

You Say You Want Estate Tax Repeal ...

There's been so much talk about estate tax repeal over the past few months, but what does that really mean? Sure, it's an easy thing to shout about from the campaign pulpit, but when it's time to draft a repeal bill, it becomes a bit more complicated. Should we repeal the estate tax but not the gift tax? What happens to the generation-skipping transfer (GST) tax? If we leave the gift tax, what's the tax rate? Is there an exemption amount? If we repeal the estate tax, what happens to the basis step-up provision?

Those are just a few of the questions swirling around the idea of "estate tax reform." As we know well, nothing official has happened yet with tax reform, but several bills (six in the House and three in the Senate) have been introduced since Jan. 1, 2017. Here's a quick run-through of those bills to get a general idea of what our representatives are considering, and failing to consider, in the context of estate tax repeal.

FAIR TAX ACT OF 2017 (H.R. 25 AND S.R. 18)

These sister bills would impose a national sales tax of 23 percent on the use or consumption of taxable property or services. It would repeal the current individual and corporate income taxes, employment and self-employment taxes, and estate and gift taxes. Interestingly, this tax bill would shift the burden of administering, collecting and remitting the sales tax revenue to the U.S. Treasury and would defund the IRS after FY 2021. If the 16th Amendment to the Constitution isn't repealed with seven years of enactment of this bill, then the law would be automatically terminated, although there's no mention of what would replace it. There's also no discussion of what happens to assets at death, so presumably the basis in the asset would carry over until it's sold.

FARMERS AGAINST CRIPPLING TAXES ACT (H.R.30) AND DEATH TAX REPEAL ACT OF 2017 (H.R.198)

"(a) IN GENERAL.—Subtitle B of the Internal Revenue Code of 1986 (relating to estate, gift, and generation-skipping taxes) is hereby repealed. (b) EFFECTIVE DATE.—The repeal made by subsection (a) shall apply to estates of decedents dying, gifts made, and generation-skipping transfers made after the date of the enactment of this Act."

These innocuous-sounding but identical bills pack a punch. The specific repeal of Subtitle B would leave Subtitle A (pertaining to income taxes) in force. This is significant, as it would preserve IRC §1014, ensuring that assets still receive a step-up in basis at death. Given the brevity of this proposed bill, it's reasonable to presume that this preservation of §1014 is inadvertent.

PERMANENTLY REPEAL THE ESTATE TAX ACT OF 2017 (H.R.451)

This proposed bill is similar to the previous set, but it only repeals Chapter 11 of the Internal Revenue Code. For those of us who don't have our IRC chapters memorized, Chapter 11 is strictly limited to the estate tax. This bill doesn't repeal Chapters 12-15, which create, respectively, the gift and GST taxes. The problem with just repealing Chapter 11 is that all of these chapters are interrelated; for example, Chapter 12, §2503 creates the gift tax annual exclusion and §2505 creates the concept of the lifetime gift tax exemption. But the amount of lifetime gift tax exemption is determined by referring back to the "applicable credit amount in effect under 2010(c)." And under this bill, because it's found in Chapter 11, §2010(c) no longer exists. Since it only repeals Chapter 11, this bill would leave the basis step-up of §1014 in place.



DEATH TAX REPEAL ACT OF 2017 (H.R.631 AND S.205)

The only estate tax repeal bill with a Democrat co-sponsor in the House version, this proposed bill amends the IRC to:

- Repeal estate and GST taxes and
- Make permanent the maximum 35 percent gift tax rate and the lifetime gift tax exemption

The bill would provide for an inflation adjustment to such exemption amount. This renders Chapter 11 (estate tax) inapplicable to decedents who die after enactment of the bill. It also repeals Chapter 13 (GST tax). The gift tax rate is set at 35 percent with a \$5 million exemption that has an inflation adjustment. It doesn't mention, or appear to impact, §1014, which means that basis step-up at death remains untouched.

FLAT TAX ACT (H.R.1040)

Proposed in February, this bill would repeal Subchapter A of Title 1 – the income tax code – in favor of creating a flat tax. It would also repeal Subchapter B, which concerns estate, gift and GST taxes. Since §1014 is part of Subchapter A, it would also be repealed. Presumably, a carry-over basis would apply to the asset, but it only appears to apply to earned income and not capital gains — so perhaps there wouldn't be any taxes due on transferring assets (regardless of whether it's during life or at death).

PROTECT FAMILY FARMS AND BUSINESSES ACT (S.47 AND H.R.308)

These sister bills would prohibit proposed IRS Treasury Regulations under IRC §2704. These regulations are designed to restrict liquidation of an interest in a closely held business. The bill would prohibit funds from being used to finalize, implement, administer or enforce the proposed regulations or any substantially similar regulations.

WHAT IT ALL MEANS

If the estate tax is repealed and the income tax is left as-is, there will be additional inadvertent applications to the transfer of assets at death. Specifically, individuals living in community property states, transferring joint property or leaving assets to a marital trust will all lose the step-up in basis for those assets. This is because obtaining a basis step-up requires that the asset be included in the decedent's taxable estate. The assets listed above wouldn't receive such inclusion.

As with so many things in life, making a statement is so much simpler than actually putting that statement into action. And it turns out that tax reform is no different. The few bills that have been introduced since the start of 2017 illustrate that there are many ways to achieve a desired outcome — but without a clear understanding of the process and agreement on the end goal, it can be very hard to get what you want.

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