Newswire Special Report Series: Navigating the New Administration

Corrections have been assessed to yesterday's Special Newswire Report.

With Republicans in control of the Presidency and both Houses of Congress, we expect increased legislative activity this session - including potential movement on comprehensive tax reform, among other items. With so many fast-moving developments that can ultimately impact the life insurance industry, AALU will provide regular policy updates throughout the week to make sure you have the information you need when talking to colleagues and clients during the next few months.

Estate Planning: What Clients are Saying

Some clients may be gambling today’s insurability based on their belief that the estate tax will be repealed and won’t return for the foreseeable future. The AALU cautions strongly against any such decision. As a general rule, the AALU feels that planning should be done on the basis of current law, especially in the context of a highly polarized political environment that makes legislative speculation extraordinarily hazardous. For further information about the estate tax, and why deferring planning may not be the best choice, click the button below.

What to Tell Your Clients About the Estate Tax

Several estate tax critics mention that revenues from the estate tax comprise less than 1% of federal government revenue. Nevertheless, according to the non-partisan Congressional Budget Office, the estate tax is projected to raise $275 billion in revenue for the federal government between 2017-2026. $275 billion over 10 years is more than what the federal government currently spends on:

- Cancer research – $50.1 billion over ten years at last year's appropriation
- Childhood cancer research – approximately $2.1 billion over ten years at last year's appropriation
- The Food & Drug Administration
- NASA – approximately $193 billion over ten years at last year's appropriation
- TSA – approximately $75.5 billion over ten years based on its FY 2015 appropriation

Notably, President Trump (as of this writing) has proposed a trillion-dollar infrastructure plan. Few expect that this dramatic increase in infrastructure spending will be covered by the current Highway Trust Fund (which has been decimated by inflation and travel trends) or by President Trump's desire to provide tax incentives for private investment in infrastructure. In fact, Transportation Secretary designee Elaine Chao asserted during a confirmation hearing that public solutions will need to be a part of any increased infrastructure spending. Whether Congress creates tax inducements, simply spends more funds, or a combination thereof, it is clear that Congress will need to make choices about how to pay for the increased spending. Given the funding challenges, estate tax repeal – at a cost of approximately $275 billion over ten years – makes one of the central public policy goals of the incoming Administration more difficult to realize.

The list of key priorities that receive less funding from the federal government than what estate tax repeal would cost is significant. The list may also pose political and policy problems for those in Congress who support repeal, especially as the debate on estate tax repeal becomes a live exercise. Estate tax repeal supporters will need to defend regressive tax policy, while either running up the debt or not doing as much to enhance the fights against cancer, terrorism, and to keep the United States ahead of China and Russia in space exploration, to name some examples.

Governing is about a series of choices. In the upcoming debates in Washington, some may ask whether repealing the estate tax for an extended period of time is a reasonable choice for a government that's nearly $20 trillion in debt. Also, the $19.3 billion raised by the estate tax in 2014 may seem more significant when compared to the $504 billion deficit projected for FY 2017. Lastly, many feel that repeal of the estate tax will cost more than $275 billion over 10 years in reality, since many taxpayers may choose to hold on to assets with unrealized gains until death.

These are only a few points that clients ought to consider as the discussion amongst policymakers gets underway.

Estate Tax

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What to Tell Your Clients about the Estate Tax

There is much speculation in the press and elsewhere about President-Elect Trump and the next Congress (115th) enacting full federal estate tax repeal. This speculation is largely based on the public statements of President-Elect Trump, as well as long-standing Republican support for estate tax repeal.

Presidential candidates make promises during the campaign, but cannot always deliver:

- In the 2008 campaign, candidate Obama promised to repeal the Bush-era tax cuts for higher income individuals. Yet in 2010, Obama agreed to extend the rates for higher income individuals for another two years.
- Candidate Obama proposed to create a cap-and-trade system to reduce global warming. That bill died in the Senate
- Finally, candidate Obama promised to sign a bill making it easier for workers to unionize. Democrats are generally sympathetic to unions, but a Democrat-controlled Congress did not pass such a measure.

AALU reminds members what is usually the case with tax policy: the situation is far less clear than some of the declarative statements made in the press and on the campaign trail. While these points are also speculative, they are based on, in part, AALU's long standing advocacy efforts working with Members of Congress and their staffs on permanent and sustainable estate tax reform.

While campaigning lends itself to simple sloganeering, governance lends itself to something far different: complex and difficult choices. AALU's belief is that some of the choices – once considered in a policy-making context – will give Republican taxwriters significant pause about pursuing estate tax repeal.

Bottom-line: Anyone betting today's insurability on tomorrow's legislative deal may wish to think twice.

What's Best for the Client

At the heart of this issue is what is best for the client. That is central to AALU's advocacy efforts. In the case of the estate tax, this involves asking the following question: **should clients gamble with their insurability?**

- Even if repealed, the estate tax will come back with a change of control in Congress. As a thought experiment, if the Democrats retake Congress after the 2020 census, then you can anticipate an immediate move to reinstate the estate tax. Given their position on the issue, Democrats are likely to support a lower exemption and higher rate than current law.

