

Mark A. Langan
E-mail: mlangan@dinse.com

March 19, 2015

via electronic mail transmission

cencoe@leg.state.vt.us

Re: S. 55 Taxation; estate taxes; rate; exclusion amount

Dear Senate Finance Committee:

Thank you for the opportunity to address the Senate Finance Committee regarding S. 55 this morning. This letter is in follow-up to Senator Lyons request to address some issues in writing concerning the bill.

State estate taxes: Currently, thirty (30) states have no estate tax or other tax imposed by reason of death. Twenty (20) states and the District of Columbia have an estate tax. Most of those states are located in the northeast. At least six (6) of those states and the District of Columbia are changing or have changed their laws to increase the state estate tax exemption to the federal exemption (currently \$5.43 million and increasing with adjustments for inflation) by 2019. This proposal will bring Vermont more in line with these other states.

Gifting Out: Under our current estate tax system, if a person gives away all of his or her assets before death, no state estate tax will be imposed since the tax is based on the taxable estate which would be zero. Most taxpayers would be reluctant to gift out all of their assets because they would not be able to pay their bills.

The bill would convert the so-called exemption into a true exemption in that the first \$2.45 million would not be taxable. A true exemption would only require a taxpayer to gift out all but \$2.45 million. Many taxpayers would be less reluctant to do this as \$2.45 million would provide sufficient assets to pay their bills for the rest of their lifetime near the end of their life.

Accordingly, the bill proposes to add back adjusted taxable gifts made within three (3) years of death to prevent taxpayers from avoiding the estate tax by taxable gifts before death. See S. 55, page 1, lines 16-17. "Adjusted taxable gifts" are gifts that do not qualify for the

LAW OFFICES OF

DINSE, KNAPP & MCANDREW, P.C.

Senate Finance Committee

March 19, 2015

Page 2

federal gift tax annual exclusion (currently \$14,000 per year per donee) and qualified gifts (for tuition and medical needs). IRC § 2503. This proposal is similar to the federal statute, IRC § 2035, which adds back certain gifts within three (3) years of death.

New York has a three-year look back rule in their estate tax law. Maine has a one-year look-back rule.

Lowering the Exemption Amount: The bill lowers the exemption amount from \$2.75 million to \$2.45 million for 2015-2016. This was done to make the tax revenue neutral.

Under the current system, if a taxable estate exceeds \$3.26 million, the \$2.75 million exemption has no effect on the estate. The tax is on every dollar - not just the excess over \$2.75 million. The current estate tax regime is complex in that it requires two calculations. The first calculation is based on the federal taxable estate less \$60,000 (a vestige from the 1970's). The second calculation requires the estate to determine what the federal estate tax would have been if the exemption amount was \$2.75 million. The estate pays the lesser of the two.

For example, if the taxable estate is \$3.0 million, then the first calculation is \$182,000 and the second calculation is \$100,000 $[(\$3.0 \text{ million} - \$2.75 \text{ million}) \times 40\%]$. Thus, the tax is \$100,000.

If, however, the taxable estate is \$3.3 million, then the first calculation is \$210,000 and the second calculation is \$220,000 $[(\$3.3 \text{ million} - \$2.75 \text{ million}) \times 40\%]$. Thus, the tax is \$210,000.

There is also the trap for the unwary that can catch an estate that is less than \$2.75 million if the decedent made lifetime taxable gifts that create a taxable estate. The federal estate tax calculation based on the \$2.75 million exemption includes taxable gifts that are added back to the taxable estate. Some tax attorneys consider this a "back-door" gift tax and this has caused confusion among estate tax preparers. This bill will eliminate that confusing aspect with a streamlined calculation.

Estates between the proposed \$2.45 million exemption and the present threshold of \$2.75 million will have a slight tax increase. A \$2.75 million estate that presently would have no tax would pay a tax of \$48,000 under this bill. This is less than two percent (2%) of the entire estate value.

LAW OFFICES OF
DINSE, KNAPP & McANDREW, P.C.

Senate Finance Committee
March 19, 2015
Page 3

While the exemption amount would be lower in 2015-2016, the exemption would increase in future years in order to be competitive with other states.

Constitutional Clean-up: While the statute defines the Vermont gross estate as containing all of a resident's assets except real estate and tangible personal property located out of state, the estate tax form includes real estate and tangible personal property located out of state if that state does not impose a state estate tax on those assets. This violates the 14th Amendment of the U.S. Constitution. The bill would correct this error.

Best Regards,

DINSE, KNAPP & McANDREW, P.C.



Mark A. Langan

MAL/bs

cc: Mary Peterson, Commissioner, Department of Taxes
Enclosures