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# TAX MEMORANDUM

**TO:** **CPAs, Clients & Associates**

**FROM:** **David L. Silverman, Esq.**

**DATE:** **April 8, 2010**

**RE:** **Tax Outlook for 2008**

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## A. Income Tax

Personal income tax rates reached a historic low of 28% under President Reagan in 1988. Pre-EGTRRA rates were increased in 1993 to 39.6%. Under EGTRRA, the highest personal income tax rate was reduced, in increments, to the present 35%, beginning in 2001. Although some EGTRRA provisions will “sunset” in 2009 and 2010, the 35% top income tax bracket will remain effective until changed by Congress. Republican and Democratic candidates seem divided over the issue of whether to raise income tax rates. Senator Clinton favors higher rates for taxpayers earning more than $250,000. Revenues so generated would be used to pay for health care or to offset lost AMT revenues. Governor Romney supports making the Bush tax reductions permanent, and lowering tax rates for all taxpayers. Mr. Giuliani supports income tax reductions.

**B. <u>Capital Gains and Dividends Tax</u>**

TRA 1986 imposed a 28% tax rate on long term capital gains, equal to the (then) highest ordinary income tax rate. When income tax rates were increased in 1993, the capital gains tax rate remained at 28%. Capital gains rates were reduced during the Clinton Administration to 20% under TRA 1997. Under EGTRAA, rates were reduced further, to 15%. Unless Congress passes new legislation, rates will revert to 20% when EGTRRA sunsets in 2009. Senator Clinton has spoken of raising the capital gains tax to 20%. Senators Edwards and Obama would raise the tax to 28%. Although Mayor Giuliani stated that as President he "intends" to lower taxes, his position with respect to capital gains is unclear. Governor Romney favors elimination of the capital gains tax and the dividends tax. Mr. Romney also proposes that interest income not be subject to tax.

**C. <u>Estate Tax</u>**

As clearly as it appeared a few years ago that the estate tax would be eliminated, it now appears that an estate tax imposed on estates worth $5 million — or perhaps even less — will survive the "sunset" of EGTRRA in 2010. The Actuary of the Social Security Administration estimated that maintaining the estate tax at 2009 levels, with a $3.5 million exemption and a 45% top rate, would raise revenue sufficient to offset one-quarter of the Social Security Trust Fund shortfall in over the next 75 years. No democratic candidate favors elimination of the estate tax. Both Mayor Giuliani and Governor Romney support its elimination. Still, there is no reason to believe that a Republican elected in 2008 would fare better than President Bush who, at the zenith of his power — and with a sympathetic Congress — failed to permanently eliminate the estate tax. Some believe that the applicable exclusion amount will remain at $3.5 million after reaching that point on January 1, 2009.

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**D. Gift Tax**

The primary function of the gift tax today is not to collect tax revenues — few advisors would counsel their clients to make gifts resulting in current gift tax liability — but rather to limit the ability of the donor to reduce the size of his eventual taxable estate. Often this is achieved by making lifetime gifts of interests in family entities, or cash. The lifetime gift tax exemption, now $1 million, is not scheduled to change even after EGTRRA sunsets. Since the estate and gift taxes are still partially unified, lifetime gifts (other than annual exclusion gifts) count toward the applicable exclusion amount at death. After 2009, the gift tax rate will reference the individual donor's top income tax rate for the applicable year. For most donors, that rate would now be 35%.

Note: Since taxable gifts exceeding $1 million result in current gift tax liability, leveraging the lifetime exclusion is important. This can be accomplished by gifting interests in discounted family entities. Reporting such gifts triggers the 3-year statute of limitations for audit. On the other hand, if no return is filed, the IRS may challenge the value of the gift at the death. The IRS is less likely to audit a return where a successful audit would yield no tax revenue. Immunizing the transaction from gift tax might be accomplished by reducing the (discounted) gift to an amount that would result in no gift tax even if the allowed discount were reduced after audit. If no audit occurred within 3 years, the remainder of the exclusion amount could then be gifted.

**E. Alternative Minimum Tax**

AMT revenues are expected to generate $1 trillion over the next 10 years. Recent tax cuts under President Bush resulted in the AMT affecting more taxpayers. Unless Congress acts, 23.4 million taxpayers will have AMT liability in 2007. Both Mr. Giuliani and Governor Romney favor elimination of the AMT, although it is unclear how that would be financed. Senator Clinton favors AMT reform "to make sure it doesn't hit middle class families." Ms. Clinton would delegate such reform to Rep. Charles B. Rangel. Short of full repeal, the AMT could be amended to have little or no impact on those with lower incomes. Options for amending the AMT include indexing exemption amounts for inflation. Another option would be for Congress to amend the AMT as to have little or no effect on taxpayers with incomes below a threshold level. Mr. Rangel will introduce in November a bill in the House which eliminates the AMT entirely. A new "replacement tax" would be imposed on the top 10 percent of income earners who would otherwise had AMT liability. In effect, the bill would eliminate the Bush tax reductions for high income taxpayers. Although President Bush would likely veto such legislation if passed by Congress, Mr. Rangel's tax views appear to reflect the consensus of most moderate Democratic presidential candidates.