

Steady As She Goes, 2008

Also: Echoes of 2007, a Collection of Quotations

By Robert L. Moshman, Esq.

It's that time of year when members of the financial professions take stock of tax thresholds, digest reams of new information, and adapt to new rules. There are always new rules; annual change is the norm, and the status quo is the exception.

Introducing 2008, the year of the exception. The transfer tax system has slipped into 2008 without any perceptible change--top estate tax and exemption holding at 45% and \$2 million, respectively. And therein lies the rub; the most stable moment of the wealth transfer system in many years arrives during the phase-in of what is supposed to be the most dramatic of tax changes, a repeal of the estate tax.

We can dispense with the drum roll to introduce 2008 (it has already slipped in without fanfare), but it is vital that we take note of applicable rules and cost-of-living adjustments. And there is at least one novel angle—a temporary 0% tax rate on capital gains for persons in the 5% and 15% income tax bracket. Several useful strategies apply.

The Big Picture

The stock market, led once again by the high-tech sector, has increased the size of estates. However, weakness in the economy and real estate is keeping wealth in check. And the “sub prime mortgage crisis,” has become a factor.

Real Estate Bubble: Remember that real estate bubble that wasn't supposed to pop? Analysts may continue debating what constitutes a bursting real estate bubble, but by the time they arrive with the conclusive numbers and reach a consensus, they will only be confirming what those who work with real estate already know: Real estate has been hurting!

Will stagnant sales cause a complete collapse of home prices? New home sales fell approximately 25% nationwide in 2007 and new home prices have been described as being "in free fall." Existing home sales peaked in mid-2005 and have been falling ever since. An inventory of existing homes has now accumulated and will undoubtedly force home prices lower.

Now add the sub-prime mortgage crisis to this mix and you have foreclosures, which in turn add to inventory of properties for sale and depress prices with low auction-level sales.

David Seiders, chief economist with the National Association of Home Builders, projects a total decline of 10% to 15% in home prices from the 2005 peak. In a conference call with reporters, he said we will find the bottom of the real estate market in 2008 and then rebound in 2009.

Economy, Inflation, Oil: In 2006, oil prices had spiked up as high as \$78 a barrel and prices continued rising in 2007, ultimately peaking at \$99.29 in November. Oil prices receded slightly during the latter few weeks of the year. In July, the Dow Jones Industrial Average fell 400 points due to oil prices and the weak housing market. However, corporate profits rose and the Dow Jones industrial average closed above 12,000 for the first time in October.

How will the economy and stock market fare over the next year? Former chairman of the Federal Reserve Alan Greenspan uttered that most feared of words, “stagflation,” connoting a potential period of higher inflation and slow growth.

Fears of a recession were somewhat allayed by consumer spending late in the year but economic weakness in 2008 remains a concern. Down the road, if there is any plan to bring American troops home, expect stock market volatility. Investors have emotions that move the marketplace. Returning troops may increase demand on goods, but they will soon compete for jobs, curbing wage inflation.

Meanwhile, other nations are experiencing varying levels of economic growth. Germany and Japan anticipate economic growth of 1.7% and 2% in 2008, respectively. In contrast, Asian markets have been experiencing strong growth. China's economy is expected to “slow” in 2008...to 10.9% growth!

Repeal in 24 Months

In the movies, the ticking time bomb is always disarmed with only seconds to spare. In real life, nobody builds a stalemate into better drama than Congress. In past years, Congress has allowed budget impasses to shut down the government and has allowed critical tax provisions to expire, only to revise them retroactively.

In a perfect world, Congress would resolve the fate of the estate tax as soon as possible to allow citizens the basic ability to plan their estate ahead of time with some degree of confidence so they know which tax system will govern their estate.

We said the same thing last year at this time...and nothing has changed except for the fact that the countdown to estate tax repeal has reached 24 months and counting. The estate tax will be gone on January 1, 2010...unless Congress steps in.

Note: There is a presidential election on the horizon and a new administration will take office in 12 months. At that time the estate tax exemption will reach \$3.5 million. For many estates, the fate of the stepped up basis for property transferred at death is the most significant aspect of the estate tax repeal.

Estate Tax Resurrection

Will the estate tax be repealed in 2010...only to be resurrected one year later in 2011? That's how things will play out if the tax code is not amended.

