Are there no creative thinkers in Congress?

How about some *real* reform of the Estate Tax? (On the lighter side)

By Dan W. Holbrook

Federal estate tax reform is inevitable, and imminent.[1] Unless changed, the exemption will jump to $3.5 million in 2009, to infinity for 12 months in 2010, and back to $1 million in 2011 and after. Wildly careening death taxes not only preclude proper planning but invite abnormal timing of wealth transfers and even of death itself, voluntary or involuntary. This legislative train wreck cannot, must not happen. The U.S. Senate failed in June to reach cloture for a vote on repeal, so repeal is dead, and now we wait for compromise on reform.

Most of the discussion has focused on how high the exemption, and how low the rate. Are there no creative thinkers in Congress? Well, yes there are. The exciting news as this is being written is that the House of Representatives has just passed H.R. 5638, the Permanent Estate Tax Relief Act of 2006 (PETRA). Now it goes to the Senate, whose notorious reluctance to deal with estate taxation still leaves things uncertain. Still, PETRA includes two excellent proposals: reunification and a portable credit.

First, PETRA "reunifies" the gift and estate taxes, so that the lower $1 million lifetime gift tax exemption disappears, and only one exemption per person applies cumulatively for both gift and estate taxes. The proposed exemption is $5 million per person, indexed for inflation, which can therefore cover $10 million per couple.

Second, and far more creatively, PETRA allows any exemption unused at the death of the first spouse to be added to the surviving spouse's exemption. Spouses will be able to leave everything to each other at the first death, with the survivor having the full $10 million exemption to shelter against the tax.[2] This concept is known as a "portable credit," since the "exemption" is actually applied by taking a credit directly against the tax.

Unfortunately, portability under PETRA is flawed in one important respect. One might think that Congress would limit the amount of credit that could be transferred to the surviving spouse to the actual amount transferred by the first spouse to the survivor. Not so — the surviving spouse can tack on the entire $5 million exemption of his or her predeceased spouse that wasn't used to make transfers to non-spouses, in most cases effectively doubling the survivor's own $5 million exemption. Thus PETRA creates a huge incentive for a wealthy single person left with less than $10 million of exemption to find and marry a poor but terminally ill person. Or maybe it can work the other way? "Terminally ill poor man with intact exemption seeks rich woman ..."

Thus we should applaud Congress for forward thinking but should consider the social consequences as well. In that spirit, permit me to suggest some less modest proposals, *tongue firmly planted in cheek*.

1. Freely marketable credit. Why limit portability of the unused credit to transfers between spouses, and only at death? Why shouldn't our estate tax "applicable credit amount" belong to us, to be used whenever we wish? Sure, most of us hope that we will need them at our death, but for those who despair or don't care, why not let us sell our credits right now on the open market? As argued above, PETRA has already opened the door to this with the portable credit. The Donald Trumps of this country are surely willing to pay cash now for credits against their tax later. Big business has been buying and selling certain income tax credits for decades, so ample precedent exists. Supply and demand in the open market would establish fair prices. This could generate a massive redistribution of wealth, with the genuinely poor earning far more selling part of their credit than their blood. The enormous marketplace would require a National Credit Exchange to track taxpayers'

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information. The IRS could charge a percentage on each purchase, thus getting a portion of the estate tax earlier, improving its cash flow, and building a much better database on its taxpayers.

2. Unlimited deduction for one non-spouse. Current law permits unlimited tax-free transfers between spouses during life or at death. The unlimited marital deduction assumes that the decedent really wants to provide for and protect his most loved one at the cost of deferring the tax to the loved one's later death. In this age of domestic partners and gay marriages, why should Congress deny tax deferral to non-married partners? Australia, before it repealed its estate tax, had a marital deduction for "putative spouses," defined as live-in lovers for at least 5 years, with no minimum number of years if a child resulted from the union. But why require such picky definitions of who's a "spouse equivalent" and who's not? Why not let any decedent leave any amount tax-free to one "loved one," so long as those assets are certain to be subject to inclusion in the estate of the loved one at their later death?[3] For example, that special person might be a loving child who cared for aging, cranky Mom when all the others were "too busy." Or it could be a high school sweetheart, or the president of the United States, or the attorney who thought up this idea. And why limit it to humans? The Uniform Trust Code (adopted in Tennessee) permits trusts for animals, and surely there are many folks who consider their pet their greatest "loved one."

