[JOINT COMMITTEE PRINT]

DESCRIPTION OF GIFT AND ESTATE TAX MATTERS, INCLUDING S. 309, S. 310, S. 953, S. 1180, S. 1210, S. 1250, S. 1251, S. 1252, S. RES. 126, AND CERTAIN OTHER MATTERS

SCHEDULED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON ESTATE AND GIFT TAXATION

OF THE

COMMITTEE ON FINANCE

ON

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PREPARED BY THE STAFF

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INTRODUCTION

The Subcommittee on Estate and Gift Taxation of the Senate Committee on Finance has scheduled a hearing on June 27, 1983, on the following bills and resolution: S. 309 (relating to special estate tax credit for the estate of Nell J. Redfield), introduced by Senators Laxalt and Hecht; S. 310 (relating to special estate tax credit for the estate of Elizabeth Schultz Rabe), introduced by Senators Laxalt and Hecht; S. 953 (relating to permission to elect current use valuation on amended returns), introduced by Senator Laxalt; S. 1180 (relating to the gift and estate tax treatment of disclaimers of property created by transfers before November 15, 1958), introduced by Senators Durenberger, Boren, and Wallop; S. 1210 (relating to permission to elect alternate valuation date on a late return), introduced by Senators Baker and Sasser; S. 1250 (relating to the repeal of the gift, estate, and generation-skipping transfer taxes), introduced by Senators Symms, Boren, and others; S. 1251 (relating to amendments to the provision permitting the installment payment of estate taxes attributable to interests in certain closely held businesses), introduced by Senators Symms, Wallop, Boren, Grassley, Bentsen, and others; S. 1252 (relating to the repeal of the generation-skipping transfer tax), introduced by Senators Symms, Armstrong, Boren, Grassley, Wallop, Pryor, and others); and S. Res. 126 (relating to the sense of the Senate that certain scheduled modifications in the gift and estate taxes not be altered), introduced by Senators Wallop, Boren, Symms, Durenberger, Grassley, Bentsen, Dole, Roth, Baucus, and others. In addition, the Subcommittee has invited comments on (1) the Treasury Department proposal on the generation-skipping transfer tax; (2) modifications to the gift, estate, and generation-skipping transfer tax rates, (3) the relationship between the Federal unlimited marital deduction and State death taxes, and (4) modification of certain of the rules relating to current use valuation.

The first part of this pamphlet is a summary of the bills, resolution, and other matters which are the subject matter of the hearing. The second part contains background information concerning Federal gift, estate, and generation-skipping transfer taxes, including an overview of present law, a summary of the legislative history of those taxes, and statistical information concerning the burdens and revenues from those taxes. The third part is a more detailed description of the bills and resolution which are the subject of the hearing, including a description of present law, issues, explanation of provisions, and estimated revenue effects. The fourth part is a description of the other matters—which comments have been invited.

I. SUMMARY

A. Present Law

Under present law, a gift tax is imposed on lifetime transfers and an estate tax is imposed on deathtime transfers. In addition, a generation-skipping transfer tax is imposed on certain transfers which benefit more than one generation but which would not be subject to gift or estate tax upon the termination of the interests of intervening younger generations.

Under the Tax Reform Act of 1976, the gift and estate taxes were unified so that a single progressive rate schedule is applied to cumulative lifetime and deathtime transfers. Under the unified rate schedule, as amended by the Economic Recovery Tax Act of 1981 (ERTA), the rates range from 18 percent on the first $10,000 of taxable transfers to 60 percent on taxable transfers in excess of $3.5 million. The maximum rate is scheduled to decline in annual increments of 5 percent, to 50 percent on transfers in excess of $2.5 million. The 50 percent maximum rate will be effective on January 1, 1985.

A unified credit is allowed against an individual's gift and estate tax liabilities. With the present unified credit of $79,300 and the existing rate schedule, there is no gift or estate tax on transfers of up to $275,000. The unified credit is scheduled to increase annually through 1987, at which time no gift or estate taxes will be imposed on transfers of up to $600,000. In addition, a limited estate tax credit is allowed for State death taxes.

Present law allows an annual exclusion, for gift tax purposes, of $10,000 per donee. In addition, in the case of a qualified disclaimer by a donee or heir, the donee or heir is not deemed to have made a gift.

An unlimited deduction is allowed in computing the gift and estate taxes for certain transfers to spouses (i.e., the marital deduction). An unlimited deduction is allowed for gift and estate tax purposes for certain transfers for charitable, etc., purposes (i.e., the charitable deduction).

The estate tax provisions also allow certain real property used in the trade or business of farming or in other closely held trades or businesses to be valued at its current use value rather than its highest and best use value. The maximum reduction in the value of the real property by reason of the special valuation provision is $750,000. The estate tax benefits of the special valuation provision are recaptured in whole or in part if the heir disposes of the land or ceases to use it as a farm or in the closely held business within 10 years of the decedent's death.

Present law also allows the installment payment of estate taxes attributable to closely held businesses. Under this provision, payments may be made over a 14-year period and there is a special 4-

percent interest rate on the estate tax attributable to the first $1 million of interests in closely held businesses.

B. Bills, Resolution, and Other Matters

1. S. 309

S. 309 would provide a special estate tax credit to the Estate of Nell J. Redfield, if certain forest land included in that estate is transferred to the National Forest Service.

2. S. 310

S. 310 would provide a special estate tax credit to the Estate of Elizabeth Schultz Rabe, if certain forest land included in that estate is transferred to the National Forest Service.

3. S. 953

S. 953 would permit current use valuation elections to be made on amended estate tax returns, effective for estates of individuals dying after 1976.

4. S. 1180

S. 1180 would permit disclaimers of certain interests transferred before November 15, 1958, to be made after expiration of the time otherwise provided for disclaiming.

5. S. 1210

S. 1210 would permit the estate tax alternate valuation date to be elected on late returns in certain cases.

6. S. 1250

S. 1250 would repeal the gift, estate, and generation-skipping transfer taxes, effective with respect to individuals dying, and gifts made, after 1982.

7. S. 1251

S. 1251 would expand the types of assets that are eligible for special treatment under the estate tax installment payment provision as an interest in a closely held business, would liberalize the rules under which unpaid installments of tax and interest are accelerated, would provide a new interest rate on deferred tax and new rules on the deductibility of that interest, and would provide for judicial review of Internal Revenue Service determinations under that provision.

8. S. 1252

S. 1252 would repeal the generation-skipping transfer tax, effective for transfers after June 11, 1976.

9. S. Res. 126

S. Res. 126 would express the sense of the Senate that certain gift and estate tax reductions scheduled to become effective after 1983 should not be modified as part of any tax increase this year.

10. Other matters

Treasury Department proposal on generation-skipping transfer tax.—The Treasury Department proposal would modify the present generation-skipping transfer tax provisions by providing a flat-rate tax generally imposed on generation-skipping transfers in excess of $1 million and making other simplifying changes to the tax.

Relationship of Federal unlimited marital deduction to State death taxes.—Under present law, State death taxes may exceed the available Federal credit for those taxes and thereby result in imposition of a Federal estate tax where no such tax otherwise would be imposed due to the Federal unlimited marital deduction.

Modification of current use valuation rules.—The maximum reduction in value that can be achieved under the current use valuation provision is limited to $750,000; special rules are also provided for current use valuation of standing timber (Other farm crops may not be specially valued.).

II. BACKGROUND INFORMATION

A. Overview of Present Law

Under present law, a gift tax is imposed on lifetime transfers and an estate tax is imposed on deathtime transfers. Under the Tax Reform Act of 1976, the gift and estate taxes were unified so that a single progressive rate schedule is applied to cumulative lifetime and deathtime transfers.

1. Rates, unified credit, and computation of tax

Under the unified gift and estate tax rate schedule, rates range from 18 percent on the first $10,000 in taxable transfers to 60 percent on taxable transfers in excess of $3.5 million. The maximum tax rate is scheduled to decline to 55 percent on transfers in excess of $3 million, effective on January 1, 1984, and to 50 percent on transfers in excess of $2.5 million, effective on January 1, 1985.[1]

The amount of gift tax payable (for any calendar year) is determined by applying the unified rate schedule to cumulative lifetime taxable transfers and then subtracting the taxes payable on the lifetime transfers made for past taxable periods. This amount then is reduced by any available unified credit (and certain other credits) to determine the amount of gift tax liability for that period.

The amount of estate tax generally is determined by applying the unified rate schedule to the aggregate cumulative post-1976 lifetime and deathtime transfers and then subtracting the post-1976 gift taxes payable on the lifetime transfers. (In essence, deathtime transfers are treated as the last taxable gift by the decedent.) This amount then is reduced by any remaining unified credit and by certain other credits (discussed below) in determining the amount of estate tax liability.

The unified credit presently is $79,300.[2] With a unified credit of $79,300 and the existing rate schedule, there is no gift or estate tax on transfers of up to $275,000.[3] The unified credit is scheduled to increase to $96,300 (effective on January 1, 1984), to $121,800 (effective on January 1, 1985), to $155,800 (effective on January 1, 1986)

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[1] Prior to the Tax Reform Act of 1976, there were separate rate schedules for the gift and estate taxes. The gift tax rates were approximately three-fourths of the estate tax rates. The Tax Reform Act of 1976 combined the separate rate schedules into a unified transfer tax rate schedule.

[2] Prior to the enactment of the Tax Reform Act of 1976, there was a $30,000 lifetime exemption for gift tax purposes and a $60,000 exemption for estate tax purposes. The Tax Reform Act of 1976 converted the gift and estate tax exemptions into a unified credit. With a unified credit, the gift or estate tax first is computed without any exemption and then the unified credit is subtracted to determine the gift or estate tax liability. The $47,000 unified credit established by the Tax Reform Act of 1976 was phased in over a five-year period as follows: $30,000 for 1977, $34,000 for 1978, $38,000 for 1979, $42,500 for 1980, and $47,000 for 1981.

[3] Note that the effect of the unified credit is, in essence, to reduce the rates of tax on the first $275,000 of transfers to zero and to subject transfers in excess of that amounts to tax at the rates based upon cumulative transfers including that amount. Thus, the lowest rate at which tax liability is actually incurred under the gift and estate tax presently is 34 percent.

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and to $192,800 (effective on January 1, 1987). The amounts that can be transferred free of tax with each of these credits amounts are $325,000, $400,000, $500,000 and $600,000, respectively.

2. Transfers subject to tax: taxable gifts and the gross estate

Gift tax

The gift tax is imposed on any transfer of property by gift whether made directly or indirectly and whether made in trust or otherwise (Code sec. 2501). The amount of the taxable gift is determined by the fair market value of the property on the date of gift. In addition, the exercise or the failure to exercise certain powers of appointment are also subject to the gift tax.

Present law provides an annual exclusion of $10,000 ($20,000 where the nondonor spouse consents to split the gift) of transfers of present interests in property for each donee. In addition, certain transfers of interests in qualified pension plans are excluded from the tax and unlimited transfers between spouses are permitted without imposition of a gift tax.