AFTER 2010: In theory, the estate tax will be repealed in 2010, but then, by virtue of congressional metaphysics, we revert to 2001, more or less, and therefore have an abrupt change from 0% estate tax in 2010 to a top rate of 55% in 2011, with an additional 5% surtax and a \$1-million exemption.

RETURN OF THE SURTAX: When it comes to “going retro” with a 2001-era transfer tax springing back into existence in 2011, a vestigial appendage of that former system will also be making a return appearance. This is especially incongruous given the context--going from a complete repeal to a system that has not only an estate tax, but also a surtax on top!

The 5% surtax would apply to portions of estates between \$10 million and \$17,184,000. Imposing the 5% surtax on that portion of estates generates \$359,200 and is designed to offset the benefit of the graduated estate tax rates.

In the age of estate tax repeal, an extra 5% surtax on estates already paying a top rate of 55% is a bizarre anachronism. This surtax was originally supposed to not only offset the benefit of the graduated tax rates, but also the \$1-million exemption that formerly applied and would therefore have applied on portions of estates between \$10 million and \$24.1 million. However, language to accomplish Congressional intent was inadvertently omitted from the Taxpayer Relief Act of 1997 and then intentionally excluded from subsequent technical corrections.

Tax Thresholds for 2008

INCOME TAX BRACKETS: Top individual rates remain at 35% for 2008. For individuals, a 33% rate applies to income over \$164,551. The 35% rate kicks in at \$357,701 for individuals as well as married filing jointly. For estates and trusts, the income tax ranges from 15% for amounts under \$2,200 and 35% for amounts exceeding \$10,700.

SOCIAL SECURITY: The first \$102,000 of income is subject to Social Security tax withholding (up from \$97,500 in 2007) and the rate remains 7.65% for employees and 15.3% for self employed. Cost-of-living increases of 2.3% apply to Social Security and SSI for 2008.

TOP ESTATE TAX RATE: In case you are tuning into this discussion recently, the estate tax was repealed in 2001 but we are in the seventh year of an eight-year phase-out. The top estate tax rate remains at 45% this year and through 2009 and applies to estate assets in excess of \$1.5 million.

ESTATE TAX EXEMPTION: We remain at \$2-million estate tax exemption for 2008, the third and final year at that level before increasing to \$3.5 million in 2009. This could be modified by new tax legislation during 2008, of course. (See chart, page four.)

GENERATION-SKIPPING TRANSFER TAX: Also unchanged. Both the tax rate and exemption for estates continue to apply to the GST tax, i.e., 45% and \$2 million.

GIFT TAX: Top rate also remains at 45%. Last year, the gift tax annual exemption moved up from \$11,000 to \$12,000 based on cumulative cost-of-living adjustments. This year, the exemption remains at \$12,000. With gift splitting, a married couple can give each beneficiary \$24,000 free of gift tax each year. If current inflation trends remain in place, the next jump, to \$13,000, will arrive in two or three years.

GIFT TAX LIFETIME EXEMPTION: The lifetime exemption for gift taxation remained at \$1 million, and will remain at that level through 2011.

STATE DEATH TAX: The state death tax credit had been phased out. State death taxes are treated as a deduction. The number of states with some form of death taxes (24) seems to have stabilized. Some of these states have “decoupled” from the Federal approach.

SPECIAL-USE VALUATION: The aggregate decrease in value of an estate using §2032A for estate tax purposes was limited to \$900,000 in 2006. This limit rose to \$940,000 in 2007 and \$960,000 in 2008.

NON-CITIZEN SPOUSES: The exemption under sections 2053 and 2523(I)(2) for gifts to non-citizen spouses increased from \$125,000 in 2007 to \$128,000 for 2008.

QUALIFIED FUNERAL TRUST: The limit is \$9,000 for 2008, up from \$8,800 for 2007.

CAPITAL GAINS: A top rate of 15% continues to apply but those in low tax brackets pay 0% in 2008 through 2010.

ATTORNEY FEES: Amounts awarded as attorney fees in 2008 are at a rate of \$170 per hour.

ELECTIVE DEFERRALS: 401(k) and certain other plans will have a contribution ceiling of \$15,500 for 2008, unchanged from 2007.

