Weary Businesses Will Welcome Estate Tax Compromise

In the past, Roger Hannay was not interested in compromises.

The president of Hannay Reels

, a four-generation family business in Westerlo, wanted total repeal of the estate tax. He made speeches, wrote letters and told anyone who would listen why the tax was detrimental to companies like his.

The estate tax imposes a levy of up to 47 percent on inherited assets above a certain threshold. This year, that threshold is $1.5 million. The exemption rises to $3.5 million by 2009. Then, under the tax-cut package of 2001, the estate tax vanishes in 2010.

However, unless Congress takes additional action, it will return in 2011, at its 2001 level--a 55 percent rate on estates valued at more than $1 million.

Hannay and others representing family-owned businesses have been pushing for permanent repeal for the past four years. They've won in the House, but have repeatedly fallen short of the 60 votes needed in the Senate.

Now, as Congress prepares for one more vote on the issue before adjourning for its August recess, Hannay and others are talking concession.

"I used to think 'take no prisoners,'" Hannay said. " 'Go for the gold and if you don't get it all, come back another year.' Now I am starting to think we should go for the compromise and we'll try again next year."

The Kyl Plan

Senate Republicans, lead by Sen. Jon Kyl of Arizona, have proposed cutting the estate tax rate to 15 percent, the rate now applied to most long-term capital gains. Also under discussion is establishing a permanent estate tax exemption or $8 million or $10 million.

The idea is to ease the burden on family businesses without producing a windfall for the superwealthy.

"If Congress does decide to raise the federal estate tax [exemption] to $10 million, this would completely eliminate a federal estate tax burden for all of my clients and for all but a very small percentage of families in the Capital Region," said Kimberly Verner, senior associate in the Albany law firm of Tully Rinckey & Associates PLLC.

Hannay, who has two children actively involved in the business, said the Kyl plan would have a "significant impact" on the manufacturer of hose and cable reels.

"So if you ask me would I choose nothing or that, I'd say I would take that," he said.

A compromise of some sort does seem the most likely result this year. At last count, there were 56 Senate votes in favor of repeal and at least 63 in favor of reform.

A family burden

The estate tax is primarily a problem for businesses that are asset-rich and cash-poor. For example, a business may have large commercial real estate holdings, but few liquid assets. When the owner dies, his or her heirs must hand 47 percent of the value of that real estate over to the federal government.

Kevin McCoy, managing partner of Marvin & Co.

, a Latham-based certified public accounting firm, noted that the recent increase in Capital Region property values has put more people in line for the estate tax, at least in its current form.

"If you have a couple of houses and some commercial properties, all of a sudden you're up to a $10 million estate," he said. "[Now you] have $4 million to $5 million in estate tax to come up with. You sometimes see someone sell their property and wonder why. Often it was to pay the estate tax."

Andy Cirincione, who owns a 30-year-old heating and air-conditioning business in Suffolk County, said his heirs would have to sell both the business and the family home to pay the estate tax.

"It may sound like 'get the fiddle,' but after everything I've worked for, my family could be forced to sell everything after I die," Cirincione said. "Unless I get into expensive estate planning, and have you ever tried to set up a trust?"

Business owners also may purchase life insurance valued at more than their assets, but that can cost tens of thousands of dollars a year.

"My son has come into the business and I would like to continue it for him," Cirincione said. "But If I don't do something he'll be in a pickle. You talk to the average person, they don't understand. They think you have all these tax loopholes. But it's hard. You're taxed to death, and then when you die, you're taxed again."

Seeing double

Some observers say that is precisely the problem with the estate tax.

"As a practical matter, in order to accumulate wealth, a person generally must first pay an income tax on the accumulation," said Daniel Ertel, a CPA in private practice in Schenectady. "Thus, the estate tax is essentially a double tax on a person's wealth."

Ertel gave the example of someone who dies with a large individual retirement account. The IRA proceeds can be subject to both the 48 percent estate tax, and then the 35 percent income tax, for a combined federal tax rate of 83 percent. Then there is still the matter of New York tax.

Critics of the estate tax say it penalizes hard working business owners and acts as a disincentive for growth.

"You do not have to be a rocket scientist to realize the negative impact that an estate tax has on the business owner," said David Evans, managing director of the tax practice of UHY Advisors

, an Albany CPA firm.

Evans said repealing the estate tax would allow businesses to use their capital more productively.

"They will have the capital to grow, which means hiring more people and producing more wealth to contribute to a local economic tide that ultimately floats all of our boats," he said.

Others agreed.

"Very simply, who is in favor of an estate tax?" asked Bernie Coluccio, president of The Beltrone Group LLC, a Latham-based commercial real estate developer. "No one!"

Budget woes

Actually, there are people in favor of keeping the estate tax. They say the country cannot afford the loss of revenue, which has been estimated at $745 billion over the next decade. They argue that repealing the tax would likely result in higher income taxes for everyone.

"The federal government is going bankrupt, with record deficits every new year," said John Lavelle, a partner in the Latham law firm of Lavelle & Finn LLP

. "The real question is not, should we have an estate tax, yes or no, but do you prefer an estate tax, currently imposed on only the wealthiest 2 percent of the population, or would you prefer to pay more income tax, that 60 percent of the population pays?"

Others have warned of benefit cuts. Gene Sperling, senior fellow for the Center for American Progress and former national economic adviser to President Clinton, said too many senators are more focused on a handful of wealthy donors than they are on "the millions of constituents who will pay higher debt or get less Medicaid or Social Security benefits" if the estate tax is repealed.

"This is really going to be a gut check for fiscally responsible senators," Sperling said.

Critics say even Kyl's plan would cost the government too much in taxes. It's possible that the two sides will settle on a smaller exemption.

In the meantime, many businesses and their advisers would be happy just to see Congress set forth definite guidelines and tax rates for the coming years.

"The federal estate tax is in a state of flux and this makes families and business owners uneasy," said Tully Rinckey's Verner. "It also makes the estate and financial planning process far more complex. If the estate tax laws are set at today's exemption of $1.5 million, but with a reduced tax rate of 15 percent, my clients would at least know how to budget or fund this tax burden."

Even if the Kyl plan is adopted, those pushing for total repeal have no intention of giving up.

"I think the Democrats think that would make everyone shut up and go away," Hannay said. "But I don't think that is going to happen."