Estate tax

Under present law, all property included in the "gross estate" of the decedent is subject to tax (sec. 2001). The gross estate generally includes the value of all property in which a decedent has an interest at his or her death (sec. 2031).[4] The amount included in the gross estate is generally the fair market value of the property at the date of the decedent's death, unless the executor elects to value all property in the gross estate at the alternate valuation date (which is six months after the date of the decedent's death).[5]

In addition, the gross estate includes the value of certain properties not owned by the decedent at the time of his or her death if certain conditions are met. These conditions include, generally, transfers for less than adequate and full consideration if (1) the decedent retained the beneficial enjoyment of the property during his or her life (sec. 2036) or the power to alter, amend, revoke, or terminate a previous lifetime transfer (sec. 2038), (2) the property was transferred within three years of death (under certain limited circumstances) (sec. 2035), (3) the property was previously transferred during the decedent's lifetime but the transfer takes effect at the death of the decedent (sec. 2037). Also, interests in certain annuities (other than certain interests in qualified retirement plans) are excluded from the decedent's estate to the extent their value does not exceed $100,000 (sec. 2039). In addition, the gross estate includes the value of property subject to certain general powers of appointment possessed by the decedent (sec. 2041), and the proceeds of life insurance on the decedent if the insurance proceeds are receivable by the executor of the decedent's estate or the decedent possessed an incident of ownership in the policy (sec. 2042).

[4] Special rules (discussed below in Part II.3.) are provided for jointly held property.

[5] See below (Part II.4.) for a discussion of the special method permitted for the valuation of real estate used in certain farming and other closely held businesses under Code section 2032A.

3. Jointly held property

The present estate tax provisions contain several special rules governing the treatment of jointly held property for estate tax purposes. These rules apply to forms of ownership where there is a right of survivorship upon the death of one of the joint tenants. They do not apply to community property or property owned as tenants in common.

In general, under these rules, the gross estate includes the value of property held jointly at the time of the decedent's death by the decedent and another person or persons with the right of survivorship, except that portion of the property that was acquired by the other joint owner, or owners, for adequate and full consideration in money or money's worth, or by bequest or gift from a third party. The decedent's estate has the burden of proving that the other joint owner, or owners, acquired their interests for consideration, or by bequest or gift. Consideration furnished by the surviving joint owner, or owners, does not include money or property shown to have been acquired from the decedent for less than a full and adequate consideration in money or money's worth.

The Economic Recovery Tax Act of 1981 (ERTA) provided special rules for certain qualified interests held in joint tenancy by the decedent and his or her spouse. If a decedent owns a qualified joint interest, one-half of the value of such interest is included in the gross estate of the decedent, valued as of the date of the decedent's death (or alternate valuation date), regardless of which joint tenant furnished the consideration. An interest is a qualified joint interest only if the interest was created by the decedent or his or her spouse, or both, and there are no joint tenants other than the decedent and the spouse.

4. Current use valuation

If certain requirements are met, present law allows real property used in family farms and other closely held businesses to be included in a decedent's gross estate at the property's current use value, rather than its full fair market value, provided that the gross estate may not be reduced more than, $750,000 (sec. 2032A).

An estate may qualify for current use valuation if: (1) the decedent was a citizen or resident of the United States at the time of his or her death; (2) the value of the farm or closely held business assets in the decedent's estate, including both real and personal property (but reduced by secured debts attributable to the real and personal property), is at least 50 percent of the decedent's gross estate (reduced by secured debts); (3) at least 25 percent of the adjusted value of the gross estate is qualified farm or closely held business real property; [6] (4) the real property qualifying for current use valuation passes to a qualified heir; [7] (5) such real property has been owned by the decedent or a member of his or her family and used or held for use as a farm or closely held business ("a qualified use") for 5 of the last 8 years prior to the decedent's death; and (6)

[6] For purposes of the 50-percent and 25-percent tests, the value of property is determined without regard to its current use value.

[7] The term "qualified heir" means a member of the decedent's family, including his or her spouse, lineal descendants, parents, and their descendants.

there has been material participation in the operation of the farm or closely held business by the decedent or a member of his or her family for periods aggregating 5 years out of the 8 years immediately preceding the earliest of the decedent's death or continuous disability or retirement lasting until that date (secs. 2032A (a) and (b)).[8]

If, within 10 years after the death of the decedent (but before the death of the qualified heir), the specially valued real property is disposed of to nonfamily members or ceases to be used for the farming or other closely held business purposes based upon which it was valued, all or a portion of the Federal estate tax benefits obtained from the reduced valuation will be recaptured by means of a special "additional estate tax" imposed on the qualified heir.

5. Allowable deductions

Charitable deduction

Present law allows a deduction for certain amounts transferred for charitable, etc., purposes in computing both the amount of taxable gifts and the taxable estate. The deduction is allowed for amounts transferred to the United States or any State or local government, to certain organizations organized and operated exclusively for charitable, etc., purposes, and to certain organizations of war veterans. Where the charitable transfer is an interest that is less than the donor/decedent's entire interest in the transferred property (e.g., a remainder interest), present law requires that the gift or bequest take certain specified forms in order to be deductible.

Marital deduction

Both the gift tax and the estate tax allow an unlimited deduction for certain amounts transferred from one spouse to another spouse. The Economic Recovery Tax Act of 1981 repealed the former quantative limits on the marital deduction so that no gift or estate tax is imposed on transfers between spouses. This provision was effective on January 1, 1982. ERTA further made certain terminable interests (commonly referred to as "QTIP" interests) eligible for the marital deduction and provided that those interests are includible in the estate of the surviving spouse. Terminable interests generally are not deductible and are created when an interest in property passes to the spouse and another interest in the same property passes to some other person for less than adequate and full consideration. For example, an income interest to the spouse where the remainder interest is transferred to a third party is a terminable interest.

Under the marital deduction as first adopted in 1948, a donor was allowed a marital deduction for gift tax purposes equal to one-half of the property transferred to his or her spouse. For estate tax purposes, the estate was allowed a deduction for property trans-

[8] In the case of qualifying real property where the material participation requirement is satisfied, the real property which qualifies for current use valuation includes the farmhouse, or other residential buildings, and related improvements located on qualifying real property if such buildings are occupied on a regular basis by the owner or lessee of the real property (or by employees of the owner or lessee) for the purpose of operating or maintaining the real property or the business conducted on the property. Qualified real property also includes roads, buildings, and other structures and improvements functionally related to the qualified use.

ferred to the spouse of the decedent up to one-half of the adjusted gross estate.[9] The adoption of the marital deduction allowed one spouse to transfer one-half of his or her wealth to the other spouse free of gift or estate taxes. Thus, residents of common law States could achieve roughly the same tax treatment as residents of community law States.[10]

Expenses, indebtedness, taxes, and losses

In addition to the charitable and marital deductions, estate tax deductions are allowed for certain administrative expenses of the estate, certain indebtedness of the decedent, and certain taxes other than estate, succession, legacy, or inheritance taxes (sec. 2053). A deduction also is allowed for casualty losses incurred by the decedent's estate (sec. 2054).

6. Credits against tax

In addition to the unified credit, several credits are allowed to estates which directly reduce the amount of the estate tax. Two of the most important are the credit for tax on prior transfers and the credit for State death taxes.

Credit for tax on prior transfers

Where property includible in the decedent's gross estate has recently been subject to a previous Federal estate tax, a credit is allowed for all or a portion of that previous Federal estate tax. The amount of the credit is reduced the longer the period of time between imposition of the previous Federal estate tax and the death of the decedent. After 10 years, there is no credit (sec. 2013).

State death tax credit

A limited credit is allowed against the Federal estate tax for the amount of any estate, inheritance, legacy, or succession taxes actually paid to any State or the District of Columbia on account of any property included in the gross estate (sec. 2011). The amount of the credit varies with the size of the taxable estate and ranges from no credit on small estates to 16 percent on estates exceeding approximately $10 million.[11]

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[9] The Tax Reform Act of 1976 modified the marital deduction for both gift and estate tax purposes to allow a full marital deduction for certain limited amounts of property passing between spouses.

[10] The original purpose of the marital deduction was generally to equate the tax treatment of property ownership in common law States with the tax treatment in community law States. In a community law State, one-half of all community property generally is owned for tax purposes by each spouse even though only one spouse generated the income to acquire the property. In a common law State, the property is generally considered owned for tax purposes by the spouse who generated the income to acquire the property. Because a progressive rate structure taxes one large accumulation of wealth more heavily than two smaller accumulations, residents in community property States were taxed less heavily than residents in common law States prior to the adoption of the marital deduction.

[11] The maximum limitation on the amount of the State death tax credit is essentially a percentage of the rates of Federal estate tax that existed after World War I. After that war, there was pressure to repeal the estate tax. Instead of repealing the tax, Congress adopted the State death tax credit. The effect of the credit is to provide additional revenues to the States. Indeed, most States impose an additional tax commonly referred to as a "pick up" or "make up" tax, equal to the difference between the maximum State death tax credit and any inheritance or other succession taxes the State imposes. The effect of the "pick up" tax is to insure maximum revenues for the State without otherwise increasing the total death taxes paid by the decedent's estate and heirs.

7. Generation-skipping transfer tax

Under the Federal estate tax law, the gross estate generally includes only interests in property owned by the decedent at his or her death. For example, where an individual is given only an income interest in property for life, the gross estate of the individual does not include the value of the property generating the income because the income interest terminates at death and, consequently, the individual does not own any interest in such property at his or her death.[12] Moreover, the rules requiring inclusion of property where the decedent retained a life estate in previously transferred property do not apply in such a case because the income beneficiary did not create the income interest. Consequently, it is possible under the Federal estate tax law to transfer the beneficial enjoyment of property from one generation to another without estate tax (i.e., to skip a generation) by simply providing the intermediate generation with an income interest.

In order to prevent the avoidance of the Federal gift or estate taxes through the use of generation-skipping arrangements, Congress enacted the generation-skipping transfer tax as part of the Tax Reform Act of 1976. Under that Act, a new generation-skipping transfer tax is imposed on generation-skipping transfers under a trust or similar arrangement [13] upon the distribution of the trust assets to a generation-skipping beneficiary (for example, a great-grandchild of the transferor) or upon the termination of an intervening interest in the trust (for example, the termination of an interest held by the transferor's grandchild).

Basically, a generation-skipping trust is one which provides for a splitting of the benefits between two or more generations which are younger than the generation of the grantor of the trust. The generation-skipping transfer tax is not imposed in the case of outright transfers. In addition, the tax is not imposed if the grandchild has (1) nothing more than a right of management over the trust assets or (2) a limited power to appoint the trust assets among the lineal descendants of the grantor.

The tax is substantially equivalent to the tax which would have been imposed if the property had been actually transferred outright to each successive generation. For example, where a trust is created for the benefit of the grantor's grandchild, with remainder to the great-grandchild, then, upon the death of the grandchild, the tax is computed by adding the grandchild's portion of the trust assets to the grandchild's estate and taxable gifts and computing the additional tax at the grandchild's marginal transfer tax rate. In other words, for purposes of determining the amount of the tax, the grandchild is treated as a "deemed transferor" of the trust property.

The grandchild's marginal estate tax is used for purposes of determining the tax imposed on the generation-skipping transfer, but the grandchild's estate is not liable for the payment of the tax. In-

[12] QTIP interests (discussed above) for which a marital deduction is claimed in the estate of the first spouse are included in the second spouse's estate under a special provision of the Code.

[13] For purposes of these rules, trust equivalents include life estates, estates for years, certain insurance and annuity contracts, and other arrangements where there is a splitting of the beneficial enjoyment of assets between generations.

stead, the tax generally must be paid out of the proceeds of the trust property. However, the trust is entitled to any unused portion of the grandchild's unified transfer tax credit, the credit for tax on prior transfers, the charitable deduction (if part of the trust property is left to charity), the credit for State death taxes, and deduction for certain administrative expenses.