CONTRIBUTION LIMITS: Limits for SIMPLE accounts remain at \$10,500 for 2008. Limits increase from \$45,000 in 2007 to \$46,000 in 2008 for defined contribution plans. Roth IRA eligibility limits for 2008 are \$101,000 of income for an individual, \$159,000 for spouses filing jointly. Regular IRA contribution limits for 2008 are \$5,000 for those 49 and younger and \$6,000 for those 50 and older (the “catch up” limit).

COMPENSATION LIMITS for eligibility in SEPs and other plans increase to \$230,000 for 2008.

Sources: For 2008 rates, see: Revenue Procedure 2007-66, page 958 of Internal Revenue Bulletin 2007-45, November 5, 2007. For 2007 rates, see: Revenue Procedure 2006-16, October 18, 2006, and Revenue Procedure 2006-53.

Echoes of 2007

“Misers are no fun to live with but they make great ancestors.” —*Tom Snyder*.

“We don’t pay taxes. Only the little people pay taxes.” —*Attributed to Leona Helmsley by her housekeeper. This quote was denied by Mrs. Helmsley, but it came to represent her attitude and the “greed is good ethic of the 1980s.*

“Please, don't squeeze the Charmin!” —*Actor Dick Wilson, who played uptight grocer Mr. Wipple in ads, died at age 91.*

“I believe in the Rip Van Winkle theory: that a man from 1910 must be able to wake up after being asleep for seventy years, walk into a ballpark and understand baseball perfectly.” —*Bowie Kuhn.*

“I am a Ford, not a Lincoln. My addresses will never be as eloquent as Mr. Lincoln’s. But I will do my very best to equal his brevity and his plain speaking.” —*President Gerald R. Ford, died December 26, 2006.*

“You can make a throne of bayonets, but you can’t sit on it for long.” —*Boris Yeltsin (1931 - 2007).*

“[He's] a wonderful guy and quite a gentleman.” —*Evel Knievel after meeting with Kanye West. The former motorcycle daredevil then dropped his trademark infringement lawsuit against West. Knievel passed away two days later.*

“I’ve always tried to go a step past wherever people expected me to end up.” —*Beverly Sills*

“It’s not what you gather in life, but what you scatter in life that tells the kind of life you’ve lived and the kind of person you are.” —*Helen Walton, wife of Wal-Mart founder Sam Walton, died in 2007 at age of 87.*

“Do not the most moving moments of our lives find us all without words?” —*Marcel Marceau, Reader’s Digest (June 1958).*

* * *

Best wishes to you in 2007.

Estate Tax Phase Out 2001 — 2011

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
INCOME TAX TOP RATE	39.1%	38.6%	35%	35%	35%	35%	35%	35%	35%	35%	39.6%*
CAPITAL GAINS	20% and 10%	20% and 10%	15% and 5% (after 5%)	15% and 5%	15% and 5%	15% and 5%	15% and 5%	15% and 0%	15% and 0%	15% and 0%	20% and 10%
DIVIDENDS	Taxed as income	Taxed as income	15% and 5%	15% and 5%	15% and 5%	15% and 5%	15% and 5%	15% and 0%	15% and 0%	15% and 0%	Taxed as ordinary income
GIFT TAX TOP RATE	5%+	0%	9%	48%	7%	6%	5%	5%	5%	5%	55%+*
GIFT TAX EXEMPTION	675,000	1 million	1 million	\$1 million	1 million	1 million	1 million	1 million	1 million	1 million	\$1 million
ESTATE TAX TOP RATE	5%+	0%	9%	48%	7%	6%	5%	5%	5%	5%	55%+*
ESTATE TAX EXEMPTION	675,000	1 million	1 million	\$1.5 million	1.5 million	2 million	2 million	2 million	3.5 million	5 million	\$5 million
BASIS AT DEATH	stepped up basis	stepped up basis	stepped up basis	Stepped up basis	stepped up basis	stepped up basis	stepped up basis	stepped up basis	stepped up basis	carry Over basis**	Stepped up basis*

+ = In addition to the 55% rate, a 5% surtax applied to certain estates exceeding \$10 million.

* = In 2011, item reverts to 2001 level unless Congress enacts further legislation.

** For carryover basis in 2010 (and beyond if extended by Congress) a limited stepped-up basis would continue to apply to the first \$1.3 million of capital gains transferred to a non-spouse and the first \$3 million of capital gains transferred to a spouse.

(c) KS 2008.1