V. ESTATE, GIFT, AND GENERATION-SKIPPING TRANSFER TAX PROVISIONS


PRESENT LAW

Estate and gift tax rules

In general.

Under present law, a gift tax is imposed on lifetime transfers and an estate tax is imposed on transfers at death. The gift tax and the estate tax are unified so that a single graduated rate schedule applies to cumulative taxable transfers made by a taxpayer during his or her lifetime and at death. The unified estate and gift tax rates begin at 18 percent on the first $10,000 of cumulative taxable transfers and reach 55 percent on cumulative taxable transfers over $3 million. In addition, a 5-percent surtax is imposed on cumulative taxable transfers between $10 million and $17,184,000, which has the effect of phasing out the benefit of the graduated rates. Thus, these estates are subject to a top marginal rate of 60 percent. Estates over $17,184,000 are subject to a flat rate of 55 percent on all amounts exceeding the unified credit effective exemption amount, as the benefit of the graduated rates has been phased out.

Gift tax annual exclusion

Donors of lifetime gifts are provided an annual exclusion of $10,000 (indexed for inflation occurring after 1997), the inflation-adjusted amount for 2001 remains at $10,000) of transfers of present interests in property to any one donee during the taxable year. If the donor spouse consents to split the gift with the donor spouse, then the annual exclusion is $20,000. Unlimited transfers between spouses are permitted without imposition of a gift tax.

Unified credit

A unified credit is available with respect to taxable transfers by gift and at death. The unified credit amount effectively exempts transfers of $250,000 on transfers in 2001 of $700,000 in 2002 and 2003, $850,000 in 2004, $950,000 in 2005, and $1 million in 2006 and thereafter. The benefit of the unified credit applies at the lowest estate and gift tax rates. For example, in 2001, the unified credit applies between the 18-percent and 37-percent estate and gift tax rates. Thus, in 2001, taxable transfers, after application of the unified credit, are effectively subject to estate and gift tax rates beginning at 37 percent.

Transfers to a surviving spouse

In general.—A 100-percent marital deduction generally is permitted for the value of property transferred between spouses. In addition, transfers of a “qualified terminable interest” also are eligible for the marital deduction. A “qualified terminable interest” is property: (1) which passes from the decedent, (2) in which the surviving spouse has a “qualifying income interest for life,” and (3) to which an election under section 2041 is made. A “qualifying income interest for life” exists if: (1) the surviving spouse is entitled to all the income from the property (payable annually or at more frequent intervals) or the right to use property during the spouse’s life, and (2) no person has the power to appoint any part of the property to any person other than the surviving spouse.

Transfers to surviving spouses who are not U.S. citizens.—A marital deduction generally is denied for property passing to a surviving spouse who is not a citizen of the United States. A marital deduction is permitted, however, for property passing to a qualified domestic trust of which the noncitizen survivor is a beneficiary. A qualified domestic trust is a trust that has as its trustee at least one U.S. citizen or U.S. corporation. No corpus may be distributed from a qualified domestic trust unless the U.S. trustee has the right to withhold any estate tax imposed on the distribution.

There is an estate tax imposed on (1) any distribution from a qualified domestic trust before the date of the death of the noncitizen surviving spouse and (2) the value of the property remaining in a qualified domestic trust on the date of the death of the noncitizen surviving spouse. The tax is computed as an additional estate tax on the estate of the first spouse to die.

Expenses, indebtedness, and taxes

An estate tax deduction is allowed for funeral expenses and administration expenses of an estate. An estate tax deduction also is allowed in respect of, property for which the value of the decedent’s interest therein, undiminished by the debt, is included in the value of the gross estate. Furthermore, the total amount of claims and debts against the estate exceeding the value of the property to which the claims relate, an estate tax deduction for the excess is allowed, which excess is paid before the due date of the estate tax return. A deduction for claims against the estate generally is permitted only if the claim is allowable by the law of the jurisdiction under which the estate is being administered. A deduction also is allowed for the full unpaid amount of any mortgage upon, or of any other indebtedness in respect of, any property included in the gross estate (including interest which has accrued thereon to the date of the decedent’s death), provided that the full value of the underlying property is included in the decedent’s gross estate.

Basis of property received

In general.—Gain or loss, if any, on the disposition of the property is measured by the taxpayer’s basis in the property (including any property received by gift), less the taxpayer’s basis in such property. Basis generally represents a taxpayer’s investment in property with certain adjustments required after acquisition. For example, basis is increased by the cost of capital improvements made to the property and decreased by depreciation deductions taken with respect to the property.

Property received from a donor of a lifetime gift takes a step-up basis. “Carryover basis” means that the basis in the hands of the donee is the same as it was in the hands of the donor. The basis of property transferred by lifetime gift also is increased, but not above fair market value, by any gift tax paid by the donor. The basis of a lifetime gift, however, generally cannot exceed the property’s fair market value on the date of the gift. If the basis of the property is greater than the fair market value of the property on the date of gift, then, for purposes of determining loss, the basis is the property’s fair market value on the date of gift.

