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Obama Plans to Keep Estate Tax

Democrats Want to Freeze Levy at Current Levels Instead of Letting It Expire Next Year

By JONATHAN WEISMAN

President-elect Barack Obama and congressional leaders plan to move soon to block the estate tax from disappearing in 2010, suggesting the levy might outlive the "Death Tax Repeal" movement that has tried mightily to kill it.

The Democratic stance on the estate tax contrasts with Mr. Obama's reluctance to press forward with his campaign pledge to raise income-tax rates on top earners, which he worries could have an adverse economic impact during a recession.

But Democrats are determined to act quickly to prevent the estate tax's scheduled repeal. Elimination of the levy on big inheritances was approved by Congress under President George W. Bush in 2001, with rollbacks phased in slowly and its full elimination slated to take effect next year.

The Senate Finance Committee will move within weeks on legislation to reverse that law, and Mr. Obama is expected to detail his estate-tax preservation proposal in his budget next month, congressional tax writers said.

Under the Obama plan detailed during the campaign, the estate tax would be locked in permanently at the rate and exemption levels that took effect this year. That would exempt estates of $3.5 million -- $7 million for couples -- from any taxation. The value of estates above that would be taxed at 45%. If the tax were returned to Clinton-era levels, it would exclude $1 million from taxation with the rest taxed at 55%.

In making their case for the restoration, Democrats contend that such a large additional tax break for the rich shouldn't go into force halfway through Mr. Obama's proposed economic-recovery package. They argue that the deficit is already in record territory, while their plan wouldn't have any impact on the economy since it would merely keep the estate-tax rate at its current level. Mr. Obama and his party also say that the affluent already have benefited handsomely from the Bush tax cuts.

They also reason that if they don't act now, it will be politically harder to go ahead with their plan to resurrect the estate tax once it has disappeared.

For small-business groups, farmers' associations and the affluent families that created and bankrolled the "Death Tax" repeal effort, the emerging Democratic plan marks a stark defeat.

Advocates of killing off the tax say the emerging Obama policy is the wrong medicine for the recession, arguing the levy is economically burdensome like the income tax. Bill Rys, tax counsel for the National Federation of Independent Business, said small businesses struggling with falling sales and layoffs shouldn't have to devote resources to estate planning.

"With auto sales at a 16-year low, dealerships are already struggling. Freezing the 2009 levels would put an even greater burden on the future," said Bailey Wood, chief lobbyist for the National Automobile Dealers Association.

At the level proposed in the Obama policy, all but the largest estates -- fewer than 2% of annual deaths -- would escape taxation. Over 10 years, the Obama plan would cost the Treasury around $324 billion more than if the Clinton estate-tax levels were maintained, according to the Joint Committee on Taxation. Full repeal would cost more than $500 billion over a decade.

The estate tax was enacted in the early 20th century as a levy on wealth and inherited assets. It was later amended to allow a spouse to avoid the tax.

Most such taxes are still collected from estates of the ultra-rich. But business and farm groups say small businesses and family farms struggle with it as well, at the very least devoting time and energy to planning ways to escape or minimize taxation as enterprises pass from generation to generation.

Patricia Soldano, an estate-tax planner in Southern California, was a pioneer of the movement launched in the mid-1980s. Backed by affluent families such as the Mars candy family, the Gallo wine family and the heirs of the Campbell's soup fortune, Ms. Soldano enlisted Republican pollster Frank Luntz to poll-test the "Death Tax" term, forged alliances with the young Republicans who would sweep to power in 1994 and teamed up with small-business and farm groups.

By framing it as a tax on dying rather than wealth and thrusting family farms and small businesses front and center, the movement was able to divorce the cause from the issue of dynastic wealth and broaden its appeal to Main Street advocates.

The campaign seemed to have succeeded in 2001 when, with huge projected budget surpluses, Mr. Bush pushed and Congress approved an estate-tax repeal.

But to win the necessary votes for the larger, $1.35 trillion tax cut of which it was part, Republican leaders used legislative tactics that mandated the entire tax package expire in a decade. To lower the 10-year cost, the estate tax didn't begin dropping significantly until the end of the window and wouldn't disappear until 2010.

During the long phase-in, the politics have begun to shift again. Almost since the change was put in place, repeal advocates have pushed for an earlier permanent elimination in the face of huge budget deficits, with no luck. They always sensed an estate-tax elimination set far in the future was tenuous at best, especially since the law as written has the repeal last only one year.

Then, anticipating Democratic majorities in Congress that would ultimately seek to block full repeal, the coalition began seeking compromises that would leave a minimal tax in place for a tiny fraction of estates. Estate-tax opponents agreed they would get the best possible deal with Mr. Bush still in office.

But sharp divisions in the coalition emerged between the super rich and the merely rich. Business groups have sought a measure of certainty with an estate tax that is free of graduated timelines or sunset provisions, with the largest possible tax exemption -- $10 million, or $20 million per couple. The rate of taxation above that level was of little concern, since virtually every small business would be exempt from taxation.

Yet the super affluent who began the movement wanted the lowest possible rate, since even a $10 million exemption would leave the bulk of their estates subject to tax. They backed a call by Mark Bloomfield of the American Council for Capital Formation to tax all estate transfers as capital gains, at 15%, with little or no exemption.

"The very wealthy, in their quest to reduce their exposure, made proposals that threw the small-business community overboard," said one prominent small-business lobbyist, referring to a move to have estates taxed as capital gains upon their disposition, without regard to the amount shielded from taxation.

Ms. Soldano said "the small-business people were being shortsighted in thinking, 'Let's just fix it now for me.'"

Former Sen. Don Nickles, an Oklahoma Republican who fought the tax his entire political career, said he and Arizona Republican Sen. Jon Kyl must have given 10 speeches to the movement, exhorting them to come together and accept the best that could pass Congress while the GOP had control.

Now, the movement is likely to confront an estate tax that is far bigger than what it may have gotten with more compromise.

"People mistook political reality," Mr. Bloomfield said. "The end result is we'll have a worse tax policy than if Sen. Kyl had succeeded."

Senate Finance Committee Chairman Max Baucus said in a recent interview that he will move "in the next few weeks" on legislation to deal with urgent tax matters not related to any economic stimulus. Estate-tax preservation will be front and center, an aide to the Montana Democrat said.

But movement veterans are already conceding defeat is likely. "I am disappointed," Ms. Soldano said, "because I really thought we could achieve so much more."

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