	Levin	Sanders	Obama	Clinton	Current Law
Estate tax Exemption	$3.5M ($7 million joint)	$3.5M ($7 million joint)	$3.5M ($7 million joint)	$3.5M ($7 million joint)	$5.45 million ($10.9 million joint)
Top Rate	45%	55%	45%	45% for this $3.5 ($7m joint) 65% (for $500 million per individual or $1 billion per couple)	40%

- Do Republicans have sixty votes for repeal in the Senate? Not likely. If Republicans have fewer than 60 votes, then estate tax repeal will have to be done using a procedure known as reconciliation – which imposes significant political, procedural, and policy challenges and restrictions. Not the least of which will be the sun-setting of repeal after the prescribed budget window (often ten years). So clients could find themselves in a situation with less insurability but the same estate tax liability ten years after repeal.
- There has been a federal estate tax for 99 out of the last 100 years. The first federal tax was a stamp tax required for wills established by Congress in 1797. Between then and 1916, the federal government used other temporary taxes on inherited wealth to fund, largely, war efforts.

Bottom line: if the estate tax is repealed, it will come back. Just a question of when.

Estate Tax Repeal Makes Infrastructure Spending Harder

- If the estate tax is repealed, that would mean less money to fund future infrastructure bills (as desired by President-Elect Trump, who had proposed between $800 billion to $1 trillion in additional infrastructure spending during the campaign). Ideas like offering bonds, levying a one-time repatriation tax, increasing tolls, etc. to pay for infrastructure spending all have their shortcomings.
- If Republicans turned to other ideas to help fund infrastructure spending (e.g. – user pay concepts like raising the gas tax), while repealing the estate tax, President Elect-Trump's blue collar support could evaporate quickly.

Congressional Environment Presents Challenges to Reform

- Republicans have mentioned the importance of bipartisan tax reform, including Ways and Means Committee Chairman Kevin Brady (R-TX) at a life insurance industry conference this Fall.

- The working Democratic position on tax reform is that it should raise $1 trillion, which is incompatible with the House Republican tax reform blueprint that costs approximately $3 trillion over ten years as estimated by the Tax Policy Center.
- So if bipartisan agreement is desirable, is it worth cutting taxes for two out of every 1,000 estates while raising $268 billion in taxes from others to fund this tax cut? That's a question Republican tax policy makers will need to answer.
- Privately many Republicans would prefer not to waste political and policy capital on an issue that largely has been "solved." In fact, some trade groups – who in the past have supported repeal – no longer advocate in favor of repeal because current law has solved the estate tax issue for them.
- Political Spin Cycle: Some Republicans privately tell the AALU that they feel the need to publically support repeal because they feel that Democrats are revisiting the deal struck in 2010 and made permanent in 2012. The most recent spate of rhetoric on the issue from the Republicans occurred in the context of Treasury's proposed 2704 regulations, as well as Hillary Clinton's shift to the left on her estate tax position.

- Message votes. It's easier to vote for legislation that you know will not be enacted, as with the case of H.R. 1105, a bill to repeal the estate tax (which also retained a step-up in basis). House Republican voted for that bill knowing full well that it would be vetoed by President Obama and they didn't have the votes to override said veto. It was an easy vote. Voting for this legislation – given the optics of who benefits and who doesn't – will be much harder given its likely enactment during a Trump Administration.

Public Opinion

- Currently estate tax speculation is confined to those most impacted by it. This will change if the issue is turned into a debate on the Senate floor, etc.
- Many commentators have attributed President-Elect Trump's victory to higher than expected support from working class voters in places like Wisconsin, Ohio, Pennsylvania, and Michigan.
- Repealing the estate tax is very regressive tax policy that benefits the wealthiest .2% of estates in the country. Such a move could be construed as politically 'tone-deaf' given the increasing amount of wealth inequality and drop in income for major parts of the "Trump Coalition." Trump won in places like blue collar, Democratic Northampton County, PA and lost in places like Greenwich, CT. In a remarkable turn-around for a Republican Presidential Candidate, Trump and Clinton essentially split voters earning less than $50,000 annually.

To Step-Up or Not to Step-Up: Is that really the question?

- H.R. 1105 retains the step-up in basis, which is a major windfall for those taxpayers who have accumulated vast wealth in unrecognized assets. Clearly, estate tax repeal with step-up is highly regressive tax policy and falls far short of the stated Republican policy goal of fairness.
- If the Republicans were to repeal the estate tax and replace it with a carry-over basis tax regime, then the tax policy goal of simplicity would be unrealized. Carry-over would create an administrative nightmare for those who inherit appreciated assets. Many decedents die owning hundreds if not thousands of assets. Each asset would have different acquisition dates and cost, often with subsequent events impacting basis. Further, because there's been a step-up since 1916, decedents lack the incentive to keep records. Congress previously enacted carryover basis in 1976, but repealed it retroactively in 1978 due to the excessive burden endured by taxpayers.
- So Republican tax policy makers are presented with a tax policy conundrum if they repeal the estate tax: either explicitly shield the gains of unrealized assets for possibly multiple generations of the very wealthy from taxation, or go to carryover which would be a tax administrative nightmare and tax more Americans via the income tax versus those who currently pay the estate tax.

No one can predict the legislative output of the next Congress. What can be stated is that estate tax repeal presents Republicans with a series of uncomfortable policy choices that may not equal the perceived benefit of repeal, and ultimately end up hurting more taxpayers in the case of an estate tax with a less generous exemption and rate being enacted by a future Congress hungry for revenue.