Property passing from a decedent’s estate generally is increased by any appreciation after the decedent’s death. “Stepped-up basis” for estate tax purposes means that the basis of property passing from a decedent’s estate generally is the fair market value on the date of the decedent’s death (or, if the alternate valuation date is elected, the earlier of six months after the decedent’s death or the date the property is sold or distributed by the estate). This step up (or step down) in basis eliminates the recognition of income on any appreciation of the property that occurred prior to the decedent’s death, and has the effect of eliminating the tax benefit from any unrealized loss.

Special rule for community property.—In community property states, a surviving spouse’s one-half share of community property held by the decedent and the surviving spouse (under the community property laws of any State, U.S. possession, or foreign country) generally is treated as having passed from the decedent, and thus is eligible for stepped-up basis. This rule applies if at least one-half of the whole of the community interest is includible in the decedent’s gross estate.

Special rules for interests in certain foreign entities.—Stepped-up basis treatment generally is denied to certain interests in foreign entities. Under present law, stock or securities in a foreign personal holding company take a carryover basis. Stock in a foreign investment company takes a stepped-up basis reduced by the decedent’s ratable share of the company’s accumulated earnings and profits. In addition, stock in a passive foreign investment company (including those
for which a mark-to-market election has been made) generally takes a carryover basis, except that a passive foreign investment company for which a decedent shareholder is treated as a nonresident alien does not qualify for such an election.

To qualify for the estate tax valuation date (i.e., generally the date of the decedent’s death unless an alternate valuation date is elected), the stock must have been owned primarily by the decedent and at least 25 percent of the adjusted value of the estate tax valuation date (i.e., generally the date of the decedent’s death unless an alternate valuation date is elected).

Provisions affecting small and family-owned businesses and farms

Special-use valuation.—An executor can elect to value estate tax purposes certain qualified real property used in farming or another qualifying closely-held trade or business at its current-use, rather than its fair market value. The maximum reduction in value for such real property is $750,000 (adjusted for inflation occurring after 1997; the inflation-adjusted amount for 2001 is $800,000).

Real property generally can qualify for special-use valuation if at least 50 percent of the adjusted value of the decedent’s gross estate consists of a farm or closely-held business assets in the decedent’s estate (including business and personal use property) and at least 25 percent of the adjusted value of the gross estate consists of farm or closely-held business property. In addition, the property must be used in a qualified use (e.g., farming) by the decedent or a member of the decedent’s family for five of the eight years before the decedent’s death.

If, at the special-use valuation election is made, the heir who acquired the real property ceases to use it in its qualified use within 10 years of the decedent’s death, an additional estate tax is imposed in order to re-capture the special-use tax benefit of the special-use valuation.

Family-owned business deduction.—An estate is permitted to deduct the adjusted value of a qualified-family-owned business interest of the decedent, up to $675,000. A qualified family-owned business interest is defined as a trade or business (regardless of the form in which it is held) with a principal place of business in the United States if the decedent’s family owns at least 10 percent of the trade or business, two families own 70 percent, or three families own 90 percent, as long as the decedent’s family owns at least 30 percent of the trade or business. An interest in a trade or business does not qualify if any interest in the business (or a related entity) was publicly-traded at any time within three years of the decedent’s death. An interest in a trade or business also does not qualify if more than 35 percent of the adjusted ordinary gross income of the business for the year of the decedent’s death is derived from the sale of property to unrelated parties. In the case of a trade or business that owns an interest in another trade or business (i.e., “tiered entities”), special look-through rules apply. The value of a trade or business qualifying as a family-owned business interest is reduced to the extent the business holds passive assets or excess cash or marketable securities.

To qualify for the estate tax valuation date (i.e., generally the date of the decedent’s death), the property must have been owned and materially participated in by the decedent or a member of the decedent’s family for at least five of the eight years preceding the date of death. In addition, at least one qualified heir (or member of the qualified heir’s family) is required to materially participate in the trade or business for at least 10 years following the decedent’s death.

The qualified family-owned business rules provide for a valuation date based on the number of years after the decedent’s death in which the disqualifying event occurred.

Under the provision, if the disqualifying event occurs more than 10 years after the decedent’s death, then 100 percent of the tax is recaptured. If the disqualifying event occurs during the seventh year after the decedent’s death, the qualified family-owned business deduction is limited to 70 percent of the qualified family-owned business deduction that would have been allowed if the disqualifying event had not occurred. If the disqualifying event occurs during the eighth year, the qualified family-owned business deduction is limited to 60 percent of the qualified family-owned business deduction that would have been allowed if the disqualifying event had not occurred.

The amount of gain that must be recognized by the decedent when a sale or exchange of property is made during the recapture period can be extended for a period of up to two years if the qualified heir does not begin to use the property for a period of up to two years after the decedent’s death.

An estate can claim the benefits of both the qualified family-owned business deduction and special-use valuation. For purposes of determining whether the value of the trade or business exceeds 50 percent of the decedent’s gross estate, the property’s special-use value is used if the estate claimed special-use valuation.

State death tax credit

A credit is allowed against the Federal estate tax for any State, or the District of Columbia with respect to tax on gains from the sale or exchange of property which would have been included in the decedent’s gross estate (that is, the Federal estate tax will be reduced by the amount of any State death taxes actually paid to any State or the District of Columbia with respect to any property included in the decedent’s gross estate).

