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The House passed legislation that would permanently extend this year's estate tax rates and exemptions, but the Senate may not act on the bill before Jan. 1.

If an estate tax bill isn't enacted by then, the federal tax on inherited assets would go away in 2010. The tax, however, would be scheduled to return in 2011 at much higher rates and lower exemptions.

Everyone agrees that doesn't make sense, but that's the situation Congress created in 2001, when it passed a 10-year tax bill that gradually phased out the estate tax. At the time, supporters of estate tax repeal hoped they could win permanent repeal before the tax returned at 2001 levels in 2011.

Now, as 2009 draws to a close, permanent repeal is off the table. And with the Senate stuck on health care reform, it's not clear whether that chamber will address the estate tax's future before the end of the year.

"I don't know how they solve it," said Clint Stretch, managing principal, tax policy, for Deloitte Tax LLP in Washington, D.C. "My guess is that they do."

If they don't, "we're in a bit of a touchy situation," said Will Fuller, senior estate planner and director with the law firm Howard Rice Nemerovski Canady Falk & Rabkin in San Francisco.

#### Small biz wants high exemption

The House voted 225-200 Dec. 3 to make the current estate tax rate of 45 percent permanent and exempt \$3.5 million of assets from the tax. No Republicans voted for the bill.

"Death should not be a taxable event," said Rep. Sam Graves, R-Mo., the ranking Republican on the House Small Business Committee.

Drew Greenblatt, president of [Marlin Steel Wire Products](#) in Baltimore, said his family shouldn't have to pay a 45 percent tax on his assets when he dies because his income already is taxed at an 35 percent annual rate. The estate tax forces him to spend thousands of dollars a year on insurance policies, he said, money that could be used to hire additional workers.

"We make an insurance company rich because I don't want to give my wife a \$2 million tax bill the day I die," Greenblatt said.

Many groups representing family-owned businesses agree the estate tax is unfair and should be repealed, but they're willing to settle for permanent estate tax legislation that would reduce the tax rate to 35 percent and raise the exemption to \$5 million.

Plus, they want the exemption to be adjusted for inflation. Otherwise, more Americans would be subject to the tax every year. Bill Rys, tax counsel for the National Federation of Independent Business, said the estate tax exemption needs to be high enough so that it's not an issue for small businesses.

"It shouldn't be something that small business owners have to stay up at night and worry about," Rys said.

Nearly all small business owners, however, already are exempt from the estate tax, according to the Center for Budget and Policy Priorities. It points to a study by Urban Institute-Brookings Institution Tax Policy Center that found that only 100 small businesses and farm estates would owe any estate tax next year if the 2009 exemption is continued.

Tax lapse would be messy

Allowing the estate tax to lapse Jan. 1 would create its own set of problems, especially if Congress reinstated it later in the year.

For one thing, it's not clear if Congress could apply the tax retroactively to the estates of people who died during a period when death wasn't a taxable event. Any attempt to do so likely would be challenged in court.

Stretch said a temporary lull in the estate tax also could have "a perverse impact" in situations where a wealthy individual is receiving extraordinary life-prolonging medical care. Family members could make their decisions on when to pull the plug based on estate tax reasons.

"It's a very morbid prospect," Fuller said.

Also, estate tax repeal isn't attractive as it seems, because the 2001 law coupled repeal with a change in how capital gains are calculated for heirs. So-called

"carryover basis" tax rules would be enacted. That means heirs would have to pay capital gains taxes on inherited assets based on the price that their dead benefactor paid for them, instead of the assets' value at the time of the decedents' death. That would expose heirs to much higher capital gains taxes and force them to try to figure out what an asset was worth decades ago.

Because of this change, "many, many small businesses" would be better off with an estate tax at 2009 levels than they would be under repeal, said Paula Calimafde, a Bethesda, Md., attorney who chairs the Small Business Council of America.

<http://www.bizjournals.com/extraedge/washingtonbureau/archive/2009/12/14/bureau1.html>

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