

A little history of estate taxes...

Estate tax was first imposed by Congress in 1916 in an effort to find the funding for our involvement in World War I. The manner of taxation went largely unchanged from the Woodrow Wilson years of Presidency until the time of Ronald Reagan. Here is an example of how taxes worked:

Mr. & Mrs. Johansson immigrated in 1946 buying a farm in Iowa. Through hard work the farm grew in value. Mr. Johansson died in a farming accident in 1978.

In stepped the IRS and valued the farm at \$1,000,000. The Johansson's originally paid only \$3,000 but had made improvements totaling approximately \$40,000 over the last 32 years bringing their total cost basis to \$43,000. Mrs. Johansson was entitled to what was then termed a *marital exemption*, which allowed her to inherit \$250,000 of the property outright.

Here is how the taxes would be calculated: You would start with the value of \$1,000,000 subtract the \$250,000 marital exemption and the \$43,000 cost basis. Thus, the new adjusted book value was \$707,000. Taxes were 26% on the first \$300,000 and 32% on everything above that figure. The result, within only nine months of her husband's death \$208,240 was **due in cash!**

Needless to say, Mrs. Johansson did not exactly have that sitting around. The farming industry is one in which your value is in the land and any profits are quickly invested back into more equipment, seed, feed, etc. Her only option to raise the cash due was to **sell the farm**. This is exactly where the expression comes from.

In 1980, President Reagan changed the estate tax. His changes allowed all of the deceased spouse's property would pass to the surviving spouse untaxed without limit. This is called the **interspousal transfer**. However, when the surviving spouse passed on leaving her assets to their children, there would be a \$300,000 exemption with everything beyond that being taxed progressively starting at 55%. Let's assume a woman dies with a \$600,000 estate. Her children would have paid \$165,000 equal to 55% on the 2nd \$300,000 because the 1st \$300,000 was exempt.

Over the years the exemption has been raised to \$1,000,000. It is scheduled to progress to \$3,000,000 with estate tax projected to be totally repealed in 2010. There is a sunset provision in the law that reads this law must be revisited before permanent repeal is established in 2010. However, repeal will never happen for two reasons:

1. When this concept was proposed by Bush there was a 3 trillion dollar government surplus that has since evaporated.
2. As with all tax reducing strategies, there is an associated cost elsewhere, especially when there will be lost revenue to make up for.

Well, the money necessary to “fund” this bill so to speak would be money that would have to come from the coffers of Medicare and Social Security. Quite frankly, no politician in this country wants to pick up the sword and lead the fight in a matter aiding the rich at the expense of the average. Especially, when all of the “average” is of voting age and do vote.

The truth is that permanent repeal would affect very few estates; yet the number of Senior Citizens affected would be significant. When I compute the number of Seniors on Medicare and Social Security who would see reduced benefits versus the number of estates affected, it is a 5000:1 ratio.

The sunset provision states, “If estate tax in 2010 is not declared to be permanent than it will recede back to the 2004 level.” (The exemption would drop back from \$3,000,000 to \$1,000,000.)

Many people think they live in a state without inheritance tax because they have never paid it at the state level. However, they are wrong!

The Federal Government has always taken inheritance money and then passed a share of it onto the state unbeknownst to most people. The Federal Government has said they want to repeal the Federal estate tax by 2010, but have told the states the passed on shares will phase out in 2005. Many states want that revenue. Again, unbeknownst to many people, the states have now added their own inheritance tax or “sop-up tax” as they are termed. This assures the states do not lose the revenue they were formerly receiving.

Now, we need to deal with the exemptions. There are essentially four classes of beneficiaries: **A, C, D & E**. (Why there is no B is a mystery!) Here is how they work:

Class A: Consanguineal kin (pronounced con-sang-gwin-ee-ul) from Latin for *blood line*. This is father, mother, grandparents, husband, wife, child; children of decedent, legally adopted children or a mutually acknowledged stepchild are **TOTALLY EXEPT**.

Class C: Brother or sister of a decedent, wife or widow of a son of decedent, husband or widower of a daughter of decedent have a \$25,000 exemption. They are taxed 11% on the next \$1,075,000 and 16% for any amount over \$1,700,000.

Class D: Every other transferee, distribute or beneficiary. These are nieces, nephews, cousins, best friends, life partners, etc. Their exemption is \$500. They are taxed 15% on the first \$500,000 and 16% over \$700,000.

Class E: Transfers to charities. Everything is exempt.