The amount of credit allowable for State death taxes is determined under a graded rate table, the top rate of which is 16 percent, based on the size of the decedent’s adjusted taxable estate. Most States impose a “pick-up” or “soak-up” estate tax, which serves to impose a State tax equal to the maximum Federal credit allowable.

Estate and gift taxation of nonresident noncitizens

Nonresident noncitizens are subject to gift tax with respect to certain transfers by gift of U.S.-situated property. Such property includes real estate and tangible property located within the United States. Nonresident noncitizens generally are not subject to U.S. gift tax on transfers of intangibles, such as stock or securities, regardless of where such property is situated.

States of nonresident noncitizens generally tax such transfers. Such tax rates generally are not deductible by the transferor or the recipient of the property. In addition, the transferor or the recipient of the property may be taxed on the gain realized on the sale or exchange of such property.

Estate tax on non-exempt trusts

Under present law, non-exempt split-interest trusts are subject to certain restrictions that are applicable to private foundations if an income, estate, or gift tax charitable deduction is allowed. A non-exempt split-interest trust is subject to these rules would be prohibited from
engaging in self-dealing, retaining any excess business holdings, and from making certain investments or taxable expenditures. Failure to comply with these restrictions would result in the basis of properties placed on private foundations, which include excise taxes on self-dealing, excess business holdings, investments which jeopardize the foundation’s purposes, and certain taxable expenditures.

**HOUSE BILL**

No provision. However, H. R. 8, as passed by the House, provides as follows:

**Overview of H.R. 8**

Beginning in 2011, the estate, gift, and generation-skipping transfers taxes are repealed. In 2006 and thereafter (until repeal in 2010), the basis of assets received from a decedent generally will equal the basis of the decedent (i.e., carryover basis) at death. However, a decedent’s estate is permitted to increase the basis of appreciated assets transferred by up to a total of $1.3 million. The basis of appreciated property transferred to a surviving spouse can be increased (i.e., stepped up) by an additional $3 million. Thus, the basis of property transferred to a surviving spouse can be increased (i.e., stepped up) by a total of $4.3 million. In no case can the basis of an asset be increased above its fair market value. For these purposes, the executor will determine which assets and to what extent each asset receives a basis increase of $3 million and $3 million amounts are adjusted annually for inflation occurring after 2010.

In 2002, the unified credit is replaced with a unified exemption, and the 5-percent surtax (which phases out the benefit of the graduated rates) and the rates in excess of 53 percent are repealed. Beginning in 2003, the estate, gift, and generation-skipping transfer tax rates are further reduced each year until the estate, gift, and generation-skipping transfer taxes are repealed in 2011.

**Phaseout and repeal of estate, gift, and generation-skipping transfer taxes**

**In general**

In 2002, the top estate and gift tax rates above 53 percent are repealed, as is the 5-percent surtax, which phases out the benefit of the graduated rates. In 2003, all rates in excess of 53 percent are repealed. In 2004 through 2006, each of the rates of tax is reduced by one percentage point. In each year 2007 through 2010, each of the rates of tax is reduced by an additional percentage point. The surtax and the generation-skipping transfer tax rate in effect for a given year is the highest estate and gift tax rate in effect for that year. The reduction in estate and gift tax rates is coordinated with the income tax rates such that the highest estate and gift tax rate (and, thus, the generation-skipping transfer tax rate) will not be reduced below the top individual rate, and the lower estate and gift tax rates will not be reduced below the lowest individual tax rate. For each year 2002 through 2010, the estate and gift tax rates are reduced in proportion to the reduction in the estate and gift tax rates.

Beginning in 2011, the estate, gift, and generation-skipping transfer taxes are repealed.

**Replace unified credit with unified exemption**

Beginning in 2002, the unified credit is replaced with a unified exemption amount. The unified exemption amount, which will follow the dollar amounts of the present-law unified credit, is a 3.5 times the effective exemption amount, will be determined as follows: in 2002 and 2003, $700,000; in 2004, $850,000; in 2005, $950,000; and in 2006 and thereafter (until repeal in 2010), the estate and gift tax rates are reduced in proportion to the reduction in the estate and gift tax rates.

**Basis of property acquired from a decedent**

**In general**

Beginning in 2011, after the estate, gift, and generation-skipping transfer taxes have been repealed, the present-law rules providing for a fair market value basis of property acquired from a decedent are repealed. Instead, a modified carryover basis regime generally takes effect. Recipients of property transfers occurring after the decedent’s death will receive a basis equal to the lesser of the adjusted basis of the decedent or the fair market value of the property on the date of the decedent’s death.

The modified carryover basis rules apply to property acquired by bequest, devise, or inheritance by the decedent from the decedent, property passing from the decedent to the extent such property passed without consideration, and certain other property to which the present law rules apply.

Property acquired from a decedent is treated as if the property had been acquired by gift. Thus, the character of gain on the sale of property received from a decedent’s estate is carried over to the heir. For example, real estate that has been depreciated and would be subject to capital gain treatment if the property (which will be treated as owned by the heir) is sold will be subject to recapture if sold by the heir.