8. Taxation of nonresident aliens

Gift tax

The Federal gift tax is imposed on nonresident aliens with respect to tangible real and personal property alocated within the United States. The regular gift tax rates apply. The rules are essentially the same as for citizens, except that the charitable deduction generally is allowed only for transfers to domestic charities and no marital deduction is allowed.

Estate tax

Present law imposes a separate estate tax on nonresident aliens (secs. 2101 to 2108). The tax is imposed only on the part of the gross estate that is situated in the United States. Deductions for expenses, indebtedness, taxes, and losses are allowed only for the proportion of the gross estate located within the United States. As in the case of the gift tax, the charitable deduction is allowed only for transfers to domestic charities and no marital deduction is allowed. There is a separate rate schedule which ranges from 6 percent on the first $100,000 in taxable estate to 30 percent on taxable estates of over $20 million. The unified credit is $3,600. Present law also imposes a special tax if an individual changes his or her United States citizenship within 10 years of death and one of the principal purposes of changing the citizenship was to avoid Federal gift, estate, or income taxes.

B. Summary of Legislative History [14]

1. 1797 to 1915

The first Federal involvement with an estate tax began in 1797 when Congress enacted a stamp tax on legacies, probates of wills and letters of administration. The stamp tax lasted until 1802 when it was repealed.

As a method of raising revenue to finance the Civil War, Congress enacted an inheritance tax [15] in 1862. Rates ranged up to 5 percent. The tax was repealed in 1870.

The next Federal estate tax [16] was imposed by the War Revenue Act of 1898. Rates ranged to 15 percent and there was an exemption of $10,000. The tax was repealed in 1902.

2. 1916 to present

1916 to 1942

The Revenue Act of 1916 imposed an estate tax that has remained in force until the present time, although it has been modified in numerous ways since then. The 1916 estate tax rates ranged from one percent on small estates to 10 percent on estates over $5 million. An exemption of $50,000 was allowed.

Between 1916 and 1942, the estate tax rates were raised or lowered on several occasions. The estate tax rates were raised twice in 1917. After these changes, the rates ranged from 2 percent on small estates to 25 percent on estates over $10 million. The Revenue Act of 1918 modified the estate tax by exempting estates of less than $1 million from the tax.

The Revenue Act of 1924 made several changes to the estate tax laws. It raised the top estate tax rate to 40 percent on estates over $10 million. It allowed a limited credit for State death taxes. The Revenue Act of 1924 also imposed a gift tax for the first time.

The Revenue Act of 1926 reduced the estate tax rates and repealed the gift tax. The maximum rate was reduced to 20 percent for estates over $10 million. The estate tax exemption was increased from $50,000 to $100,000, and the maximum credit for State death taxes was increased to 80 percent of the Federal estate tax.

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[14] For a more detailed history of the Federal gift and estate taxes, see Howard Zaritsky, "Federal Estate, Gift and Generation-Skipping Taxes: A Legislative History and a Description of Current Law", Congressional Research Service Report No. 80-76A (April 10, 1980).

[15] An inheritance tax is a tax imposed upon an individual's privilege of inheriting property from a decedent. Typically, the rates of an inheritance tax vary with the closeness of the familial relationship between the decedent and the heir. The rate schedule is applied separately to each heir. In contrast, an estate tax is a tax imposed on the decedent upon the privilege of leaving property to his or her heirs. The rate schedule is applied once to all property passing (or deemed to pass) at the decedent's death, regardless of the number of heirs or their familial relationship to the decedent.

[16] The Income Tax Act of 1894 treated gifts and inheritances as income and, thus, the tax was technically not an estate tax. The 1894 income tax act was held unconstitutional in 1895.

The Revenue Act of 1932 increased the estate tax rates, reduced the exemption to $50,000, and reenacted the gift tax. The top marginal rate under the 1932 Act was 45 percent on estates over $10 million. The gift tax rates were established at three-fourths of the estate tax rates, and there was an annual exclusion of $5,000 and a lifetime exemption of $50,000.

The Revenue Act of 1934 increased the top marginal estate tax rate to 60 percent on estates over $10 million. The Revenue Act of 1935 increased the top marginal rate to 70 percent on estates over $10 million and reduced the gift and estate tax exemptions to $40,000.

The Revenue Act of 1941 increased the gift and estate tax rates from 3 percent on small estates to 77 percent on estates over $10 million. The Revenue Act of 1942 modified the gift and estate exemptions and exclusions. Under the 1942 Act, the estate tax exemption was set at $60,000 and the gift tax exemption was set at $30,000. The annual gift tax exclusion was reduced from $5,000 to $3,000.

1943 to 1981

The rates and exemptions established by the Revenue Act of 1941 and 1942 remained in effect until the Tax Reform Act of 1976. The only other major change to the gift and estate taxes during this period was the introduction of the marital deduction by the Revenue Act of 1948. As stated above, the purpose of the marital deduction was generally to equate the tax treatment in common law States with the tax treatment in community law States.

The Tax Reform Act of 1976 modified the gift and estate tax laws in a number of ways. The most significant are as follows:[17] (1) the Act unified the gift and estate tax laws into the single cumulative transfer tax system based on combined lifetime and deathtime transfers;[18] (2) the rates were changed so that they began at 18 percent on small estates and increased to 70 percent on estates of over $5 million; (3) the gift tax and estate tax exemptions were combined and changed into a unified credit of $47,000, which allowed combined lifetime and deathtime transfers of $175,625 to be free from gift or estate taxes; (4) the marital deduction was increased to 100 percent of the first $100,000 of gifts and the first $250,000 of legacies and bequests to the spouse; (5) special valuation methods were provided for the valuation of certain real property used in farming or in other closely held businesses; and (6) a generation-skipping transfer tax was imposed.

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[17] The Tax Reform Act of 1976 also revised the income tax treatment of inherited property by providing that the basis of inherited property in the hands of the heir was the same as the basis of the property in the hands of the decedent with certain adjustments (i.e., a "carryover basis"). Under prior law, the basis of inherited property was its fair market value on the date of the decedent's death (or alternate valuation date, if elected). The carryover basis rules of the 1976 Act were repealed retroactively by the Crude Oil Windfall Profits Tax Act of 1980.

[18] Prior to enactment of the Tax Reform Act of 1976, the amount of lifetime transfers generally did not affect the amount of estate tax because there were separate rate schedules for both the gift tax and the estate tax. Under the unified system of the Tax Reform Act of 1976, deathtime transfers, in essence, are treated as the last gift of the decedent under a single rate schedule.

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1982 to present

The Economic Recovery Tax Act of 1981 further modified the gift and estate tax laws in several significant ways. The Act increased the unified credit to an equivalent amount of $600,000 (phased in over 6 years), and reduced the maximum rate from 70 percent to 50 percent (phased in over 4 years). An unlimited marital deduction was provided and certain terminable interests i.e., so-called QTIP property became eligible for the deduction for the first time. The gift tax annual exclusion was increased from $3,000 to $10,000 per donee. Rules governing the installment payment of estate tax attributable to interests in closely held businesses and the current use valuation of certain real property were liberalized.

Finally, ERTA made a number of other modifications to the gift and estate tax rules, including repeal (for most purposes) of the rule that gifts made by an individual within three years of death must be included in the individual's gross estate; elimination of a step-up in basis if appreciated property is acquired by gift by the individual within one year of death and then is returned to the donor or the donor's spouse; repeal of the orphan's exclusion; annual filing of gift tax returns; one-year extension of the transition rule for certain wills or revocable trusts under the tax on generation-skipping transfers; and allowance of a charitable deduction for gift and estate tax purposes for certain bequests or gifts of copyrightable works of art, etc., when the donor retains the copyright.

C. Statistical Information

1. Federal revenues

Prior to 1916, estate taxes were used primarily to raise revenue. Since 1916, the gift and estate taxes have been used to raise revenues and for other purposes such as preventing undue concentrations of wealth and complementing the income tax to fullfill the goal of the progressive tax system. Table 1 compares the revenue from the estate tax as a percent of all Federal revenues from the period 1925 to the present. As indicated, estate taxes have accounted for less than 2 percent of Federal revenues since World War II. Table 2 provides estimates of the revenues from gift and estate taxes from 1981 to 1985 based upon existing rates and credits.

Table 1.—Gift and Estate Tax Revenues as a Percent of Total Federal Revenue, Selected Years—1925 to Present

[In millions of dollars]

Year	Net estate tax [19]	Total Federal	Percent of revenues attributable to estate revenue [20] tax
1925	$86	$3,641	2.4
1930	39	4,058	1.0
1935	154	3,706	4.2
1940	250	6,879	3.6
1945	531	50,162	1.1
1950	484	40,940	1.2
1955	778	65,469	1.2
1961	1,619	94,389	1.7
1963	1,841	106,560	1.7
1966	2,414	130,856	1.8
1970	3,000	193,743	1.5
1977	4,979	357,762	1.4
1981	8,035	614,735	1.3
1982	6,827	618,221	1.1
1983 (est.)	5,723	627,914	0.9

[19] Calendar year receipts. (Note: calendar year receipts of estate tax generally are received in the next subsequent fiscal year.)
[20] Fiscal year receipts.

Table 2.—Federal Gift and Estate Tax Revenues, Fiscal Years 1983–1988

[In millions of dollars]

1983	1984	1985	1986	1987	1988
6,114	5,902	5,611	5,097	4,595	4,287

2. State revenues

As indicated above, present law allows a limited credit against Federal estate tax for death taxes paid to a State. Typically, most States impose an inheritance tax and, in addition, impose an estate tax, commonly called a "pick up" or "make up" tax equal to the difference between the maximum State death tax credit and any inheritance taxes imposed on property passing from the decedent. Table 3 sets forth the aggregate amount of the State death tax credit for the period 1925 to the present. This can be considered an additional burden of the Federal estate tax, although the revenue goes to the State governments, not the Federal Government.

Table 3.—Credit for State Inheritance Taxes Paid, Selected Years—1925 to Present

[In millions of dollars]

Year	Amount
1925	$11
1930	113
1935	44
1940	45
1945	65
1950	49
1955	86
1961	196
1963	208
1966	280
1970	333
1977	552
1981	896
1982	984
1983 (est.)	1,073

3. Historical distribution of the estate tax

Table 4 provides a comparison from 1925 until the present of (1) the number of taxable estate tax returns filed; (2) the number of estates paying estate tax, expressed as an absolute number and as a percentage of all individuals dying in that year; (3) the aggregate dollar amount of gross estate of all estate tax returns filed for that year; (4) the aggregate dollar amount of taxable estate of all estates paying tax for that year; (5) the aggregate dollar amount of estate tax paid for that year; and (6) the average estate tax rate of estates paying tax during that year.

