

Estate Planning Briefs

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JCT Overview of Taxation of Wealth and High Incomes

Given the deliberations in Congress over how to boost tax revenue from the top 1% of Americans, the bipartisan Joint Committee on Taxation has issued a detailed summary of the current tax system for wealth and high incomes. The report includes many interesting observations, as in the table below.

Income Group (Percentile)	Amount (\$ Billions)	Share (Percent)	Average Rate of All Federal Taxes (Percent)
Bottom 50	4,252	20.7	6.2
50 – 90	8,889	43.4	14.1
90 – 95	2,106	10.3	17.6
95 – 99	2,709	13.2	18.6
99 – 99.5	617	3.0	22.6
99.5 – 99.9	874	4.3	26.0
99.9 – 99.9	610	3.0	30.8
Top 0.01	447	2.2	32.9

The progressivity of the current tax system is clear from this data, though it may not be as progressive as some might wish.

The income group of \$1 million and up pays 63.3% of total federal estate taxes collected, over \$12 billion in 2016, according to the report. While the top 1% have 12.5% of the national income, they own 30.8% of national wealth. Some very wealthy people live on relatively low incomes.

– JCX 24-21

COMMENT: Professor Jeffrey Pennell offered a novel approach to wealth taxation in a recent Tax Notes article [<https://www.taxnotes.com/tax-notes-today-federal/individual-income-taxation/alternative-wealth-tax-taxing-extraordinary-income/2021/05/26/59nmg>, behind a paywall]. The current gift tax regime relies upon past gift tax returns to determine cumulative lifetime gifts, which determines when one crosses the threshold of the unified transfer tax credit. Professor



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Pennell suggests a similar approach to ultra-high incomes, to be taxed cumulatively instead of annually on a progressive rate schedule.

In his a simplified example, this tax might kick in at \$10 million of income. In a taxpayer's first \$10 million year, there would be no high-income surtax, which would protect from its application those who have one-time gains such as from sale of a business. In the second \$10 million year, a 1% surtax would result in a \$100,000 addition to regular income tax. A later \$15 million year would be added to the cumulative \$20 million, entering a 1.5% rate bracket, and so on.

This approach avoids the necessity of annually valuing illiquid assets, which is what makes administering a wealth tax, such as advocated by Senator Elizabeth Warren, so difficult.

“For the 99.5% Act”

Senator Bernie Sanders’ proposed legislation would cut the federal estate tax exemption from the current \$11.7 million to \$3.5 million, effective January 1, 2022. The federal gift tax exemption would be slashed to \$1 million on the same date. Tax rates would begin at 45% above the exemption amount, and then rise steadily, reaching 65% for estates larger than \$1 billion. A wide range of legal estate planning strategies would be effectively outlawed as of the date of enactment of the legislation. Thus, we may have a rerun of “use it or lose it” planning arguments.

The proposal may not be as radical as it first appears. Many elements were actually first proposed during the Obama administration, and so enjoy considerable support from Democrats. Also, the estate tax exemption already will be cut roughly in half under current law in 2026.

— <https://www.sanders.senate.gov/press-releases/sanders-and-colleagues-introduce-legislation-to-end-rigged-tax-code-as-inequality-increases/>

“The American Families Plan”

On the other hand, President Biden has not indicated any support for modifying transfer taxes this year. Instead, his proposed “American Families Plan” included the recommendation that stepped-up basis at death be eliminated. The administration later clarified that \$1 million worth of basis step-up would still be allowed to excuse smaller estates from the new rule.

How would eliminating basis step-up be accomplished? This is not yet clear. One approach could be to use carryover basis, as is done already for the gift tax. However, carryover basis for inherited assets was tried in the 1970s and later abandoned as too difficult to administer. Another tack could be to treat death as a realization event, imposing a capital gains tax on all unrealized gains.

— <https://www.whitehouse.gov/briefing-room/statements-releases/2021/04/28/fact-sheet-the-american-families-plan/>

COMMENT: Should all of these proposals be enacted, it has been pointed out that death taxes could reach or exceed 100%, unless deductions were allowed for taxes paid.

Pushback on Estate Tax Hikes

On the third hand, there is support among some in Congress to reduce or eliminate the federal estate tax.

Senators Tom Cotton (R-Ark.), John Boozman (R-Ark.), and Joni Ernst (R-Iowa) introduced the Estate Tax Reduction Act, which would lower the estate tax rate to 20%. The legislation was also supported by Representatives Jodey Arrington (R-Texas) and Henry Cuellar (D-Texas) in the House of Representatives. The current tax rate is so high that only 30% of family-owned businesses make it to the second generation, and just 12% survive to a third generation.

House Ways and Means Committee member Jason Smith, (R-Mo.), introduced H.R. 1712, the Death Tax Repeal Act. It would eliminate the federal estate and generation-skipping transfer tax as of the date of enactment.

Extension Granted for QDOT Notification

When Decedent died his surviving Spouse was not a U.S. citizen. To secure the marital deduction, assets were placed into a Qualifying Domestic Trust for Spouse. The trustees were two individuals, Son and U.S. Trustee. Son later died. The trust instrument provided for a bank as successor trustee if either of the individuals died, and U.S. Trustee wrongly assumed that the bank had taken over trust administration. It had not accepted the appointment.

After this date, Spouse became a U.S. citizen. The IRS should have been notified of this development by tax filing time of the following year. U.S. Trustee did not know that, and was under the impression that the bank had taken over the tax filings.

Now Spouse has died, and U.S. Trustee has asked for an extension of time for reporting Spouse's citizenship change. In private advice, the IRS grants another 120 days to do so.

— *Private Letter Ruling 20210004*

The \$10.8 Billion Inheritance Tax

The heirs of the chairman of Korea's Samsung group have agreed to pay an inheritance tax of \$10.8 billion on his fortune. The obligation will be paid in six installments. The estate will also donate some 23,000 works of art by western and Korean artists to a national organization for preservation. South Korea's top inheritance tax rate is 50%, second only to Japan's 55%.

This inheritance tax liability is three to four times higher than the entire amount of death taxes collected by the South Korean government in 2020.

— <https://www.cnbc.com/2021/04/28/samsung-inheritance-lee-family-to-pay-over-10-billion-inheritance-tax.html>

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