**Property to which the modified carryover basis rules apply**

The modified carryover basis rules apply to property acquired from the decedent. Property acquired from the decedent is (1) property acquired by bequest, devise, or inheritance by the decedent’s estate from the decedent, (2) property transferred by the decedent during his or her lifetime for present or future benefit to or by the decedent, property passing from the decedent to the extent such property passed without consideration, and (3) certain property to which the present law rules apply.

Property acquired from a decedent is treated as if the property had been acquired by gift. Thus, the character of gain on the sale of property received from a decedent’s estate is carried over to the heir. For example, real estate that has been depreciated and would be subject to capital gain treatment if the property (which will be treated as owned by the heir) is sold will be subject to recapture if sold by the heir.

**Basis of property acquired from a decedent**

**Amount of basis increase.**—The bill allows an executor to increase (i.e., step up) the basis in assets owned by the decedent and acquired by the heir. Under this rule, each decedent’s estate generally is permitted to increase (i.e., step up) the basis of assets transferred by up to a total of $1.3 million. The amount of the basis increase is determined by the amount of unused capital losses, net operating losses, and certain “built-in” losses of the decedent. In addition, the basis of property transferred to a surviving spouse can be increased by an additional $3 million. Thus, the basis of property transferred to surviving spouses can be increased by a total of $4.3 million. The basis of property acquired from the decedent also is treated as having owned the property at the date of death of the decedent. The decedent shall not, however, be treated as owning any property solely by reason of holding a power of appointment with respect to such property.

**Property not eligible for a basis increase includes: (1) property that was acquired by the decedent by gift (other than from his or her spouse) during the three-year period ending on the date of the decedent’s death; (2) any property that constitutes a right to receive income in respect of a decedent; (3) stock or securities of a foreign personal holding company; (4) stock of a domestic sales corporation (or former domestic international sales corporation); (5) stock of a foreign investment company; and (6) stock of a passive foreign investment company (except for which a decedent shareholder had made a qualified electing fund election).

**Rules applicable to basis increase.—Based on the amount of the basis increase, any property can be treated as owned by the heir for purposes of the generation-skipping transfer tax.**

**Lifetime gift**

A donor is required to report to the Internal Revenue Service ("IRS") the basis and character of any non-cash property transferred by gift with a value in excess of $25,000 (separate gifts to closely related individuals). The donor is required to report to the IRS:

- The name and taxpayer identification number of the donee,
- An accurate description of the property,
- The adjusted basis of the property in the hands of the donor at the time of gift,
- The donor’s holding period for such property,
- Sufficient information to determine whether any gain on the sale of the property would be treated as ordinary income, and
- Other information as the Treasury Secretary may prescribe.

- 14Sec. 1014(b)(2) and (3).
- 15This is the same property the basis of which is stepped up to date of death fair market value under present law sec. 1014(b)(2).
- 16Pursuant to the law property the basis of which is stepped up to date of death fair market value under present law sec. 1014(b)(3).
Similar information (including the name, address, and phone number of the person making the return) is required to be provided to recipients of such property.

**Transfers at death**

For purposes of the death of non-cash assets in excess of $1.3 million and for appreciated property the value of which exceeds $25,000 received by a decedent within three years of death, the executor of the estate (or the trustee of a revocable trust) would report to the IRS:

- The name and taxpayer identification number of the property,
- An accurate description of the property,
- The adjusted basis of the property in the hands of the decedent and its fair market value at the time of death,
- The decedent’s holding period for the property,
- Sufficient information to determine whether any of the property would be treated as ordinary income,
- The amount of basis increase allocated to the property, and
- Any other information as the Treasury Secretary may prescribe.

**Penalties for failure to file required information**

Any donor required to report to the IRS transfers at death of non-cash assets in excess of $1.3 million in value who fails to do so is liable for a penalty of $500 for each failure to report such information to the IRS and $50 for each failure to report such information to a beneficiary.

Any person required to report to the IRS transfers at death of non-cash assets in excess of $25,000 who fails to do so is liable for a penalty of $10,000 for each failure to report such information to the IRS.

Penalties are imposed with respect to any failure that is due to reasonable cause. If any failure to report to the IRS or a beneficiary under the bill is due to intentional disregard of the rules, then the penalty is five percent of the fair market value of the property for which reporting was required, determined at the date of the decedent’s death (for property passing at death) or determined at the time of gift (for a lifetime gift).

**Certain tax benefits extending past the date for repeal of the estate tax**

Prior to repeal of the estate tax, many estates may have claimed certain estate tax benefits which, upon certain events, may trigger a recapture tax. Because repeal of the estate tax is effective for decedents dying after January 1, 2011, these estate tax recapture provisions will continue to apply to estates of decedents dying before January 1, 2011.

**Qualified conservation easements**

A donor may have retained a development right in the conveyance of a conservation easement that qualified for the estate tax exclusion. Those with an interest in the land may be subject to a liability that is greater than the decedent’s basis in the property. Similarly, no gain is recognized by the estate on the distribution of such property to a beneficiary of the estate by reason of the liability.