3. Negative estate tax. Why should only the rich get the full benefit of a $2 million estate tax exemption (or whatever other amount Congress finally agrees upon)? In 1962, Nobel prize winner Milton Friedman suggested a Negative Income Tax, whereby each taxpayer each year would in effect receive money from the government equal to the income tax rate multiplied by the amount by which their income fell below a certain level. With a Negative Estate Tax, to the extent that a decedent's taxable estate was less than the federal exemption, the government could apply the estate tax rates to the difference, producing a negative tax, paid to the estate. This would guarantee every generation a reasonable inheritance from the prior generation, perhaps solving the Social Security crisis.

4. Fresh start. There is an inherent conflict between the Treasury Department (that wants you to die and pay an estate tax) and the Department of Health and Human Services (that promotes health and longevity and therefore indefinite deferral of the estate tax). There is an easy way to resolve the conflict: upon reaching his life expectancy at birth, every taxpayer could be given a one-time option to pay estate taxes at that time, as a "deemed death." All future increases to the taxpayer's estate would then receive a "fresh start," with all new credits, deductions and exemptions, or possibly even tax-free thereafter. Imagine how much more productive baby boomers could remain in their declining years if they had such strong financial incentives to continue increasing their estates rather than merely spending their children's inheritance. Moreover, this would provide an early collection of taxes for the government, and in case of audit, the government would have a live "decedent."

"Terminally ill poor man with intact exemption seeks rich woman ... "

5. Cryogenic Deduction. *The Wall Street Journal* reports that some 1,000 people have made arrangements to be frozen in liquid nitrogen immediately upon death, with the hope and expectation that they will be brought back to life when technology permits. But what would you live on if you came back and all your great-great-grandchildren had predeceased you? Not to worry — most of these hopefuls are creating "Personal Revival Trusts" with themselves as sole beneficiary, sited in states that have abolished the Rule Against Perpetuities. Thanks to the miracle of compound interest, a million dollars set aside now might be worth a cool trillion dollars after 200 years or so. Two maxims of estate tax that may apply here are (1) the estate tax is not a tax on property but rather a tax on the privilege of making a *transfer* of property (hmm, where's the *transfer* here?), and (2) you can't make a gift to yourself (picture the Monty Python character: "I'm not dead yet!"). Thus perhaps there should be no estate tax on a Personal Revival Trust. Congress could create a Cryogenic Deduction for transfers to such a trust, deferring estate tax until the "second death" of the decedent, if any, or whenever the body is thawed unsuccessfully, or when the trust is paid out to anyone else. This might just be the ultimate "estate freeze."

Notes

1. By the time of this column's publication, estate tax reform may already exist, but the suggestions herein are no less relevant to any future consideration of what the law ought to be.

2. Previously, unless the first spouse to die created a trust for the benefit of his spouse and/or descendants to utilize his exemption, that exemption was generally completely wasted, potentially costing extra taxes at the death of the second spouse equal to about 50 percent of the unused exemption of the first spouse. "Use it or lose it" is a poor governing principle for spousal estate planning. A portable credit is great news indeed, since the need to create a trust at the death of the first spouse has been the

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BUT SERIOUSLY!

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products liability suit! Able to leap tall courthouses with a single bound! I'm fighting a never-ending battle for truth, justice, contingency fees, and billable hours!

"Look! Up at the counsel table! It's a bird! It's a plane! No, it's Mr. William H. Haltom Jr., of Memphis, Tennessee, SUPER LAWYER! Didn't I read about him in the bidness section of this morning's *Banana Appeal*?"

I have even decided I am going to trade in my seersucker suit for a blue skin-tight jersey emblazoned with the letter "S", a red cape, and matching leotards. Move over Matlock!! Make way for the Lawyer of Steel!!

I just need a place to change my clothes. Anybody seen a phone booth around here? ⚖

... A WILL

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single greatest economic dislocation imposed on many of our clients by the current estate tax system. Moreover, such planning requires that spouses divide their assets between them in order to be sure that there are assets available to fund the trust when one spouse dies. Many is the surviving spouse who has hated having to put up with some trustee whom she feels is too controlling over what are really her own assets.

3. The unlimited non-spouse deduction would need to be "one-time only" to prevent passing through multiple estates or multiple generations tax-free. Thus it would probably require a trust. A model might be the Qualified Domestic Trust (QDOT) used to qualify for marital deduction for non-citizen spouses. It would also be necessary for the decedent to designate the "loved one" to whom the deduction is to apply, rather than leaving it up to the Personal Representative of the estate to pick and choose among the various beneficiaries.

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