Table 4.—Selected Federal Estate Tax Data, Selected Years—1925 to Present

[In millions of dollars]

		Taxable returns					
Year	Number of returns	Number of taxable returns	Percent of all decedents	Gross estate	Taxable estate	Net estate tax	Average tax rate
1925	14,013	10,642	0.8	$2,958	$1,621	$86	5.3
1930	8,798	7,028	.5	4,109	2,377	39	1.6
1935	11,110	8,655	.6	2,435	1,317	154	11.7
1940	15,435	12,907	.9	2,633	1,479	250	16.9
1945	15,898	13,869	1.0	3,437	1,900	531	27.9
1950	25,858	17,411	1.2	4,918	1,917	484	25.2
1955	36,595	25,143	1.6	7,467	2,991	778	26.0
1961	64,538	45,439	2.7	14,622	6,014	1,619	26.9
1963	78,393	55,207	3.0	17,007	7,071	1,841	26.0
1966	97,339	67,404	3.6	21,936	9,160	2,414	26.4
1970	133,944	93,424	4.9	29,671	11,662	3,000	25.7
1977	200,747	139,115	7.3	48,202	20,904	4,979	23.8
1981	114,720	74,607	3.7	52,641	31,856	8,035	25.2
1982	85,386	55,530	2.8	55,273	33,449	6,827	20.4
1983(est.)	−68,537	47,863	2.4	57,446	34,874	5,723	16.4

III. DESCRIPTION OF BILLS AND RESOLUTION

A. S. 309—Senators Laxalt and Hecht

Special Estate Tax Credit for the Estate of Nell J. Redfield

Present Law

A deduction generally is allowed for estate tax purposes for certain amounts transferred for charitable purposes (Code sec. 2055). The United States is a qualified donee of such deductible transfers. Credits against estate tax are not provided for transfers for charitable purposes.[20A]

If an estate has an estate tax liability after taking into account all allowable deductions and credits, that liability generally must be paid in cash or a cash equivalent (i.e., check or money order) (sec. 6311). Certain series of Treasury bonds ("flower bonds") may also be used to pay estate tax. To be eligible, these bonds must have been issued as part of certain pre-March 4, 1971, series of bonds, have been owned by the decedent at the time of his or her death, and have been included in the decedent's gross estate (sec. 6312).

Except in a case where the Internal Revenue Service must levy to secure payment of tax, real property and personal property other than cash or flower bonds cannot be used to pay estate tax.

Issues

The primary issue is whether a special estate tax credit in lieu of the regular charitable deduction provision should be permitted for a transfer of real property to the United States for addition to the national forest system.

A secondary issue is whether estate tax revenues should be dedicated to specific purposes that are presently funded by appropriations (i.e., expansion of the national forest system) rather than deposited in the general fund of the Treasury (as presently is done).

Explanation of Provisions

The bill would provide a special credit against Federal estate tax imposed on the Estate of Nell J. Redfield. The credit would apply to the transfer, without reimbursement or payment, to the Secretary of Agriculture for addition to the Toiyabe National Forest of

[20A] A similar credit to that proposed by the bill was allowed by the Tax Reform Act of 1976 to the Estate of LaVere Redfield, the husband of Nell Redfield, for property transferred to the Toiyabe National Forest.

In addition, the Economic Recovery Tax Act of 1981 permitted a credit to the Estate of Dorothy Meserve Kunhardt for the transfer of certain Matthew Brady glass plate negatives and the Alexander Gardner imperial portrait print of Abraham Lincoln to the Smithsonian Institution.

real property located within or adjacent to the boundaries of that national forest.

The amount of the credit would be equal to the lesser of (1) the fair market value of the transferred property as determined for Federal estate tax purposes or (2) the estate's Federal estate tax liability (plus interest thereon).

Effective Date

The provisions of the bill would be effective on the date of the bill's enactment.

Revenue Effect

It is estimated that this bill would produce a one-time revenue loss of $17.5 million in fiscal year 1984.

B. S. 310—Senators Laxalt and Hecht

Special Estate Tax Credit for the Estate of Elizabeth Schultz Rabe

Present Law

A deduction generally is allowed for estate tax purposes for certain amounts transferred for charitable purposes (Code sec. 2055). The United States is a qualified donee of such deductible transfers. Credits against estate tax are not provided for transfers for charitable purposes.

If an estate has an estate tax liability after taking into account all allowable deductions and credits, that liability generally must be paid in cash or a cash equivalent (i.e., check or money order) (sec. 6311). Certain series of Treasury bonds ("flower bonds") may also be used to pay estate tax. To be eligible, these bonds must have been issued as part of certain pre-March 4, 1971, series of bonds, have been owned by the decedent at the time of his or her death, and have been included in the decedent's gross estate (sec. 6312).

Except in a case where the Internal Revenue Service must levy to secure payment of tax, real property and personal property other than cash or flower bonds cannot be used to pay estate tax.

Issues

The primary issue is whether a special estate tax credit in lieu of the regular charitable deduction provision should be permitted for a transfer of real property for addition to the national forest system.

A secondary issue is whether estate tax revenues should be dedicated to specific purposes that are presently funded by appropriations (i.e., expansion of the national forest system) rather than deposited in the general fund of the Treasury (as is presently done).

Explanation of Provisions

The bill would provide a special credit against Federal estate tax imposed on the Estate of Elizabeth Schultz Rabe. The credit would apply to the transfer, without reimbursement or payment, of approximately 97.6 acres of property located in Douglas County, Nevada, to the Secretary of Agriculture for addition to the Toiyabe National Forest.

The amount of the credit would be equal to the lesser of (1) the fair market value of the transferred property as determined for Federal estate tax purposes or (2) the estate's Federal estate tax liability (plus interest thereon).

Effective Date

The provisions of the bill would be effective on the date of the bill's enactment.

Revenue Effect

It is estimted that this bill would produce a one-time revenue loss of $3 million in fiscal year 1984.

C. S. 953—Senator Laxalt

To Permit Current Use Valuation Elections on Amended Estate Tax Returns

Present Law

If certain requirements are satisfied, present law permits real property used in family farming operations and other closely held businesses to be included in a decedent's gross estate at its current use value, rather than its full fair market value, provided that the gross estate may not be reduced by more than $750,000 (Code sec. 2032A).

An estate may qualify for current use valuation if: (1) the decedent was a citizen or resident of the United States at his or her death; (2) the value of the farm or closely held business assets in the decedent's estate including both real and personal property (but reduced by secured debts attributable to the real and personal property), is at least 50 percent of the decedent's gross estate (reduced by secured debts); (3) at least 25 percent of the adjusted value of the gross estate is qualified farm or closely held business real property; [21] (4) the real property qualifying for current use valuation passes to a qualified heir; [22] (5) such real property has been owned by the decedent or a member of the decedent's family and used or held for use as a farm or closely held business ("a qualified use") for 5 of the last 8 years prior to the decedent's death; and (6) there has been material participation in the operation of the farm or closely held business by the decedent or a member of his or her family for periods aggregating 5 years out of the 8 years immediately preceding the decedent's death or the earlier beginning of the decedent's retirement or disability that lasted until the date of death (secs. 2032A (a) and (b)).

Before 1982, the current use valuation provision was available only if the executor of the decedent's estate made an election within 9 months after the date of death (15 months if an extension of time to file the estate tax return was granted) (sec. 2032A(d)(1)).

The Economic Recovery Tax Act of 1981 amended this requirement to permit current use valuation elections to be made on a late-filed return so long as the election is made on the first estate tax return filed. ERTA also provided that the election is irrevocable, once made.

[21] For purposes of the 50-percent and 25-percent tests, the value of property is determined without regard to its current use value.

[22] The term "qualified heir" means a member of the decedent's family, including his or her spouse, lineal descendants, parents, and their descendants.

Explanation of Provisions

The bill would permit current use valuation elections to be made on amended estate tax returns, as well as on the first return filed.

Effective Date

The provisions of the bill would apply to estates of decedents dying after December 31, 1976, provided the period of limitations for assessing estate tax has not expired before the date of the bill's enactment.

While estates of other decedents may be affected by enactment of the bill, the primary beneficiary of the retroactive effective date of bill is intended to be the Estate of Don B. Harris.

Revenue Effect

It is estimated that this bill would reduce Federal budget receipts by $5 million annually.

D. S. 1180—Senators Symms and Wallop

Tax Treatment of Certain Disclaimers

Present Law

In general, a disclaimer is a refusal to accept the ownership of property or rights with respect to property. If a qualified disclaimer is made, the Federal gift, estate, and generation-skipping transfer tax provisions apply with respect to the property interest disclaimed as if the interest had never been transferred to the person making the disclaimer. Thus, the transfer of property pursuant to the disclaimer will not be treated as a taxable gift.

Prior to the enactment of Code section 2518 in 1976, there were no uniform Federal disclaimer rules. Before the promulgation of Treasury regulations in 1958, the administrative practice of the Internal Revenue Service was to allow the Federal tax consequences of a disclaimer to depend upon its treatment under local law.

On November 14, 1958, the Treasury Department issued regulations (T.D. 6334) which required that a disclaimer (1) be effective under local law and (2) notwithstanding the timeliness of the disclaimer under local law, be made "within a reasonable time after knowledge of the existence of the transfer." In litigating this issue, the Treasury interpreted these regulations to require that a disclaimer be made within a reasonable time after the creation of the interest, rather than the time at which the interest vested, or became possessory. Thus, for example, where property was transferred to X for life, remainder to Y, both X and Y were required to disclaim within a reasonable time of the original transfer, although Y could not take possession of the property until X's death.

These regulations also applied to interests created in transfers before November 15, 1958. Thus, under the regulations, a disclaimer of an interest created in a transfer before to November 15, 1958, would be qualified for Federal tax purposes only if it were made within a reasonable time after the original transfer creating the interest.

This dispute as to the timing of a qualified disclaimer generated considerable litigation, with conflicting results. The Tax Court upheld the Treasury position in a series of cases including *Jewett* v. *Commissioner,* 70 T.C. 430 (1978), *Estate of Halbach* v. *Commissioner,* 71 T.C. 141 (1978), and *Cottrell* v. *Commissioner,* 72 T.C. 489 (1979). However, the Circuit Courts were divided on the issue. The Eighth Circuit rejected Treasury's position, concluding that State law determines the validity of a disclaimer in *Keinath* v. *Commissioner* 480 F.2d 57 (1973) and *Cottrell* v. *Commissioner,* 628 F.2d 1127 (1980). However, the Ninth Circuit upheld the decision in *Jewett* v. *Commissioner* in 1980 (638 F.2d 93) and the Supreme Court granted *certiorari.*

On February 23, 1982, the Supreme Court resolved the controversy in *Jewett* v. *Commissioner* [23] by upholding the Treasury position. Noting that the Treasury interpretation is entitled to respect because it has been consistently applied over the years, the Court concluded that the relevant "transfer" occurs when the interest is created and not at such later time as the interest vests or becomes possessory.

In the Tax Reform Act of 1976, Congress adopted a set of uniform rules to govern disclaimers of property interests transferred after December 31, 1976 (sec. 2518). Under that section, a disclaimer generally is effective for Federal gift and estate tax purposes if it is an irrevocable and unqualified refusal to accept an interest in property and meets four other conditions. First, the refusal must be in writing. Second, the written refusal generally must be received by the person transferring the interest, or the transferor's legal representative, no later than nine months after the transfer creating the interest.[24] Third, the disclaiming person must not have accepted the interest or any of its benefits before making the disclaimer. Fourth, the interest must pass to a person other than the person making the disclaimer or to the decedent's surviving spouse as a result of the refusal to accept the interest.[25]

Issue

The issue is whether a disclaimer by an individual of an interest created before November 15, 1958, should be effective for Federal gift and estate tax purposes where the disclaimer is made subsequent to a reasonable period after the creation of the interest.

Explanation of Provisions

Under the bill, a disclaimer of an interest created by a transfer made before November 15, 1958, would be treated as a qualified disclaimer if it meets the requirements of section 2518, other than the requirement that the disclaimer be made within nine months of the transfer creating the interest, and if the disclaimer is received by the transferor of the interest not later than 90 days after the date of the bill's enactment.

Effective Date

The bill would apply to disclaimers made with respect to transfers made before November 15, 1958.