**Income tax exclusion for the gain on the sale of a principal residence**

Income tax exclusion of up to $250,000 of gain on the sale of a principal residence is extended to estates and heirs. Under the bill, if the decedent’s estate or an heir sells the decedent’s principal residence, $250,000 of gain can be excluded on the sale of the residence, provided the decedent used the property as a principal residence for two or more years during the five-year period prior to the sale. In addition, if an heir occupies the property as a principal residence, the decedent’s estate or an heir may sell the property as a principal residence can be added to the heir’s subsequent ownership and occupancy in determining whether the property was owned and occupied for two years as a principal residence.

**Excise tax on nonexempt trusts**

Under the bill, split-interest trusts are subject to certain restrictions that are applicable to private foundations if an income tax charitable deduction, including an income tax charitable deduction by an estate or trust, was allowed with respect to transfers to the trust.

**Anti-abuse rules**

The Treasury Secretary is given authority to treat a transfer that purports to be a gift as having never been transferred, if, in connection with such transfer, it is determined that it is appropriate to prevent income tax avoidance and (1) the transferor (or any person related to or designated by the transferor or such person) has received anything of value in connection with the transfer from the transferee directly or indirectly or (2) there is an understanding or expectation that the transferor (or any person related to or designated by the transferor or such person) will receive anything of value in connection with the transfer from the transferee directly or indirectly.

**Study mandated by the bill**

The bill requires the Treasury Secretary to conduct a study of opportunities for avoidance of the income tax, if any, and potential increases in income tax revenues by reason of enactment of the bill. The results of such study are required to be submitted to the House Committee on Ways and Means and the Senate Committee on Finance no later than December 31, 2002.

**Interaction of the bill with death tax treaties**

The Committee expects that, where applicable, references in U.S. tax treaties to the unified credit will be amended to apply, in a similar manner, to the unified exemption amount (as in effect for decedents dying and gifts made after December 31, 2001)30 Effective date

The unified credit is replaced with a unified exemption, the 5-percent surtax is repealed, and the rates in excess of 53 percent are repealed for estates of decedents dying and gifts and generation-skipping transfers made after December 31, 2001. The estate and gift tax rates in excess of 50 percent are repealed for estates of decedents dying and gifts made after December 31, 2001.30 See, e.g., Article 3, Protocol Amending the Convention Between the United States of America and the Republic of Germany for the Avoidance of Double Taxation with Respect to Taxes on Estates, Inheritances, and Gifts (Senate Treaty Doc. 84-48 [the ‘‘treaty’’]), a pro rata unified credit is provided to the estate of an individual domiciled in Germany (who is not a U.S. citizen for purposes of the estate tax) or gift by an estate of an individual domiciled in Germany residing in the United States. Such an individual domiciled in Germany is entitled to a credit against U.S. estate tax based on the extent to which the assets of the estate are situated in the United States.
gifts and generation-skipping transfers made after December 31, 2002. The additional reductions in estate and gift tax rates and of the State death tax credit occur for decedents dying after gifts and generation-skipping transfers made in 2004 through 2010. The estate, gift, and generation-skipping transfer taxes are repealed and the carryover basis regime takes effect for estates of decedents dying and gifts and generation-skipping transfers made in 2004 through 2010.

The provisions relating to purported gifts and recognition of gain on transfers to nonresidents who are not U.S. citizens are effective for transfers made after December 31, 2010.

**SENATE AMENDMENT**

The Senate amendment is similar to the provision in H.R. 8; however, under the Senate amendment, the gift tax will not be repealed. The Senate amendment also includes the following modifications:

- **Phaseout and repeal of estate and generation-skipping transfer taxes; modifications to gift tax**

  The Senate amendment provides that the unified credit effective exemption amount will be phased in. The estate and gift tax rates will be reduced over time. The unified credit effective exemption amount (for estate and gift tax purposes) will be increased to $1 million in 2002 and thereafter. For gift tax purposes, the unified credit effective exemption amount will remain at $1 million in 2002 and thereafter. For estate tax purposes, the unified credit effective exemption amount and generation-skipping transfer tax exemption will increase over time.

<table>
<thead>
<tr>
<th>Calendar year</th>
<th>Estate and GST tax deathline transfer exemption amount</th>
<th>Highest estate and gift tax rates</th>
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<tr>
<td>2002</td>
<td>$1 million</td>
<td>0%</td>
</tr>
<tr>
<td>2003</td>
<td>$1 million</td>
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<td>2011</td>
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<tr>
<td>2011</td>
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<td>45% (gift tax only)</td>
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Under the Senate amendment, except as provided in regulations, a transfer to a trust will be treated as a taxable gift beginning in 2011. The family-owned business deduction rules, including the carryover of the deduction for State death taxes paid, are repealed.

**Reduction in State death tax credit; deduction for State death taxes paid**

The Senate amendment provides that, from 2002 through 2004, the top State death tax credit rate is decreased from 2002 through 2004, the top State death tax credit rate is decreased from 16 percent in value and basis of property (e.g., the fair market value and basis of property) that was reported on a gift tax return with respect to such property.

**Penalties for failure to comply with the reporting requirements**

Any donor required to report to the IRS transfers at death of non-cash assets in excess of $1.3 million in value who fails to do so is liable for a penalty of $10,000 for the failure to report such information to a donee.

