



SBCA URGES CONGRESS TO BRING CERTAINTY  
TO THE ESTATE TAX SYSTEM  
& SUPPORTS IMMEDIATE REFORM

The Small Business Council of America (SBCA) urges Congress to reform the current estate tax system now. The 2001 Tax Act created a legal landscape that makes it impossible for small business owners and other taxpayers to plan their estates with any predictability. This unpredictability has undermined taxpayer confidence in the estate tax system.

As such, the SBCA urges Congress to consider the following tax reforms:

- keep the exemption amount at \$3.5 million and then increase it gradually over a number of years until it reaches at least \$5 million and thereafter have it increase by COLA;
- maintain the current step-up in basis at death for simplicity;
- rejoin the estate and gift tax systems immediately for simplicity; and
- exempt retirement plan assets from estate tax (not income tax) in an amount up to an additional \$500 thousand which will provide a meaningful incentive for people to save for their retirement.

Under these reforms, a significant number of small business owners will find themselves in a better tax position than if the estate tax were repealed in 2010 as scheduled and far better than they would be in 2011. It is imperative for Congress to act this year to provide certainty for the Nation's small business owners. If the estate tax law is not "fixed" early in 2009, many Americans will be forced to amend their estate planning documents to take into account the possibility of repeal which requires different provisions to be included. In our view, this would be a terrible waste of resources for small business owners (as well as other Americans).

Congress should initially keep the estate tax exemption at \$3.5M. This allows couples, with proper estate planning, to leave up to \$7M in assets to their heirs without the imposition of estate tax. Congress should then gradually increase the exemption amount over a number of years until it reaches \$5M. Thereafter the exemption amount should be increased by COLA.

Congress should retain the estate tax system and its accompanying step-up in basis at death. Under the current estate tax system, the recipients of assets from a decedent's estate receive a step-up in their tax basis in those assets passed down to them. Repeal of the estate tax, however, will also cause a significant repeal of this step-up in basis. Many small business

owners will actually end up paying more taxes if Congress repeals the estate tax than they would if Congress preserves it with at least a 3.5 million estate tax exemption.

Congress should exempt retirement plan assets from the estate tax. Congress can create a meaningful incentive for people to save for their retirement by exempting a significant portion of retirement plan assets from the estate tax. The assets would still be subject to income tax as they are distributed from the plan or IRA. Currently the incentives towards locking up money in a retirement plan are being diminished by the lower tax rates on capital gains and dividends that do not apply to funds coming out of a retirement plan. Furthermore, this reform would help to alleviate the pressure our nation will face in dealing with the future health care and retirement income burdens as the baby boomer generation begins to enter retirement.

The SBCA supports the so-called "portable" estate tax exemption. This proposal provides that if the first spouse to die does not use up his/her entire estate tax exemption, then the unused portion can be used by the surviving spouse's estate. Thus, the first spouse's exemption is not lost because the first spouse did not have enough assets or because of a lack of proper estate planning for the first spouse's estate. We understand that the devil is in the details but we believe this policy could be very helpful to many small business owners. Many married couples end up with only one exemption because they do not use an estate planning attorney.

The estate tax historically was imposed only on the very wealthy as a way to avoid the problems that occur when a very small elite of the country is able to amass great wealth and pass it down to succeeding generations. The tax reforms we propose will ensure that those who have worked a lifetime to build their companies will not be subject to estate tax. It is both rational and prudent that the government tax at least some portion of a huge build up of wealth, particularly when that wealth is not the product of running an active family or closely held businesses. Conversely, Congress never intended for the estate tax to punish the hard working entrepreneurs who have built up a small business by reducing their estate.

#### An Example of the Small Business Nightmare Due to the Current Federal Estate Tax Landscape

Mr. Entrepreneur is the sole proprietor of a small business, Innovative Inc., which, together with his home, totals \$3.5 million in assets. Mr. Entrepreneur's wife has passed away and his single heir is his daughter, who may or may not want to take over the business, once her father passes away. Mr. Entrepreneur wants to provide the best that he can for his daughter, Ms. Smart, upon his passing and he is currently seeking out the best plan. Unfortunately, in the current federal estate tax landscape, the next three years are almost too volatile to do any planning unless he was able to decide what year to die!

Let's say that Mr. Entrepreneur's assets will be valued the following way upon his death:

Asset	Decedent's Basis	Fair Market Value at Death
Innovative Inc.	\$100,000	\$2,600,000
Residence	\$500,000	\$900,000

Without Congress Acting:

If Mr. Entrepreneur were to pass away in the next three years, the following will occur:

- In 2009, when the exemption level is \$3.5 million, Ms. Smart will owe no federal estate tax.
- In 2010, the federal estate tax will have been repealed and the step-up in basis is lost. Ms. Smart will have the burden to find the documentation of her father's basis in his property (which could have been purchased decades ago). In 2010, the law provides that Ms. Smart will receive \$1.3 million in assets with a stepped-up basis to fair market value. The remaining \$2.2 million in assets will have the same basis that her father had with those assets. Considering the above basis and assuming Ms. Smart chooses to sell the business and her father's house, Ms. Smart allocates the entire step-up basis to Innovative Inc., and with a capital gains tax of 15%, Ms. Smart would pay \$255,000 in capital gains tax. That is \$195,000 for Innovative Corp (15% of \$2.6 million minus the \$1.3 million in step-up basis and \$60,000 for the residence (15% of \$900,000 minus \$500,000). Depending on what documentation can be provided, Ms. Smart can pay as much as \$330,000 (15% of \$2.2 million) or as low as \$255,000. Note that these taxes will not be due until Ms. Smart sells the house and the business.
- In 2011, the federal estate tax will be \$1,220,000, because the exemption reappears at \$1 million, which, in effect, would be devastating for Ms. Smart since she could not even cover the cost by selling the residence so she would be forced to sell all or a portion of the business, even if she wanted to keep running it. It is possible that some portion of the \$1,220,000 will be paid to a state government depending upon the state's estate tax law.

How can Mr. Entrepreneur plan properly for an estate tax which in the next 3 years can fluctuate between zero and over a million dollars on a relatively modest estate!

With Congress Acting: If Congress adopts the SBCA suggestions outlined above, Ms. Smart would be able to retain the entire business and continue to run it, if she so chose (i.e., she would not be forced to sell some or all of the assets of the company to pay the estate taxes). If Congress reunited the estate and gift tax systems, Mr. Entrepreneur could gift his business to his daughter during his lifetime, if that is what he desired. Furthermore, if a gradual increase to \$5 million were enacted, Mr. Entrepreneur would not be disincentivized to grow his business which in turn would keep our economy growing. In effect, Congress would have repealed the federal estate tax for Mr. Entrepreneur and most other small business owners who were never intended by Congress to be punished for their hard work.

For more information please contact Paula A. Calimafde, Chair of the SBCA, at (301) 951-9325 or [calimafd@paleyrothman.com](mailto:calimafd@paleyrothman.com).