Revenue Effect

This bill would have a negligible effect on Federal budget receipts, however government outlays are estimated to be increased by $30 million in fiscal year 1984, $10 million in 1985 and by less than $5 million for subsequent years.

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[23] 50 U.S.L.W. 4215; 82-1 USTC ¶ 13,453; 49 AFTR 2d 148,104.

[24] However, the period for making the disclaimer is not to expire until nine months after the date on which the person making the disclaimer has attained age 21.

[25] In addition, with respect to interests created after December 31, 1981, certain transfers to the person or persons who would have otherwise received the property if an effective disclaimer had been made under local law, may be treated as qualified disclaimers, provided the transfers are made timely and the transferor has not accepted the transferred interests or any of their benefits.

E. S. 1210—Senators Baker and Sasser

Election of Alternate Valuation Date on Late Estate Tax Return

Present Law

Under present law, the executor of a decedent's estate may elect to value the property in the gross estate as of the date of the decedent's death or the "alternate valuation date," which is generally six months after the date of the decedent's death (code sec. 2032). Alternate valuation provides estate tax relief when property in a decendent's estate declines in value shortly after the decedent's death. Alternate valuation must be elected by the executor on an estate tax return filed within nine months of the date of death (15 months if an extension of time in which to file the estate tax return is granted).[26] Except in the case of taxpayers who are abroad, the Internal Revenue Service has no authority to grant an extension exceeding six months.

Issue

The issue is whether an executor should be permitted to elect alternate valuation on an estate tax return that is not timely filed, and if so, what should be the effective date of the change.

Explanation of Provisions

The bill would permit the alternation valuation date to be elected on late-filed estate tax returns provided the returns were the first such returns filed by the estates and provided that (1) the returns were filed not more than one year after the due date (including extensions) or (2) one of the principal purposes for the late filings was not the making of the election.

The bill also would amend the alternate valuation provision to permit its election only if estate tax (in excess of the unified credit) were shown due on the first estate tax return filed. Additionally, the election would be permitted only if the executor determined in good faith that the value of the gross estate was less on the alternate valuation date than on the date of death and filed a statement to that effect with the return.

Effective Date

The provisions of the bill generally would apply to estates of decedents dying after the date of the bill's enactment.

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[26] An executor may elect alternate valuation by checking a box on Form 706, United States Estate Tax Return. An executor's failure to check the appropriate box on a timely filed Form 706 may not prevent the use of alternative valuation where the entries on the form are otherwise consistent with an election of alternate valuation (Rev. Rul. 61-128. 1961-2 C.B. 150).

The bill includes a transitional rule applicable to estates of decedents dying before the date of the bill's enactment whose estate tax returns were filed after their due date if the estate would have been eligible for the election had the decedent died after the date of the bill's enactment. The transitional rule would permit an effective election of alternate valuation to be made within one year after enactment of the bill by filing a written notice with the Internal Revenue Service. If an election were made under the transitional rule, an assessment of a deficiency in tax could be made within two years of the election although such assessment would otherwise be barred.

The retroactive provisions of the bill primarily are intended to benefit the Estate of Sylvia Buring.

Revenue Effect

It is estimated that this bill would have a negligible effect on Federal budget receipts.

F. S. 1250—Senator Symms

Repeal of Gift, Estate and Generation-Skipping Transfer Taxes

Present Law

Under present law, a gift tax is imposed on inter vivos transfers and an estate tax is imposed on deathtime transfers. The rates of tax begin at 18 percent on the first $10,000 of transfers and reach 60 percent for transfers in excess of $3.5 million. Deductions are allowed for transfers to spouses (marital deduction) and to charities (charitable deduction). Gift and estate taxes can be reduced by a unified credit of $79,300 (which permits the transfer of $275,000 free of gift or estate tax). This credit is scheduled to increase in annual increments through 1987, at which time the credit will permit transfers up to $600,000 without tax. In addition, present law imposes a generation-skipping transfer tax on transfers if beneficiaries of more than one generation receive interests in the transferred property.

Issue

The issue is whether the gift, estate, and generation-skipping transfer taxes should be repealed.

Explanation of Provisions

The bill would repeal the gift, estate, and generation-skipping transfer taxes. In addition to several conforming changes to other provisions of the Code, the bill also would provide that—

(1) Expenses of the decedent's last illness, paid within one year of the death, would be deductible under Code section 213 in computing the decedent's income tax for the year of his or her death as if the expenses had been paid when incurred; and

(2) Section 303, which accords capital gains treatment for amounts received in redemptions of corporate stock to pay death taxes and administration expenses, would be repealed.

Effective Date

The provisions of the bill would apply with respect to decedents dying after December 31, 1982, and to gifts made after that date.

Revenue Effect

It is estimated that this bill would reduce Federal budget receipts by $5,902 million in fiscal year 1984, $5,611 million in 1985, $5,097 million in 1986, $4,595 million in 1987, and by $4,287 million in 1988.

G. S. 1251—Senators Symms, Wallop, Boren, Grassley, Bentsen, and others

"Section 6166 Technical Revision Act of 1983"

Present Law

Overview

In general, estate tax must be paid within 9 months after a decedent's death. However, if certain requirements are satisfied and the executor makes an election,[27] payment of estate tax attributable to certain interests in closely held businesses can be extended and paid in installments over 14 years (interest for 4 years followed by from 2 to 10 annual payments of principal and interest) (code sec. 6166).[28] A special 4-percent interest rate is provided for tax attributable to the first $1 million in value of the closely held business interest (sec. 6601(j)).[29] Tax in excess of this amount ($345,800 less the amount of decedent's unified credit) accrues interest at the regular rate charged on deficiencies (sec. 6601(a)). The regular deficiency rate currently is 16 percent. The rate is scheduled to be reduced further, to 11 percent, on July 1, 1983.

Qualification requirements

To qualify for the installment payment provision, at least 35 percent of the value of the decedent's adjusted gross estate must consist of the value (net of business indebtedness) of an interest in a closely held business. Under section 6166, all businesses owned by the decedent and carried on as a proprietorship qualify as an interest in a closely held business. In addition, an interest in a closely held business includes interests in partnerships and corporations if certain "percentage tests" or "numerical tests" are satisfied. An interest of a partner in a partnership carrying on a trade or business qualifies if—

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[27] The election must be made within 9 months after the decedent's death (15 months if an extension of time to file the decedent's estate tax return is granted) (secs. 6166(d) and 6081). If a deficiency is later assessed, the deficiency is prorated among the installment payments to the extent that it would have been eligible for extended payment had the amount been shown on the estate tax return and if the deficiency was not due to negligence or intentional disregard of rules and regulations (sec. 6166(e)). Additionally, a special election is available to pay deficiency amounts in installments where (1) no installment payment election was initially made, (2) the estate, after examination, meets all requirements of the provisions, and (3) the deficiency was not due to negligence or intentional disregard of rules and regulations (sec. 6166(h)).

[28] Because eligibility for the installment payment provision relates to the time of payment rather than the amount of tax, the decision of the Internal Revenue Service as to an estate's eligibility or as to acceleration of unpaid tax is not subject to judicial review under present law.

[29] While the installment payment provision is generally explained as deferring estate tax attributable to closely held business property, that is not always true. The estate may extend payment of a percentage of its tax equal to the percentage of the adjusted gross estate which the business property comprises. This extension is available even if the inclusion of the business property does not result in any additional estate tax—as, for example, where it passes tax-free to a surviving spouse pursuant to the marital deduction.

(a) 20 percent or more of the value of the total capital interest in the partnership in included in the value of the decedent's gross estate ("percentage test"); or

(b) the partnership has 15 or fewer partners ("numerical test").

Stock in a corporation carrying on a trade or business qualifies if—

(a) 20 percent or more in value of the voting stock in the corporation is included in the value of the decedent's gross estate ("percentage test"); or

(b) the corporation has 15 or fewer shareholders ("numerical test").[30]

Attribution rules

Present law contains rules under which property owned by certain other persons is treated as owned by the decedent for purposes of determining whether the decedent's interest was an interest in a closely held business ("attribution rules"). These attribution rules are of two types—automatic and elective. Under these attribution rules, stock and partnership interests held by a husband and wife as community property or as joint tenants, tenants by the entirety, or tenants in common, are treated as owned by the decedent in determining the number of shareholders or partners a corporation or a partnership has. Additionally, all stock and partnership interests owned by members of the decedent's family[31] are treated as owned by the decedent. To prevent the use of trusts, corporations, and partnerships to avoid the numerical qualification tests for corporations and partnerships, the installment payment provision provides that property owned directly or indirectly by a corporation, partnership, estate, or trust is treated as owned proportionately by the owners of the entity.

The elective attribution rules permit an executor to elect to treat capital interests in partnerships and nonreadily tradable stock[32] owned by members of the decedent's family as owned by the decedent to determine whether the decedent owned 20 percent or more of voting stock or partnership capital in the closely held businesss (i.e., satisfied the percentage tests). If the elective attribution rules are used to qualify a business interest for the installment payment provision, the estate is not entitled to the special 4-percent interest rate or the initial 5-year deferral period for principal.

Aggregation rules

Present law also permits "aggregation" of interests in multiple closely held businesses to qualify an estate for the installment payment provision if 20 percent or more of the total value of each aggregated business is included in the value of the decedent's gross

[30] In the case of proprietorships, Treasury regulations provide that only assets actually used in the business are considered for purposes of the "35 percent of adjusted gross estate" test. In the case of partnerships and corporations, on the other hand, all partnership and corporate assets are considered even where some of the assets are not actually used in the business operation (Treas. Reg. sec. 20.6166A-2(c)).

[31] Family members include an individual's brothers and sisters, spouse, ancestors, and lineal descendants (sec. 267(c)(4)).

[32] Nonreadily tradable stock is stock for which there was no market on a stock exchange or over the counter market at the time of the decedent's death.

estate. Under the aggregation rules, the value of property owned by a surviving spouse with the decedent as community property, joint tenants, tenants by the entirety, or tenants in common is treated as owned by the decedent.

Definition of trade or business

Under present law, the installment payment election is available only for interests in active trades or businesses as opposed to passive investment assets. The Congressional intent that this provision not apply to all businesses or investment assets is illustrated by the Report of the Committee on Ways and Means on the Small Business Tax Revision Act of 1958 (H. Rept. No. 2198),[33] where the committee stated,

> The bill is to aid and encourage small business. It is not, however, an attempt to settle all of the small-business's problems, even in the area of Federal taxation.
>
> The . . . goal of the bill is to prevent the breakup of small businesses once they are established, and to prevent their consolidation into larger businesses. To aid in this respect your committee has provided up to 10 years for payment of estate taxes where investments are in a closely held business. This should make it unnecessary to sell a decedent's business in order to finance his estate tax.

The determination of whether an interest in an active trade or business is present is factual and must be made on a case-by-case basis. In interpreting the legislative history of the provision, the Internal Revenue Service takes the position that a passive holding company is not carrying on an active trade or business. Further, the Service takes the position that the holding company is not pierced to determine whether any subsidiary owned in part or in whole by it is carrying on an active trade or business. Likewise, the Service takes the position that assets passively leased to a separate active business, in which the decedent also owns an interest, do not constitute an active trade or business for purposes of the installment payment provision. The most detailed guidelines on what constitutes a trade or business under the installment payment provision are found in three 1975 revenue rulings—Rev. Rul. 75-365, 1975-2 C.B. 471; Rev. Rul. 75-366, 1975-2 C.B. 472; and Rev. Rul. 75-367, 1975-2 C.B. 472—issued under former section 6166A.[34]

In Rev. Rul. 75-365, supra, the IRS ruled that rental commercial property, rental farm property, and notes receivable did not constitute a trade or business within the meaning of the installment payment provision. The Service stated that the determination of what constitutes a trade or business is not made merely by reference to a broad definition of business or by reference to case law under section 162. It noted that—

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[33] The Small Business Tax Revision Act was enacted as Title II of the Technical Amendments Act of 1958 (P.L. 85-866, approved September 2, 1958). That Act included the predecessor provision to the present installment payment provision.