- **Certain tax benefits extending past the date for repeal of the estate tax**

  Under the Senate amendment, there will continue to be the additional estate tax for those with a retained development right with respect to political contributions. Any person required to report to the IRS transfers to nonresident noncitizens are effective for transfers made after December 31, 2010.

**Phasedout and repeal of estate and generation-skipping transfers tax**

In general

Under the Senate amendment, the 5-percent surtax (which phases out the benefit of the graduated rates) and the rates in excess of 50 percent are repealed. In addition, in 2002, the unified credit effective exemption amount (for both estate and gift tax purposes) is increased to $1 million. In 2003, the estate and gift tax rates in excess of 49 percent are repealed. In 2004, the estate and gift tax rates in excess of 48 percent are repealed, and the unified credit effective exemption amount for estate tax purposes is increased to $1.5 million. The unified credit effective exemption amount for gift tax purposes remains at $1 million as increased in 2002.

**Overview**

The conference agreement follows the Senate amendment with modifications. Under the conference agreement, the estate, gift, and generation-skipping transfer taxes are reduced between 1992 and 2004, and the estate and generation-skipping transfer taxes are repealed in 2010.

**Phasedout and repeal of estate and generation-skipping transfers tax**

Under the Senate amendment, the estate and gift tax rates and unified credit effective exemption amounts for estate tax purposes are reduced as follows:

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<tr>
<td>2009</td>
<td>$1.5 million</td>
<td>46%</td>
</tr>
<tr>
<td>2010</td>
<td>$1.5 million</td>
<td>45%</td>
</tr>
<tr>
<td>2011</td>
<td>N/A (taxes repealed)</td>
<td>45% (gift tax only)</td>
</tr>
</tbody>
</table>

The generation-skipping transfer tax exemption for a given year (prior to repeal) is equal to the unified credit effective exemption amount for estate tax purposes. In addition, as under present law, the generation-skipping transfer tax rate for a given year is 15 percent.
will be the highest estate and gift tax rate in effect for such year.

Repeal of estate and generation-skipping transfer taxes; modifications to gift tax

In 2010, the estate and generation-skipping transfer taxes are repealed. Also beginning in 2010, the top individual income tax rate as provided under the bill, and, except as provided in regulations, a transfer to trust will be treated as a taxable gift, unless the trust is treated as wholly owned by the donor or the donor’s spouse under the grantor trust provisions of the Code.

Reduction in State death tax credit; deduction for state death taxes paid

Under the conference agreement, from 2002 through 2004, the State death tax credit allowable under present law is reduced as follows: in 2002, the State death tax credit is reduced by 25 percent (from present law amounts); in 2003, the State death tax credit is reduced by 50 percent (from present law amounts); and in 2004, the State death tax credit is reduced by 75 percent (from present law amounts). The reduction in the State death tax credit is repealed, after which there will be a deduction for death taxes (e.g., any estate, inheritance, legacy, or succession taxes) actually imposed on the State death tax of the State in which such refund suit has become final, or (b) 60 days after a decision of a court in which such refund suit has become final.

Basis of property acquired from a decedent

The conference agreement includes the rules regarding the determination of basis of property acquired from a decedent after repeal of the estate tax included in H.R. 8 and the Senate amendment; however, these rules will be in effect beginning in 2010 (i.e., when the estate tax is repealed under the conference agreement).

Reporting requirements

The conference agreement follows the Senate amendment.

Certain tax benefits extending past the date for repeal of the estate tax

The conference agreement follows the Senate amendment, with a modification regarding property in a qualified domestic trust. There will continue to be an estate tax imposed on (1) any distribution prior to January 1, 2021, from a qualified domestic trust before the later of (a) two years after the date of the decedent’s death or (b) the expiration of the period of limitations in which to file a claim for refund or 60 days after a decision of a court in which such refund suit has become final.

Basis of property acquired from a decedent

The conference agreement includes the rules regarding the determination of basis of property acquired from a decedent after repeal of the estate tax included in H.R. 8 and the Senate amendment; however, these rules will be in effect beginning in 2010 (i.e., when the estate tax is repealed under the conference agreement).

Effective date

The estate and gift rate reductions, increases in the estate tax unified credit exemption equivalent amounts and generation-skipping transfer tax exemption amount, and reductions in and repeal of the state death tax credit are phased-in over time, beginning with estate and gift tax rates and transfers of generation-skipping transfers after December 31, 2001. The repeal of the qualified family-owned business deduction is effective for estates of decedents dying after December 31, 2005.

The estate and generation-skipping transfer taxes are repealed, and the carryover basis regime takes effect for estates of decedents dying after December 31, 2009. The provisions relating to recognition of gain on transfers by the estate of a U.S. person (i.e., at death) to nonresidents who are not U.S. citizens is effective for transfers made after December 31, 2009.

The top gift tax rate will be the top individual income tax rate as provided in the bill, and transfers to trusts generally will be treated as a taxable gift unless the trust is treated as wholly owned by the donor or the donor’s spouse, effective for gifts made after December 31, 2009.

