

Trust & Investments

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Affluenza: Planning Concerns of the Wealthy for their Children

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TIME TO REPEAL THE FEDERAL ESTATE TAX?

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The 1997 Taxpayer Relief Act made progress toward defanging the federal gift and estate taxes. The legislation gradually increased the lifetime exemption for taxable transfers from \$600,000 (where it had been stuck for a decade) to \$1 million. The bill also provided a new exemption for family-owned businesses and farms. The latter is complicated, and few families actually will qualify. And raising the exemption levels is just tinkering. If critics of the unified "wealth transfer" tax are serious, they should press for outright repeal.

Numerous bills have been introduced in Congress in recent years to repeal the wealth transfer tax. Mostly Republicans have supported the cause, but several Democrats also oppose the tax because of its impact on small, family-owned farms. But rather than tinker, why not go all the way? While the political debate is sure to be charged, there are good reasons for dumping the gift and estate taxes altogether.

The best reason is that the tax doesn't raise enough revenue to justify its existence. According to the Congressional Budget Office, the gift and estate taxes together raised only \$15 billion in 1995. That amounted to 1.1 percent of total federal receipts for the year — an increase from the record low of 0.8 percent in 1988 but still quite insignificant. With the lifetime exemption,

individuals with taxable estates below \$625,000 and married couples with joint estates below \$1.25 million need never pay any gift or estate tax. There is another important exemption from the gift tax that allows individuals to give up to \$10,000 a year to anyone else completely tax free. Every December accountants and tax lawyers across the country remind their wealthy clients to make these \$10,000 gifts to children and grandchildren.

But married couples still must arrange their assets (and draft their wills) to take advantage of each spouse's exemption. There are a number of time-honored techniques for achieving this; the most important is a "credit shelter" trust in each spouse's will. This simple device can save a couple's heirs more than \$192,800 in tax. But it is highly unproductive and very expensive to arrange one's financial affairs to suit the tax laws. Indeed, it is ridiculous that the tax laws should encourage people to consume their life's savings before they die, set up unwanted trusts, or give away their assets just to avoid the wealth transfer tax. Unfortunately, it is too expensive not to do so.

The major obstacle to repeal is that even the minimal revenue that the wealth transfer tax raises must be replaced. One way to offset the revenue loss is by eliminating several

unwarranted loopholes in the income tax, for instance, the long-standing policy of forgiving tax on a decedent's property at death. This allows assets to be transferred from generation to generation without paying tax on any built-in gain. Eliminating this income tax loophole would more than compensate for repeal of the wealth transfer tax. It also might bring liberal Democrats on board. Another possibility would be to include in income all gifts and bequests. Transfers of wealth still would be taxed, but under the income tax. The advantage would be that with only one tax regime, the income tax, all the substantial compliance costs associated with the gift and estate taxes would be eliminated.

The professionals who make a living off the wealth transfer tax are sure to lead the opposition. Likewise, liberals will oppose repeal out of conviction. But there is such a compelling case to repeal the tax that perhaps common sense will prevail. ■