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Estate Tax Reform Options

The federal estate tax needs to be changed, that much everyone agrees upon.

Today the federal estate tax exemption is \$3.5 million, which means that with some careful planning married couples can shelter \$7 million from taxation over two deaths. President Obama has proposed freezing those rules, as it would keep this tax targeted to the most affluent Americans.

If Congress does nothing, current law calls for the complete elimination of the federal estate tax for 2010 only. Then in 2011 the tax comes back with only a \$1 million exemption. This “nightmare scenario” has been in place since 2001, and many observers expected it to be corrected before now.

In August the nonpartisan Congressional Budget Office presented a comprehensive review of tax and spending choices to the Congressional Budget Committees. The 284-page document included an analysis of four alternatives for restoring certainty to the federal estate tax. The “cost” of each of the alternatives, in terms of projected revenue loss, was estimated based upon a comparison to current law.

Alternative 1 boosts the exempt amount to \$5 million, adds inflation indexing, and drops the deduction for state death taxes (and does not restore the state death tax credit). In 2014, under this scenario, only 5,300 estates would be required to pay federal estate tax, compared to 58,000 under current law. The tax rate would be set equal to the top rate on capital gains, 15% through 2010 and then 20%. This approach reduces revenues by just \$128 billion over the next five years.

Alternative 2 is exactly the same, but with higher tax rates. Only the first \$25 million would be taxed at the capital gain tax rate, everything over that at 30%. That shaves the revenue cost to \$117 billion.

Alternative 3 is similar to the President’s proposal, outlined in the budget. The exemption would be left at \$3.5 million, indexed for inflation, the deduction for state death taxes would be retained, and the tax rate set at 45%. With this approach the number of taxable estates in 2014 increases by more than 50%, to 9,400, and the revenue reduction falls to \$65 billion.

Continued on back page

	Exemption	Top Tax Rate	Carryover Basis?	Taxable Estates (in 2014)	Five-year Revenue Cost
Alternative 1	\$5 million	20%	No	5,300	\$128 billion
Alternative 2	\$5 million	30%	No	5,300	\$117 billion
Alternative 3	\$3.5 million	45%	No	9,400	\$65 billion
Alternative 4	No estate tax	N/A	Yes	None	\$163 billion

Source: Congressional Budget Office, Budget Options Volume 2, August 2009

Alternative 4, probably the least likely to be adopted, would make the changes for 2010 permanent. That is, repeal the federal estate tax, keep the federal gift tax with a \$1 million exemption, and implement carryover basis for inherited assets. This approach costs \$163 billion over five years.

So what will Congress do? The leading solution, according to The Wall Street Journal, is a one-year patch, as is done with the AMT, extending the 2009 rules only into 2010. Given the politics of health care, there may not be time for deliberation on permanent estate tax reform. At least one commentator has suggested that a revenue-hungry Congress might then let the exempt amount fall back to \$1 million in 2011.



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Our team of 55 Professionals have an average of over 12 years with Security National Bank and over 800 years of combined banking and finance experience.

Marilyn Hagberg *Vice-President and Trust Officer*



Education

J.D., University of South Dakota School of Law, M.A. Russian History, Ohio State University; B.A. Morningside College; Graduate, National Trust School & National Graduate Trust School.

Member

Siouxland Estate Planning Council, Iowa State Bar Association, Nebraska State Bar Association, The State Bar of South Dakota.

Experience

1 1/2 years in Retail Banking prior to joining the Wealth Management Division; 20 years in Estate, Tax and Trust and Pension Services.

Activities

Active on the boards of Jackson Recovery Centers, the Sioux City Symphony Orchestra, and Downtown Rotary. De-stresses with bicycling, yoga and sudoku.



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