[34] Section 6166A, designated section 6166 before 1977, provided for payment of estate tax attributable to interests in closely held businesses in from 2 to 10 annual installments. Section 6166A was repealed by the Economic Recovery Tax Act of 1981, effective for estates of individuals dying after December 31, 1981.

> Although the management of real property by the owner may, for some purposes, be considered the conduct of business in the case of a sole proprietorship (the installment payment provision applies) only with respect to a business such as a manufacturing, mercantile, or service enterprise, as distinguished from management of investment assets.
>
> It follows that the mere grouping together of income-producing assets from which a decedent obtained income only through ownership of the property rather than from the conduct of a business, in and of itself, does not amount to an interest in a closely held business within the intent of the statute. (*Id.*).

Rev. Rul. 75-366, supra, applied the trade or business test in a farming situation. In that case, the decedent leased real property to a tenant on a crop share basis. In addition to sharing in the farm expenses and production, the decedent actively participated in important management decisions. The decedent was held to be in the business of farming under these facts, the Service saying—

> An individual is engaged in the business of farming if he cultivates, operates, or manages a farm for gain or profit, either as owner or tenant, and if he receives a rental based upon farm production rather than a fixed rental. Farming under these circumstances is a productive enterprise which is like a manufacturing enterprise as distinguished from management of investment assets.
>
> In the present case the decedent had participated in the management of the farming operations and his income was based upon the farm production rather than on a fixed rental.
>
> Accordingly, the farm real estate included in the decedent's estate qualifies . . . as an interest in a closely held business. (Id.).

Finally, Rev. Rul. 75-367, supra, held that a subchapter S corporation engaged in home construction was a trade or business within the meaning of the installment payment provision, but ownership and management of eight rental homes was not. The ruling also held that a proprietorship that developed land and sold new homes built by the construction company was carrying on a trade or business. In that ruling, the Service construed Congressional intent in enacting the installment payment provision as being to permit—

> * * * (T)he deferral of the payment of the Federal estate tax where, in order to pay the tax, it would be necessary to sell assets used in a going business and thus disrupt or destroy the business enterprise. This (provision) was not intended to protect continued management of income producing properties or to permit deferral of the tax merely because the payment of the tax might make necessary the sale of income-producing assets, except where they formed a part of an active enterprise producing business income rather than income solely from the ownership of property. Id. at 473.

When interests in oil and gas ventures constitute a trade or business within the meaning of the installment payment provision was the subject of a separate ruling by the IRS. In Rev. Rul. 61-55, 1961-1 C.B. 713, the Service held that ownership, exploration, development, and operation of oil and gas properties is a trade or business, but the mere ownership of royalty interests is not.[35]

Acceleration of unpaid tax

The right to defer payment of estate tax is terminated upon the occurrence of certain events during the 14-year extension period. If such a termination occurs, all unpaid installments of tax and accrued interest are accelerated and are payable on notice and demand from the IRS.

Disposition of interest and withdrawal of funds from the business

If the persons receiving property from the decedent whose estate elects the installment payment provision make cumulative dispositions of the interest in the business and withdrawals from the business totaling 50 percent or more of the value of the decedent's interests, all unpaid installments and interest are accelerated. Generally, mere changes in form of ownership are not treated as dispositions.[36] Additionally, the Economic Recovery Tax Act of 1981 provided a new exception which excludes dispositions by reason of death of the heir (or a subsequent transferee) from this rule. However, this exception applies only if the property is transferred to a member of the deceased heir's (or subsequent transferee's) family.

A further exception is provided for withdrawals from a corporation pursuant to a redemption under section 303, but only if all proceeds of the redemption are used to pay Federal estate taxes no later than the due date of the first installment becoming due after the redemption (or one year after the redemption, if earlier).[37]

Undistributed income of estate

If an estate has undistributed net income in any year, the income must be applied against unpaid installments by the due date of the estate's income tax return, or the unpaid tax and accrued interest is accelerated.

Late payments of principal or interest

In general, if an estate fails to make any payment of principal or interest by its due date, all unpaid amounts are accelerated. A limited exception is provided for late payments received within six months after the due date. However, such late payments are not eligible for the special 4-percent interest rate, and the estate must

[35] Under present income tax law, co-ownership of working interests in an oil and gas lease is treated as a partnership; however, if the co-owners elect, they will be treated as proprietors rather than partners (sec. 761(a)). This "election-out" of partnership treatment is not available for estate tax purposes.

[36] Under present law, a corporate reorganization which is not an income taxable event under section 368(a)(1) (D), (E), (F) is not treated as a disposition of an interest in the business for purposes of accelerating unpaid installments of tax. Likewise, certain dispositions of stock in controlled corporations (sec. 355) are not treated as dispositions.

[37] Section 303 provides special tax treatment for redemptions of corporate stock to the extent that the redemption proceeds to a shareholder do not exceed the total death taxes (including, but not limited to, Federal estate taxes) imposed by reason of the decedent shareholder's death and the amount of funeral and administration expenses allowable as an estate tax deduction to the estate.

pay a special penalty of 5 percent of the payment for each month (or part thereof) that the payment is late.

Deductibility of interest

Interest accrued as a result of extending payment of tax under the installment payment provision is deductible by the estate. The interest may be claimed as an administration expense in determining estate tax (sec. 2053) or may be claimed as an income tax deduction. The executor must elect the manner in which the deduction is to be claimed (sec. 642(g)).

In general, interest is only deductible for estate tax purposes when it is actually paid. The IRS holds that this general rule applies also to interest on tax payment of which is extended under the installment payment provision (Rev. Rul. 80-250, 1980-2 C.B. 278). Therefore, if an estate elects to claim such interest as an estate tax deduction, an amended estate tax return must be filed each year as the interest is paid. The interest deduction reduces the decedent's estate tax, and this reduction is reflected in reductions in the unpaid installments (Rev. Proc. 81-27, 1981 I.R.B. 21).

Other extensions of time to pay estate tax

If an estate is not eligible to defer estate tax under the installment payment provision, payment of the tax may be extended under the general estate tax extension of time to pay. Present law permits an extension of time to pay tax for up to 10 years upon a showing of reasonable cause. This extension is granted for a maximum period of one year at a time and can be renewed annually (as long as the reasonable cause continues to exist). One situation in which reasonable cause is present is where an estate does not have sufficient funds to pay the tax when otherwise due without borrowing at a rate of interest higher than that generally available (Treas. Reg. sec. 20.6161-1(a)).

Issues

The principal issue is whether the installment payment provision should be expanded to allow estate tax attributable to additional types of business investments.

A second issue is whether the circumstances under which estate tax deferred under the installment payment provision is accelerated should be liberalized.

A third issue is whether the normal rule that interest is deductible for estate tax purposes only when paid should be changed in the case of interest accruing on estate tax deferred under this provision so as to permit a deduction for the full amount of interest which might be paid when the estate tax return is filed.

A fourth issue is whether an interest rate, other than the regular deficiency rate, should apply to extended amounts of tax in excess of amounts subject to the special 4-percent rate of present law.

A final issue is whether decisions of the Internal Revenue Services as to qualification of an estate for the installment payment provision or acceleration of unpaid tax should be subject to judicial review even though the amount is not in dispute.

Explanation of Provisions

Overview

The bill would expand the types of assets that are eligible for special treatment under the installment payment provision as an interest in a closely held business in several ways, would liberalize the rules under which unpaid installments of tax and interest are accelerated, would provide a new interest rate on deferred tax and new rules on the deductibility of that interest, and would provide for judicial review of IRS determinations under the provision.

Qualification requirements

General rules

The bill would expand the types of business interests that qualify for the installment payment provision in numerous ways. First, the bill would increase the number of partners or shareholders a closely held business can have under the numerical tests for qualifying an interest in a partnership or corporation as an interest in a closely held business from 15 to 35. Thus, under the bill, if a partnership or corporation had 35 or fewer partners or shareholders, the numercial test would be satisfied.

The bill would count interests in partnership profits under the percentage test for qualifying interests in a partnership as an interest in a closely held business. Only interests in partnership capital are counted under present law. Thus, under the bill, if the decedent owned capital or profits interests in a partnership, or a combination of the two, totaling 20 percent or more of the value of the business, the percentage test would be satisfied.

The bill would count nonvoting stock under the percentage test for qualifying an interest in a corporation as an interest in a closely held business. Only voting stock is counted under present law. Thus, under the bill, if the decedent owned voting or nonvoting stock, or a combination of the two, totaling 20 percent or more of the value of the business, the percentage tests for corporations would be satisfied.

The bill would treat certain notes and other evidences of indebtedness as interests in closely held businesses (in addition to stock and partnership interests which are considered under present law) in determining whether the decedent owned an interest in a closely held business. This type of interest would be considered in addition to, or in combination with, corporate stock or interests in partnership profits and capital. Only debt interests acquired in exchange for stock and partnership interests owned by the decedent or for money which the decedent loaned the business more than one year before his or her death, would be considered. Thus, under the bill, the fact that the decedent withdrew from the business by selling the decedent's interest pursuant to a "buy-out" agreement with another owner who planned to continue the business after withdrawal from the business of the decedent would not preclude availability of the installment payment provision for the decedent's estate.

The bill would eliminate the present law difference in treatment of certain nonbusiness assets owned by partnerships and corporations as compared to those assets owned by individuals carrying on businesses as proprietorships. The bill would apply the present rule for proprietorships to all businesses where assets were contributed to the business by or on behalf of the decedent and were not used in the conduct of the business throughout the one-year period ending on the date of the decedent's death. Therefore, under the bill, these nonbusiness assets would not be included in determining whether the decedent's interest in the business satisfied the requirement that 20 percent or more of the total interests in a partnership or 20 percent or more of the stock in a corporation (i.e., the percentage tests) be included in the decedent's gross estate.

Attribution rules

The bill would combine the automatic and elective attribution rules of present law and would eliminate the penalties that apply under the present elective attribution rules. The new attribution rules would apply to both the numerical tests and percentage tests for determining whether partnerships and corporations are closely held businesses. In addition, the definition of family member (i.e., persons whose stock or partnership interests are treated as owned by the decedent) would be expanded to include spouses of brothers, sisters, and lineal desendants of the decedent as well as estates of family members. The broader attribution rules would normally increase the value of the business interest treated as owned by the decedent for purposes of determining whether his or her estate qualified under the installment payment provision.

Aggregation rules

The bill would expand the present law rules under which interests in multiple businesses are aggregated to qualify for the installment payment provision. Under the bill, interests which satisfy either the numerical test or the percentage test for determining whether the business is a closely held business could be aggregated to meet the requirement that an interest in a closely held business equal at least 35 percent of the decedent's adjusted gross estate. This aggregation would be permitted only if the value of each such business comprised at least 5 percent of the value of the decedent's adjusted gross estate. Thus, an estate could aggregate interests in a maximum of 20 businesses to qualify for the installment payment provision.

Definition of trade of business

The bill would expand the types of assets that, in combination, constitute a trade or business under the installment payment provision to include interests (stock, partnership interests, and indebtedness) in passive holding companies to the extent that the holding company assets represent interests in active businesses which would meet the requirements of the provision if owned directly.

