

# FINANCIALink<sup>®</sup>

Your Money Management Newsletter

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Title

## The Great "Death Tax" Debate



*"...a congressional committee estimated that the federal estate tax has reduced the nation's capital stock by \$850 billion."*

The federal estate tax, which is scheduled for repeal in 2010, is the subject of two proposals currently under consideration in Washington. As you might have guessed, neither would allow the scheduled repeal to take place.

Under a tax law passed in 2001, the top federal estate tax rate has slowly been reduced, falling from 55% in 2001 to 45% in 2009. At the same time, the amount of an estate that is exempt from the tax has increased, rising from \$1 million in 2001 to \$3.5 million in 2009. The law cuts the estate tax rate to zero in 2010, but only for that year; it will revert to a \$1 million exemption and a 55% top tax rate in 2011. But now it seems unlikely that the current law will be allowed to run its course.

### A Pair of Proposals

President Barack Obama's fiscal 2009 budget includes a proposal to extend the estate tax indefinitely at the 2009 levels. Inherited wealth above the \$3.5 million exemption (\$7 million for married couples) would continue to be taxed at a top rate of 45%. The president's budget has already passed the House of Representatives.<sup>1</sup>

The Senate has passed competing legislation that includes a higher \$5 million exemption (\$10 million for married couples) and a lower 35% tax rate on wealth in excess of the exemption.<sup>2</sup> How lawmakers

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will resolve the difference between the proposals is not yet known.

### **Fair Game or Foul Play?**

Proponents of the estate tax like to point out that it affects few taxpayers. In 2008, half of the estate tax revenues were expected to be generated by the wealthiest 0.1% of U.S. households. The top 5% of income earners were expected to pay 97% of all estate tax revenues; the top 20% were expected to pay all but 0.3% of estate tax revenues.<sup>3</sup>

Bill Gates, the richest man in the world according to *Forbes*, once said, "Taxing dead multi-millionaires is eminently more fair than taxing the not-so-rich living."<sup>4</sup> Warren Buffett, the second richest man according to *Forbes*, has also campaigned to retain the estate tax. He once testified before Congress that, "Dynastic wealth, the enemy of a meritocracy, is on the rise."<sup>5</sup>

Those who decry the existence of the estate tax contend that it is fundamentally unfair to tax estates when taxes have already been paid in the process of accumulating wealth. They point to family-owned businesses that could be forced to sell assets to pay estate tax obligations.

Furthermore, they claim that the estate tax reduces incentives to save and invest, which in return reduces the nation's capital stock and income.

The reason that the federal estate tax accounts for only 1% of federal tax revenues is because most people who might be liable go to great effort and expense to avoid it.<sup>6</sup> The tax records only show how many people pay the estate tax. What they don't measure is the extent to which people go to avoid it, or the total cost to society for this type of behavior. However, a congressional committee estimated that the federal estate tax has reduced the nation's capital stock by \$850 billion.<sup>7</sup>

Arthur Laffer, an influential economist who served on Ronald Reagan's Economic Policy Advisory Board, has argued that high estate taxes don't necessarily raise more revenue, they just prompt people to consume more of their income while they are living. According to Laffer, it makes no sense that Americans who blow their after-tax income in Las Vegas owe no tax, but those who opt to save it and leave it to their children or grandchildren have been taxed at levels as high as 55% in

recent years. He calls it a 0% tax on carousing but a 55% tax on thrift.<sup>8</sup>

Writing in *The Wall Street Journal*, Laffer noted: "Passing onto successive generations greater health, wealth and wisdom is what society in general, and America specifically, is all about. Imagine what America would look like today if our forefathers had been selfish and left us nothing."<sup>9</sup>

### **How to Prepare**

There are a number of methods to help protect wealth from estate taxation, ranging from simple charitable donations, to lifetime transfers to heirs, to elaborate trust strategies that involve a complex web of tax rules and regulations and typically require the counsel of an experienced estate planning professional.

Whatever form the final legislation takes, it appears that the federal estate tax will be a factor in estate conservation for years to come.

1-2) *The Wall Street Journal*, April 6, 2009

3) The Urban-Brookings Tax Policy Center, October 20, 2008

4) *TheBigMoney.com*, April 15, 2009

5) Reuters, November 14, 2007

6-9) *The Wall Street Journal*, April 2, 2009

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