminated from the country's current annual income. Rather than having the wealthiest .1% contribute to our drained national coffers, the cost of refurbishing our federal bank account would be passed on to lower-income, wage-earning Americans via increased income taxation.

The federal budget would be better served if Congress were to modify EGTRRA, make changes that would maintain more than half of the revenues, or over \$12 billion, with the cost to be borne by only the heirs of the country's top one-third largest taxable estates. If the estate-tax exclusion were simply increased to \$5 million, with rates left untouched, then only 6.5% of the estates that paid estate taxes in 1999 would be subject to increased taxation, yet over 50% of estate tax revenues would be collected.

The vast majority of Americans would have no estate-tax liability, but the country would have lost less than 50% of its estate tax revenue. Only the very wealthiest of heirs, not families or small family business owners, would incur liability. The wealthiest taxpayers would continue to benefit from the estate-tax deduction allowed for charitable gifts, while the country would still receive significant estate-tax revenues.

A Plausible Solution

While permanent estate tax repeal is neither achievable and nor sustainable, permanent estate-tax reform is a practical, possible solution that would have far-reaching impact. Estate-tax reform ensures that less than one percent of Americans would face any sort of estate tax. Those who would be liable for this tax would be able to plan for it effectively, minimizing negative implications of the tax.

The end result? Our American bank account would begin to fill up again, as we reinstate funding for social programs and national defense, At the same time, 99.9% of Americans would continue to enjoy reduced taxation, while less than .01% of the wealthiest estate beneficiaries would pay a slightly increased tax. Any way you look at it, we can all live with those numbers.

Sources (FYI only ... not to be included with article)

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