An estate tax on distributions made from a qualified domestic trust before the date of the death of the surviving spouse will no longer apply and distributions made after December 31, 2020. An estate tax on the value of property remaining in a qualified domestic trust on the date of death of the surviving spouse will no longer apply after December 31, 2009.

B. EXPAND ESTATE TAX RULE FOR CONSERVATION EASEMENTS (SEC. 501 OF H.R. 8, SEC. 551 OF THE SENATE AMENDMENT, AND SEC. 2031 OF THE CODE)

Present law

In general

An executor can elect to exclude from the taxable estate the fair market value of any land subject to a qualified conservation easement, up to a maximum exclusion of $100,000 in 1998, $200,000 in 1999, $300,000 in 2000, $400,000 in 2001, and $500,000 in 2002 and thereafter (sec. 2031(c)). The exclusion percentage is reduced by 2 percentage points for each percentage point (or fraction thereof) by which the fair market value of the conservation easement is less than 30 percent of the value of the land (determined without regard to the value of such easement and reduced by the value of any retained development rights).

A qualified conservation easement is one that meets the following requirements: (1) the land is located within 5 miles of a metropolitan area (as defined by the Office of Management and Budget) or a national park or wilderness area, or within 10 miles of an Urban Metropolitan Forest (as designated by the Forest Service of the U.S. Department of Agriculture); (2) the land has been owned by the decedent or a member of the decedent’s family at all times during the three-year period ending on the date of the decedent’s death; and (3) a qualified conservation contribution (within the meaning of sec. 170(h)) of a qualified real property interest (as generally defined in sec. 170(h)(2)(C)) was granted by the decedent or a member of her or her family. For purposes of the provision, preservation of a historically important land area or a certified historic structure does not qualify as a conservation purpose.

In order to qualify for the exclusion, a qualifying easement must have been granted by the decedent, a member of the decedent’s family, the executor of the decedent’s estate, or the trustee of a trust holding the land, no later than the date of the election. To the extent that the value of such land is excluded, the basis of such land acquired at death is a carryover basis (i.e., the basis is not stepped-up to its fair market value at death). Property financed with acquisition indebtedness is eligible for this provision only to the extent of the net equity in the property.

Retained development rights

The exclusion for land subject to a conservation easement does not apply to any development right retained by the donor in the conveyance of the conservation easement. An example of such a development right would be the right to extract minerals from the land. If such development rights exist, then the value of the conservation easement must be reduced by the value of any retained development right.

If the donor or holders of the development rights agree in writing to extinguish the development rights in the land, then the value of the easement need not be reduced by the development rights. In such case, those persons with an interest in the land must execute the agreement no later than the earlier of (1) 10 years after the date of the decedent’s death or (2) the date of the sale of such land subject to the conservation easement. If such agreement is not entered into within this time, then those with an interest in the land are personally liable for an additional tax, which is the amount of tax which would have been due on the retained development rights subject to the termination agreement.

H2776

CONGRESSIONAL RECORD—HOUSE

May 25, 2001

No provision. However, H.R. 8, as passed by the House expands the availability of qualified conservation easements by modifying
the distance requirements. Under the bill, the distance within which the land must be situated from a metropolitan area, national park, or wilderness area is increased from 25 to 50, and the distance from which the land must be situated from an Urban National Forest is increased from 10 to 25 miles. The bill also clarifies that the date for determining easement compliance is the date on which the donation was made.

**Effective date.**—The provisions are effective for estates of decedents dying after December 31, 2000.

**SENATE AMENDMENT**
The Senate amendment expands availability of qualified conservation easements by eliminating the requirement that the land be located in a certain distance from a metropolitan area, national park, wilderness area, or Urban National Forest. Thus, under the Senate amendment, a qualified conservation easement may be claimed with respect to any land that is located in the United States or its possessions.

The Senate amendment also clarifies that the date for determining easement compliance is the date on which the donation was made.

**Effective date.**—The provisions are effective for estates of decedents dying after December 31, 2000.

**CONFERENCE AGREEMENT**
The conference agreement follows the Senate amendment.

**C. MODIFY GENERATION-SKIPPING TRANSFER TAX RULES**

1. Deemed allocation of the generation-skipping transfer tax exemption to lifetime transfers to trusts that are not direct skips (sec. 601 of H.R. 8, sec. 561 of the Senate amendment, and sec. 2652 of the Code)

**PRESENT LAW**

A generation-skipping transfer tax generally is imposed on transfers, either directly or through a trust or similar arrangement, to a "skip person" (i.e., a beneficiary in a generation more than one generation below that of the transferor). Transfers subject to the generation-skipping transfer tax include direct skips, taxable terminations, and taxable distributions. An exemption of $1 million (indexed beginning in 1999; the inflation-adjusted amount for 2001 is $1,060,000) is provided for each person making generation-skipping transfers. The provision applies to transfers made during an individual's life, is automatically allocated on the due date for filing the decedent's estate tax return, and is allocated to transfers made during an individual's lifetime. A skip person's generation-skipping transfer tax exemption is allocated pro rata, on the basis of the value of the property at the time of the transfer. If, however, the allocation is not made on a timely filed gift tax return, then the portion of the trust which is exempt from generation-skipping transfer tax is based on the value of the property at the time of the transfer.

