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Does a Repeal of the Death Tax Mean No Tax at Death?

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Donald Trump’s election has raised the question of whether the federal estate tax will be repealed and has spawned information—some of it misguided—about the Trump agenda for estate (and gift) taxes. This update provides our preliminary thoughts on how the federal estate and gift tax system might change. These thoughts can be broadly categorized under two themes: (1) Be Careful What You Wish For; and (2) Winning is Easy…Governing is Harder.

Our ultimate message: Do not stop planning based on the assumption that the estate tax is going away forever, and continue to use trusts because of the long-term wealth preservation benefits they provide.

Be Careful What You Wish For

Both clients and wealth professionals have asked what happens when the estate tax and gift tax are repealed. As of the date this piece is published, the Trump website contains only one sentence on the topic: "The Trump plan will repeal the death tax." The website doesn’t mention the gift tax. And it doesn’t appear that the end of the estate tax would mean no tax at death. Instead, the Trump tax proposal appears to include a different tax at death, an income tax. The Trump platform refers to a “deemed sale at death” capital gains tax.

A “deemed sale at death” tax could be an actual tax event at death, or a carry-over tax basis regime. If it’s the former, then we could face a Canadian-style system with capital gains tax at death. Estates would incur tax on unrealized gains in appreciated assets, with an exemption for the first $5 million per person. Presumably there also would be exclusions from the tax for marital and charitable transfers, and the gain covered by the $5 million exemption would be credited as a basis step-up.

It’s difficult to know from the website what the Trump administration will actually propose. Even if the intent is to have only carry-over basis on appreciated gains at death, there still would be a tax impact. That’s because under the current tax regime, unrealized capital gains go away at death. Clearly, then, under the Trump proposal as currently understood, passing to the great beyond would not be a truly tax-free event.

In some ways, a system that taxes capital gains at death is more difficult to administer than an estate tax regime. People would still need to value and report all assets at death, and would face the prospect of disputing values with the IRS. There also would be the need to calculate tax basis and argue with authorities over that number. Tax basis is frequently hard to determine, especially for estates with real estate, valuable collectibles, business interests, and even marketable securities that have been owned for many years. Administratively, the current estate tax and basis step-up system is simpler, and the Trump administration might better achieve its goals by reducing the estate tax rate to 20 percent—equal to the most prevalent capital gains tax rate.

Winning is Easy…Governing is Harder

Of course, it isn't the White House alone that is responsible for decision making on tax policy. In fact, tax policy is driven more by Congress. The U.S. Constitution provides that tax legislation originates in the House of Representatives. Unfortunately, there is not much additional guidance we can glean from Congress. The "Better Way" tax reform blueprint plan released by House Republicans earlier this year also calls for repeal of the estate tax but, like the Trump plan, is silent on repeal of the gift tax. There's no clear indication that Congressional Republicans will approve the informal Trump proposal.

Congress and the Trump administration first will need to set priorities, both for general legislation and tax legislation. It goes without saying that every decision will have a budget impact, and will necessitate trade-offs. This reality cannot be ignored in the legislative process, and it isn't clear where estate tax repeal will fall in the priority list. Early indications are that it may take a back seat to corporate tax reform, repeal of the 3.8 percent Medicare surtax, and possibly even personal income tax reform.

In addition, although the Republicans control the House and hold a thin majority in the Senate, proposed tax law changes are not guaranteed to pass. Current Senate rules require 60 votes for passage of tax legislation. Republicans currently have a 52-seat majority. While it is possible to avoid the 60-vote requirement if tax repeal is done through the budget reconciliation process, then the legislation must have a sunset provision, like the legislation that resulted in the 2010 temporary repeal of the estate tax.

Conclusion

At this point in time, repeal of the estate tax is far from guaranteed. The only safe assumption is that if Congress votes to repeal the estate tax, President Trump will likely sign the bill.

Further, even if the estate tax is repealed, high net worth families still will need estate tax planning given the risk that it will come back. We will continue to encourage clients to use trusts. The best long-term planning for any high net worth family is to have a significant amount of property in flexible long-term trusts that are outside any family member's estate. This approach best preserves a family's wealth—whether the estate tax is in effect or not.

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