The bill would also expand the availability of the installment payment provision for estates owning interests in oil and gas ventures. Under the bill, if an income tax election to treat co-owners of an oil and gas lease as proprietors were in effect at the decedent's death (under sec. 761(a)), the co-owners would be treated as proprietors for estate tax purposes as well.

Two other exceptions to the active business requirement would be enacted by the bill. First, the bill would treat royalty interests in oil and gas ventures as interests in closely held businesses regardless of whether these interests are essentially passive investment assets. Second, the bill would treat assets owned by the decedent that are passively leased to a closely held business in which the decedent was a partner or shareholder as interests in such a business.

Expansion of acceleration exceptions

The bill would expand the present law situations in which an interest in a closely business can be disposed of, and in which property can be withdrawn from the business, during the extended payment period without accelerating the payment of deferred estate tax. These expanded exceptions would apply to estates of individuals who died before 1982 if the estates elected the benefits of former section 6166A as well as to all estates electing the present installment payment provision.

Dispositions and withdrawals to pay death taxes and estate expenses

The present rule under which certain redemptions of stock from a corporation solely to pay Federal estate taxes are not treated as dispositions or withdrawals under the acceleration rules would be amended to extend this rule to any disposition or withdrawal of funds of an interest in a closely held business (whether or not by means of a redemption under sec. 303) to the extent that the proceeds are used to pay any death taxes resulting from the decedent's death (including, but not limited to, Federal estate taxes) and also funeral and administration expenses (including interest on the deferred tax) allowable to the estate as an estate tax deduction. Thus, the exception would apply to proprietorships and partnerships as well as corporations and would permit interests in the business to be sold to third parties as well as redeemed by the business entity. In addition, the bill would delay the date by which the tax would have to be paid following the disposition in the case of dispositions occurring during the first 5 years of the extended payment period. In such cases, payment of the taxes or expenses would not have to be made until the due date of the first installment of tax. Therefore, estates could dispose of stock in a closely held business up to 5 years before the proceeds of the disposition were used for payment of death taxes or funeral or administration expenses.

Reorganizations

The bill would expand the present exception to the acceleration rules for certain corporate reorganizations and stock distributions to include additional types of reorganizations (under sec. 368(a)(1)) and also tax-free exchanges of common stock for preferred stock in the same corporation (under sec. 1036).

No acceleration on subsequent death

The bill would expand the present exception to the acceleration rules for dispositions to a family member by reason of death of the heir receiving the decedent's closely held business property to permit such transfers without acceleration of unpaid tax whether or not the transferee is a family member.

No acceleration in case of certain buy-outs

The bill would enact a new exception to the acceleration rules for certain dispositions of interests in and withdrawals of funds from closely held partnerships and corporations if a note, rather than cash, is received. Under the new exception, the heir receiving the decedent's closely held business interest would be treated as disposing of the interest only to the extent that the value of the surrendered stock or partnership interest exceeded the face value of the note. The exception would only be available for exchanges where the note is (1) given by the corporation or partnership, or (2) where the note is given by another shareholder, partner, or an employee, and the purchaser had been a shareholder, partner, or employee of the business at all times during the one-year period before the exchange. If the purchaser were a shareholder or employee, the corporation or partnership would be required to guarantee the note. The bill would include special rules to accelerate unpaid tax if the note became readily tradable, were surrendered, or if 50 percent or more of the value of the business were acquired by a corporation whose stock was readily tradable.[38]

Involuntary conversions

The bill would provide that, in the case of an involuntary conversion, an interest in closely held business property is not considered to be disposed of to the extent that qualified replacement property is acquired.

Like-kind exchange

The bill would provide that, in the case of a like-kind exchange, an interest in closely held business property is not considered to be disposed of to the extent that the exchange is not taxable for income tax purposes (under sec. 1031).

Interest on installment payments

Under the bill, the special 4-percent interest rate would continue to apply to the first $345,800 (minus the amount of the decedent's unified credit) of estate tax extended under the installment payment provision. However, the rate on extended amounts in excess of the amount subject to the 4-percent interest rate would not accrue interest at the rate otherwise applicable to deficiencies (currently 16 percent). Under the bill, extended amounts in excess of this 4-percent portion would accrue interest at a rate equal to the average yield to maturity, of 14-year United States obligations, during the month of December preceding the year of the decedents' death.[39]

The bill would also change the manner in which the interest on installment payments is deducted for estate tax purposes. Under

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[38] Readily tradable stock or notes would be stock or notes which there was a market on any stock exchange or in any over-the-counter market.

[39] At the present time, the Treasury Department has no obligations maturing in the month of December. Long-term obligations are normally issued in January with maturity dates of February 15, May 15, August 15, or November 15.

the bill the full amount of interest anticipated to be paid over the 14-year extended payment period would be deductible when the decedent's estate tax return was filed (even though the interest was not paid at that time). The amount of this deduction would not be discounted to reflect the fact that the interest were not presently payable. If the installment payment election was terminated before expiration of the 14-year extension period, the estate would recompute the deduction for interest, and its estate tax, at the time of the termination.

Declaratory judgment relating to installment payment provision

The bill would provide a procedure for obtaining a declaratory judgment with respect to—

(1) an estate's eligibility for extension of tax under the installment payment provision, or

(2) whether there is an acceleration of unpaid tax.

The declaratory judgment provision would only be available when there is an actual controversy; therefore, no declaratory judgment would be available before the decedent's death (with respect to eligibility for the extension) or before a transaction causing a potential acceleration of unpaid tax.

Jurisdiction to issue the declaratory judgment would be in the Tax Court, and the decision of the Tax Court would be reviewable in the same manner as other decisions. Collection of tax would be stayed until after a decision was rendered by the Tax Court, but the executor (or heir in the case of a dispute over acceleration of unpaid tax) would be required to pay the tax or post bond before appealing from the Tax Court. The bill would also permit the courts to impose penalties in the case of actions brought primarily for delay and where it was determined that the estate was not eligible for the extension provided by the installment payment provision or that the tax was properly accelerated.

Effective Dates

The provisions of the bill would apply generally to estates of individuals dying after December 31, 1981.

The provisions of the bill relating to acceleration of unpaid tax would apply to dispositions and withdrawals after December 31, 1981.

The provisions of the bill amending the rate of interest charged on installment payments and the estate tax deductibility thereof would apply to estates of individuals dying after December 31, 1981, and also—

(1) in the case of the rate of interest charged on installment payments, to tax outstanding on January 1, 1982, for an estate for which a timely election was made under either section 6166 or section 6166A, if the executor elects to have the amendment apply; and

(2) in the case of the rules on the estate tax deduction of interest on installment payments, to tax estimated to accrue after December 31, 1981, for an estate for which a timely election was made under either section 6166 or section 6166A, if the executor elects to have the amendment apply.

Elections to have these amendments apply could be made even though the estate had elected previously to claim the interest as an income tax deduction.

The declaratory judgment provisions of the bill would apply generally to estates of individuals dying, and to dispositions or withdrawals of business interests, after December 31, 1982. The provisions of the bill authorizing penalties in the case of certain declaratory judgment proceedings, and appeals from Tax Court decisions, would apply after the date of enactment.

Revenue Effect

It is estimated that this bill would reduce Federal budget receipts by \$520 million in fiscal year 1984, \$568 million in 1985, \$621 million in 1986, \$807 million in 1987, and by \$1,097 million in 1988.

H. S. 1252—Senator Symms

Repeal of the Generation-Skipping Transfer Tax

Present Law

Under present law, a tax is imposed on generation-skipping transfers under a trust or similar arrangement upon the distribution of the trust assets to a generation-skipping heir (for example, a great-grandchild of the grantor of the trust) or upon termination of an intervening interest in the trust (for example, termination of a life income interest in the trust held by the grantor's grandchild).

Basically, a generation-skipping trust is one which provides for a splitting of benefits between two or more generations that are younger than the generation of the grantor of the trust. The generation-skipping transfer tax is not imposed in the case of outright transfers to younger generation heirs or to a trust if the benefits are not split between two or more younger generations. Thus, no generation-skipping transfer tax is imposed upon a "generator-jumping" or "layering" transfer directly to the grantor's grandchildren or other lower generation heirs. In addition, the tax is not imposed if the younger generation heir has (1) nothing more than a right of management over the trust assets or (2) a limited power to appoint the trust assets among the lineal descendants of the grantor. Present law also provides a grandchild exclusion for the first $250,000 of generation-skipping transfers per deemed transferor that vest in the grandchildren of the grantor.

The tax is substantially equivalent to the tax which would have been imposed if the property had been actually transferred outright to each successive generation (in which case, the gift or estate tax would have applied). For example, assume that a trust is created for the benefit of the grantor's grandchild during the grandchild's life, with remainder to the great-grandchild. Upon the death of the grandchild, the tax is determined by adding the grandchild's portion of the trust assets to the grandchild's estate and computing the additional tax at the grandchild's marginal estate tax rate. In other words, for purposes of determining the amount of the tax, the grandchild would be treated under present law as the "deemed transferor" of the trust property.

The grandchild's marginal estate tax rate is used for purposes of determining the tax imposed on the generation-skipping transfer, but the grandchild's estate is not liable for the payment of the tax. Instead, the tax is generally paid out of the proceeds of the trust property. In determining the amount of the generation-skipping transfer tax arising after the death of the deemed transferor, the trust is entitled to any unused portion of the grandchild's unified transfer tax credit, the credit for tax on prior transfers, the credit for State death taxes, and a deduction for certain administrative expenses.

A transitional rule was included in the law for generation-skipping transfers occurring pursuant to revocable trusts or wills in existence on June 11, 1976, if the instrument was not amended after that date to create or increase the amount of a generation-skipping transfer, and if the grantor or testator died before January 1, 1983. Generation-skipping trusts that were irrevocable on June 11, 1976, are not subject to the tax.

Issue

The issue is whether the tax on generation-skipping transfers should be repealed.

Explanation of Provision

The bill would repeal the generation-skipping transfer tax.

Effective Date

The bill would apply to otherwise taxable generation-skipping transfers occurring after June 11, 1976. Refund claims with respect to such transfers would be required to be filed within two years after the date of the bill's enactment.

Revenue Effect

It is estimated that the bill would reduce Federal budget receipts by $5 million dollars annually in fiscal years 1984 to 1988. The long term effect of the bill would be to reduce budget receipts by approximately $280 million.

I. S. Res. 126—Senators Wallop, Boren, Symms, Durenberger, Grassley, Bentsen, Dole, Roth, Baucus, and others

Expressing Sense of the Senate That Scheduled Reductions in Estate Tax Should Not Be Modified

Present Law

The Economic Recovery Tax Act of 1981 (ERTA) modified the gift and estate tax laws in numerous significant ways. ERTA increased the unified credit (which determines the amount of property that can be transferred without gift or estate tax) to an equivalent amount of $600,000, and (phased in over 6 years) and reduced the maximum tax rate from 70 percent to 50 percent (phased in over 4 years). An unlimited marital deduction was provided and certain terminable interests became eligible for the deduction for the first time. The gift tax annual exclusion was increased from $3,000 to $10,000 per donee. Rules governing the installment payment of estate tax attributable to interests in closely held businesses and the current use valuation of certain real property were liberalized.

