Northwest Bank
& Trust Company
Investment Management Group

Attorney/CPA Corner
Estate Planning Update

March/April 2019

Greetings

Northwest Bank's Investment Management Group would like to help you stay informed on the issues shaping your clients' financial and estate planning needs.

If we can be of any assistance please contact one of our estate and financial planning professionals. We look forward to working with you.

Federal transfer taxes remain inconsequential

In March the Congressional Joint Committee on Taxation released a summary of the current state of federal taxation. The sources of federal revenue were identified and ranked. As has been true for many years, the federal estate, gift, and generation-skipping transfer taxes were bringing up the rear. The report included appendices that put revenue sources into historical context.

The income tax has long been the primary driver, at 45% to 50% of total collections over the years. Social insurance taxes come next, at 30% to 35%. The share of each of these has been fairly consistent despite the many tax law changes that have occurred over the years. Corporate tax collections have been more volatile, as they are more sensitive to the economy generally. In 2006, for example, corporations paid 14.7% of total federal taxes. This fell by roughly a third, to 9.0% by 2017, the year before the reforms of the Tax Cuts and Jobs Act of 2017. The estimate for 2018 is 6.2%—the same as it was in 1983.

Federal estate and gift taxes provide a scant 0.7% of total federal revenue. Their share was over 2% in 1971-1973, and it has hovered near 1% since 1990. The relative insignificance of estate and gift taxes will likely worsen, as this report covers periods before the doubling of the amount exempt from such taxes.

Shares are one thing; dollars are another. Some $22.9 billion in federal estate and gift taxes was estimated to have been collected in 2018. That sounds like a lot. But to put it into perspective, the federal excise tax on gasoline raised $22.5 billion that year; the excise tax on tobacco brought in $13.0 billion; and the excise tax on alcohol was worth $10.6 billion.

Conservation easements investigated

A bipartisan investigation of conservation easements is under way in the Senate Finance Committee, with letters having been sent to 14 people asking for testimony. The concern is that the deduction for a contribution of a conservation easement has been abused when partnerships use high appraisals to inflate deductions. Senator Ron Wyden (D-Ore.) said that the Committee wants "to ensure a few bad actors don't threaten the program by selling off deductions based on exorbitant appraisals." Committee Chair Chuck Grassley (R-Iowa) is concerned "when a handful of individuals cook up a scheme to cash in at the expense of federal revenue and in violation of Congress's intent."

Several groups that are active promoting conservation easements, including the Land Trust Alliance and Partnership for Conservation, came out in support of the investigation.

Stretch IRAs under fire

Bipartisan bills are working their way through the House and Senate, intended to expand access to tax-preferred retirement accounts. In the House there is the SECURE ACT (Setting Every Community Up for Retirement Enhancement Act, H.R. 1994), and the companion in the Senate is the Retirement Enhancement and Savings Act of 2019 (S. 972). Each bill targets stretch IRAs to find offsetting revenue for the new taxpayer incentives. The acceptable beneficiaries for stretch IRAs would be limited, and distribution of the inherited IRA would be required within ten years in the House bill and five years in the Senate bill.

Wealth tax alternative

The ranking Democratic member of the Senate Finance Committee, Senator Wyden of Oregon, has a new idea for wringing more tax dollars from the wealthy. He proposes that investments be marked to market annually, and ordinary income tax rates be applied to the unrealized gains. Reportedly, Wyden is preparing a white paper on the strategy. A similar proposal was scored by the Joint Committee on Taxation in 2016 as raising $16.5 billion over ten years.

SALT guidance

The IRS will apply the tax benefit rule to taxpayers who receive state tax refunds and who exceeded the $10,000 cap on deductions for such taxes, according to Revenue Ruling 2019-11 (2019-17 IRB 1). Four examples are included. The holding is: "If a taxpayer received a tax benefit from deducting state or local taxes in a prior taxable year and the taxpayer recovers all or a portion of those taxes in the current taxable year, the taxpayer must include in gross income the lesser of (1) the difference between the taxpayer's total itemized deductions taken in the prior year and the amount of itemized deductions the taxpayer would have taken in the prior year had the taxpayer paid the proper amount of state and local tax or (2) the difference between the taxpayer's itemized deductions taken in the prior year and the standard deduction amount for the prior year, if the taxpayer was not precluded from taking the standard deduction in the prior year."

Essentially, if the refund already has been taxed because of the deduction limitation, it won't be taxed again.

Estate tax boost proposed

If her proposal for an annual wealth tax fails to gain traction, Senator Elizabeth Warren (D-Mass.) has an alternative to consider, a draconian increase in the federal estate and gift tax. Her bill, the American Housing and Economic Mobility Act of 2019 (S. 787), would:

- nearly double transfer tax rates, with a 55% basic tax rate, 60% for estates larger than $13 million, 65% for those over $93 million, and 75% for those above $1 billion;
- slash the basic exclusion from transfer taxes by two-thirds, to $3.5 million;
- cut the gift tax annual exclusion by 33%, to $10,000, and limit donors to two such exclusions per year;
- mandate a minimum 10-year term for grantor annuity trusts;
- kill the exemption from the generation-skipping transfer tax for certain trusts; and
- amend the grantor trust rules.

The bill has not yet been scored by the Joint Committee on Taxation.