NOT LOOKING SO GOOD

The scenario for estate tax relief has taken on a frosty tinge. To explain, I have to start with a Washington classic – the end of the year frenzy.

Normally, Congress gets to the end of a calendar year and there is a rush to advance a range of initiatives to the next stage in the legislative process. This week would be “frenzy week” under normal circumstances. However, only the House is scheduled to go home at the end of the week, but frenzy week will go on anyway.

One rule of frenzy week is to expect the unexpected. To follow the axiom, maybe the Senate will magically finish this stage of its work on the health care reform bill – Senate passage - and go home.

Last week, I described the real driver in Congress’ activity at the moment – finishing funding the government for the rest of this fiscal year. They have come up with a strategy to do so. As previously indicated, some appropriations bills have been passed and signed into law. One approach would be to take all of the other unfinished funding bills and throw them into one single bill (an “omnibus bill”); other options are short or long term continuing resolutions that fund the government until a fixed date. Currently, the unfunded portions of the government are working under a continuing resolution that expires on Friday, December 18th, hence the end of the week takes on more importance than just an end of the session wrap up target date.

Congress has decided on a “duo-bus.” Last week it passed a bill combining several of the pending appropriations bills. It is readying a second one that will include all the remaining items. In the parlance of Washington, the second one is the “Christmas tree.” Since the House is planning to go out of town, there is no room for back and forth about the contents of the bill. In this case, since the Senate may continue in session, the House can hang a lot of ornaments on the tree, send it over the Senate and say “See ya. Enjoy discussing health care. We will be back in 2010.” The Senate will not get to hang extra ornaments on the tree unless it can convince the House to come back to Washington as in “we could finish health care reform completely.” (Slight chance of this in my view.)

What will hang from the tree? Democrats are eager to put some sort of stimulus/job creation garland on it, more on that in the next story. Tax extenders? The House did pass their version of a tax extender bill last week. It extends some 40 plus credits and deductions, such as the Research & Development Credit, for another year. I give this a chance, although there is some mumbling in the Senate, that they might look to handle the tax extenders next year. Can you say, “Retroactivity?”

Now this brings me to the estate tax relief scenario. As reported, the House has passed a bill that extends permanently the 2009 top rate of 45 percent and 2009 exemption of $3.5 million, without indexing. The House also added a statutory pay-go requirement to it.

Now I need to rewind the clock to this spring. In Senate offices back then, you typically heard either “We would like to do something like the Lincoln (D-AR)/Kyl (R-AZ) bill and raise the exemption higher and lower the rate” or, you heard at least “We would like freeze it permanently at 2009 levels and index it.” However, at the end of most conversations, we heard, “But we don’t think the Senate will have time to deal with it, and we will probably end up with a one-year
extension of the 2009 rate and exemption.” At the time, our view is that we got to get these folks to stop sounding so resigned to an outcome. And we tried. However, at the moment, it looks like their then gloomy outlook is a self-fulfilling prophecy. All signs point to the majority’s leadership in the two chambers working out a deal on estate tax that they know will “fly” in that last-call funding bill. A one-year extension seems the most likely, but a two-year extension is also mentioned. In either case, the law would revert to its pre-2001 levels at the end of the extension – automatically. As noted earlier, maybe we will get the unexpected – after all, it is frenzy week – but the vibes are not good.

Why would they go with a one-year extension? You have to look at it through their glasses. If you extend the rates and exemption instead of allow for a one-year repeal, you pick up the revenue that would otherwise not be collected during the year and you get to use it as a “pay-go” offset for some of those other ornaments hung on the funding bill tree. Second, you do not let any mega estates that are lucky enough (?!?) to be eligible to take advantage of the repeal off the hook, while smaller estates “created” in 2010, would get the advantage of the exemption and stepped up basis. In their view, “no harm, no foul.”

**STIMULUS**

Let’s say the majority does get ambitious and tries to hang a job creation/stimulus garland on the tree, what might they string together?”

It will start with an extension of jobless benefits and perhaps an extension of the COBRA subsidies passed earlier this year.

The most likely job creation/stimulus part would be additional infrastructure spending. Next would be some further tinkering of small business lending options.

After that, the candidates for inclusion drop to tax provisions and usually those require at least some of the formalities of including the tax writing committees in the process so one would “discount” their prospects - but this is frenzy week. Extending the temporary increases in the direct expensing allowance and continuing the bonus depreciation would be within the realm of probability. The President has called for a new jobs tax credit. If Congress were to adopt something that complex as part of the omnibus funding bill, it would define the new gold standard for “expect the unexpected” during frenzy week.