Finally, ERTA made a number of other modifications to the gift and estate tax rules, including repeal (for most purposes) of the rule that gifts made by a decedent within three years of death must be included in the decedent's gross estate; elimination of a step-up in basis if appreciated property is acquired by gift by the decedent within one year of the decedent's death and then is returned to the donor or the donor's spouse; repeal of the orphan's exclusion; annual filing of gift tax returns; one-year extension of the transitional rule for certain wills or revocable trusts under the tax on generation-skipping transfers; and allowance of a charitable deduction for gift and estate tax purposes for certain bequests or gifts of copyrightable works of art, etc., when the donor retains the copyright.

As indicated above, the increase in the unified credit and the reduction in the maximum rate are being phased in. Specifically, the unified credit was increased by ERTA as follows:

Year	Unified credit	Equivalent amount
1982	$62,800	$225,000
1983	79,300	275,000
1984	96,300	325,000
1985	121,800	400,000
1986	155,800	500,000
1987	192,800	600,000

The maximum rate was reduced as follows:

Year	Maximum rate (percent)
1982	65
1983	60
1984	55
1985	50

Issue

Some persons have suggested that if tax increases are enacted in 1983, Congress should "freeze" reductions scheduled to become effective after 1983 rather than enact other new increases while permitting those reductions to become effective. The issue is whether the 1981 estate tax reductions should be modified if taxes are increased in 1983 by freezing or modifying scheduled future reductions in general.

Explanation of Provision

The resolution would express the sense of the Senate that gift and estate tax reductions enacted in 1981 are vital to the continuation of family farms and small businesses and that the reductions scheduled to become effective after 1983, should not be modified or repealed.

IV. DESCRIPTION OF OTHER MATTERS

A. Treasury Department Proposal on the Generation-Skipping Transfer Tax

Present Law

Overview

Present gift and estate tax rules do not apply where an individual has only an income interest or a special power of appointment in a trust, if the individual is not the grantor of the trust. Consequently, the present gift and estate tax rules allow a parent to provide his or her children with most of the beneficial interest over a trust through an income interest and a special power of appointment without the children being subject to gift and estate taxes. In substance, these rules permit the gift and estate taxes of the children's generation which are attributable to the value of the trust to be "skipped".

In order the prevent this result, Congress enacted a generation-skipping transfer tax as part of the Tax Reform Act of 1976. The generation-skipping transfer tax applies only where the beneficial ownership of the trust is shared by two or more generations younger than the generation of the grantor of the trust. The generation-skipping transfer tax essentially is equal to the additional gift and estate taxes that the otherwise "skipped" generations would have paid if the property were given outright to them.

Generation-skipping trust

The generation-skipping transfer tax applies to a generation-skipping trust or a trust equivalent. A generation-skipping trust is one which has beneficiaries in two or more generations younger than the generation of the trust's grantor (e.g., the grantor's children and grandchildren). An individual is considered a beneficiary of the trust if he or she has either an interest in the trust or a power over the trust property. Under a special exception, an individual is not considered a beneficiary of the trust because of a power to allocate trust assets solely among the individual's lineal descendants.

The determination of the generation to which an individual belongs generally follows family relationships from the grandparents of the grantor. Where a beneficiary of the trust is not related to any family member of the grantor's grandparents, that beneficiary is assigned to a generation based upon the difference in ages between the beneficiary and the grantor.

Taxable event

The generation-skipping transfer tax is imposed when either a "taxable termination" or a "taxable distribution" occurs with respect to the generation-skipping trust.

A taxable termination occurs where there is a termination of an interest or power held by an individual in a generation younger than that of the grantor (e.g., the death of the grantor's child who had an income interest in the trust) and individuals in even a lower generation (e.g., the grantor's grandchildren) have an interest or power in the trust.

A taxable distribution is a distribution out of the generation-skipping trust of property (other than accounting income) to an individual who is in a generation at least two generations below that of the grantor, but only if another person in a younger generation than that of the grantor is also a beneficiary (e.g., a distribution to the grantor's grandchildren from a trust of which the grantor's children are also beneficiaries of the trust). Distributions of trust accounting income generally are not treated as taxable distributions. Thus, distributions of accounting income to the grantor's grandchildren are not treated as taxable distributions. However, when there are distributions of both income and corpus within the same taxable year of the trust, the income is treated as being distributed first to the older generation beneficiaries (e.g., distributions to the grantor's children are deemed to be made first from accounting income).

Determination of generation-skipping transfer tax

The generation-skipping transfer tax is the additional gift or estate tax that the "skipped" generation (i.e., the "deemed transferor") would have paid if the trust property had been given directly to the deemed transferor instead of the generation-skipping trust. The deemed transferor generally is the parent of the person who benefited from the taxable termination or taxable distribution (e.g., the child of the grantor).[40] The statute provides a special exemption under which no generation-skipping transfer tax is imposed on transfers that vest property in the grandchildren of the grantor up to $250,000 per deemed transferor.

The additional gift or estate tax that the deemed transferor would have paid is equal to the gift or estate tax that the deemed transferor would have paid had the value of the property in the generation-skipping trust been included in his or her taxable gifts or taxable estate over the actual gift or estate tax that was imposed with respect to the deemed transferor. The statute and the legislative history of the generation-skipping transfer tax anticipated that the Internal Revenue Service will provide such information concerning the gift and estate tax history of the deemed transferor as is necessary to compute the generation-skipping transfer tax.

Effective date

The present tax on generation-skipping transfers applies to generation-skipping trusts created pursuant to transfers made after June 11, 1976. However, the tax does not apply to transfers made pursuant to generation-skipping trusts created pursuant to wills (or

[40] If, however, the parent is not or was not a beneficiary of generation-skipping trust, but there is another ancestor of the beneficiary who is also in a younger generation than that of the grantor and who is related by blood to the grantor, the youngest of such ancestors is the deemed transferor.

revocable trusts) executed on or before June 11, 1976, if the will or trusts were not amended after that date and the testator or grantor died before January 1, 1983.

Description of Treasury Department Proposal

Overview

The Treasury Department proposal [41] would replace the existing generation-skipping transfer tax, which attempts to determine the additional gift and estate tax that would have been paid if the property had been transferred directly from one generation to another, with a generation-skipping transfer tax determined at a flat rate.

Transfers of each grantor would be exempt from the generation-skipping transfer tax up to $1 million. The generation-skipping transfer tax would be expanded to include direct generation-skipping transfers (e.g., a direct transfers from grandfather to grandchildren) as well as those in which benefits are "shared" by beneficiaries in more than one benefits are "shared" by beneficiaries in more than one younger generation.

Flat rate of tax

Under the Treasury Department proposal, the rate of tax on generation-skipping transfers would be 80 percent of the highest gift and estate tax rates. Thus, the rate of tax on generation-skipping transfers would be 48 percent in 1983, 44 percent in 1984, and 40 percent in 1985 and thereafter.

$1 million exemption

Under the Treasury Department proposal, an exemption would be provided for all generation-skipping transfers pursuant to transfers of each grantor of up to $1 million. In addition, an individual could use the exemption of his or her spouse with that spouse's consent. The exemption would be claimed on the gift or estate tax return which reported the transfer creating the generation-skipping trust. Once a transfer was designated as exempt, all subsequent appreciation in value of the transferred property would also be exempt. The $1 million exemption would replace the $250,000 grandchild exclusion of present law, but wold not be limited to transfers to grandchildren of the grantor.

In addition, the generation-skipping transfer tax would not apply to any inter-vivos transfer which is exempt from gift tax pursuant to the $10,000 annual exclusion.

Direct generation-skipping transfers

Under the Treasury Department proposal, the generation-skipping transfer tax would apply to direct transfers from individuals of one generation to individuals who are two or more generations younger than the transferor (e.g., a direct transfer from grandfather to grandchildren or great-grandchildren). However, only one

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[41] The Treasury proposal was submitted to Congress in the form of a memorandum that accompanied a letter, dated April 29, 1983, from John E. Chapoton, Assistant Secretary for Tax Policy, to Senator Symms.

direct generation-skipping tax would be imposed on a particular transfer (e.g., a transfer from grandfather to great-grandchildren would be subject to only one generation-skipping transfer tax even though the transfer skips two generations).

Computation of tax

In the case of a direct generation-skipping transfer, the amount subject to the generation-skipping transfer tax would be the amount received by the beneficiary. In all other cases, the amount subject to tax is the full amount transferred, including any amounts out of which the generation-skipping transfer tax was paid.

Income exception

The exemption of present law from the generation-skipping transfer tax for distributions of accounting income would be eliminated.

Effective Date

Under the Treasury Department proposal, the revised generation-skipping transfer tax would apply to all transfers from irrevocable trusts created on or after the date of enactment of the proposal and to all direct generation-skipping transfers made on or after that date. However, the revised generation-skipping transfer tax generally would not apply to transfers pursuant to wills of decedents dying no more than one year after the date of the proposal's enactment.

B. Relationship of Federal Unlimited Marital Deduction to State Death Taxes

Before enactment of the Economic Recovery Tax Act of 1981 (ERTA), a deduction was allowed in determining the amount of the Federal estate tax for certain transfers to the surviving spouse of the decedent. This deduction generally could not exceed 50 percent of the adjusted gross estate of the decedent (Code sec. 2056). ERTA removed the 50 percent limitation applicable under prior law; thus, an unlimited marital deduction is permitted under present law.

Under the rules both before and after ERTA, no marital deduction is allowed for amounts paid as State death taxes, even though the State death taxes are imposed with respect to amounts passing to a surviving spouse.

Under the law both before and after ERTA, a limited credit is allowed against the Federal estate tax for State death taxes (sec. 2011). The amount of the State death tax varies with the size of the Federal taxable estate. The size of the credit varies from 0.8 percent for taxable estates from $0 to $90,000 to 16 percent of a taxable estate over $10,000,000.

A number of States impose inheritance taxes, estate taxes, or both on their citizens. In addition, a number of these States have not modified their tax laws to provide for exemption for unlimited amounts transferred to a surviving spouse or did so with a different effective date from that in ERTA.[42] As a result, it is possible that a State would impose some death taxes in the case where all of the decedent's property is transferred to his or her surviving spouse. Since State death taxes are not deductible for Federal estate tax purposes, it is possible that, in such cases, there will be a taxable estate for Federal estate tax purposes and some Federal estate tax will be due. Moreover, since Federal estate taxes are not deductible for Federal estate tax purposes, the Federal estate tax arising from the State death taxes may give rise to additional Federal estate tax (e.g., an interrelated computation may be necessary to determine the tax in such cases).

[42] The unlimited marital deduction provided by ERTA became effective for estates of individuals dying, and gifts made, after December 31, 1981.

C. Modification of Current Use Valuation Rules

Maximum reduction in value

If certain requirements are satisfied, present law permits real property used in family farming operations and other closely held businesses to be included in a decedent's gross estate at its current use value, rather than its full fair market value, provided that the gross estate may not be reduced by more than $750,000 (Code Sec. 2032A). Before enactment of ERTA, the maximum permitted reduction in value was $500,000.

Special rules for specially valuing standing timber

Real property devoted to growing timber is treated as used for a farming purpose under the current use valuation provision. Unlike other growing crops which must be valued for estate tax purposes at their full fair martket value, standing timber can be specially valued as part of the land on which it grows. If specially valued timber is servered or disposed of during the regular 10-year recapture period applicable to specially valued property, the land upon which the timber stood is treated as having been disposed of and the special "additional estate tax" or "recapture tax" is imposed on the qualified heir. In the case of a partial disposition of specially valued timber, the proceeds received are recaptured up to the amount of tax that would be due if the disposition were of the underlying land.

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