**Effective date.**—The provisions are effective for estates of decedents dying after December 31, 2000.

**CONFERENCE AGREEMENT**
The conference agreement follows the Senate amendment.

**HOUSE BILL**

No provision. However, H.R. 8, as passed by the House, provides that generation-skipping transfer tax exemption will be automatically allocated to transfers made during life that are "indirect skips." An indirect skip is any transfer of property (that is not a direct skip) on which a deduction is allowed for the amount of an interest in the form of a charitable unitrust; or

**HOUSE**

The conference agreement follows the Senate amendment.

2. Retroactive allocation of the generation-skipping transfer tax exemption (sec. 601 of H.R. 8, sec. 561 of the Senate amendment, and sec. 2652 of the Code)

**PRESENT LAW**

A taxable termination is a termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in trust unless, immediately after such termination, a non-skip person has an interest in the property. If there is no non-skip person, the termination may a distribution (including distributions and terminations) be made to a non-skip person.

A taxable termination is a termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in trust unless, immediately after such termination, another person identified in the instrument (by name or by class) who is more than 10 years older than such individuals;

The trust instrument provides that, if one or more individuals who die before the date that such individual attains age 46, changes in the trust instrument by the transferor, or are subject to a general power of appointment exercisable by one or more of such individuals;

The trust is a trust any portion of which would be included in the gross estate of a non-skip person (other than the transferor) if such person died immediately after the transfer.

The trust is a charitable lead annuity trust or a charitable remainder annuity trust or a charitable unitrust; or

The trust is a trust with respect to which a deduction was allowed under section 2522 for the amount of an interest in the form of the right to receive annual payments of a payment to be made after the death of the transferor (determined yearly) and which is required to pay principal to a non-skip person if such person is alive when the payments commence.

If any individual makes an indirect skip during the individual's lifetime to a natural person or a trust (other than the transferor) who is more than 10 years older than such individual, the used portion of such individual's generation-skipping transfer tax exemption is allocated to the trust transferred to the extent necessary to make the inclusion ratio for such property equal to zero. An individual can elect out of the automatic allocation for lifetime direct skips.

The conference agreement follows the Senate amendment.

**Effective date.**—The provisions are effective for estates of decedents dying after December 31, 2000.

**CONFERENCE AGREEMENT**
The conference agreement follows the Senate amendment.

The Senate amendment is the same as the provision in H.R. 8.

2. Retroactive allocation of the generation-skipping transfer tax exemption (sec. 601 of H.R. 8, sec. 561 of the Senate amendment, and sec. 2652 of the Code)

**PRESENT LAW**

A taxable termination is a termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in trust unless, immediately after such termination, a non-skip person has an interest in the property, or unless at no time after the termination may a distribution (including distributions and terminations) be made to a non-skip person.

The conference agreement follows the Senate amendment.

The Senate amendment and the conference agreement follow the Senate amendment to H.R. 8. The Senate amendment is the same as the provision in H.R. 8.
A transferor likely will not allocate generation-skipping transfer tax exemption to a trust that the transferor expects will benefit only non-skip persons. However, if a taxable termination occurs, for example, the transferor’s child unexpectedly dies such that the trust terminates in favor of the transferor’s grandchild, and generation-skipping transfer tax exemption had not been allocated to the trust, then generation-skipping transfer tax would be due even if the transferor had unused generation-skipping transfer tax exemption.

HOUSE BILL

No provision. However, H.R. 8, as passed by the House, provided that generation-skipping transfer tax exemption can be allocated retroactively, but there is an unnatural order of death. If a lineal descendant of the transferor predeceases the transferor, then the transferor can allocate any unused generation-skipping transfer exemption to any previous transfer or transfers to the trust on a chronological basis. The provision allows a transferor to retroactively allocate generation-skipping transfer exemption to a trust where a beneficiary (a) is a non-skip person, (b) is a lineal descendant of the transferor’s grandparent or a grandparent of the transferor’s generation, (c) is a lineal descendant of the transferor’s spouse, or (d) dies before the transferor. Exemption is allocated under this rule retroactively, and the application of the inclusion ratio would be determined based on the value of the property on the date that the property was transferred to trust.

Effective date. The provision applies to deaths of non-skip persons occurring after December 31, 2000.

SENATE AMENDMENT

The Senate amendment is the same as the provision in H.R. 8.

CONFERENCE AGREEMENT

The conference agreement follows H.R. 8 and the Senate amendment.

3. Severing of trusts holding property having an inclusion ratio of greater than zero (sec. 602 of H.R. 8, sec. 562 of the Senate amendment) is severed according to a direction in the governing instrument or (2) the trust is severed pursuant to the trustee’s discretionary powers, but only if certain other conditions are satisfied (e.g., a severance occurs or a reformation proceeding begins before the estate tax return is due). Under current Treasury regulations, however, a trustee cannot sever one trust and make the other a successor or successor one by severing a trust that is subject to the generation-skipping transfer tax after the trust has been created.

HOUSE BILL

No provision. However, H.R. 8, as passed by the House, provides that a trust can be severed in a “qualified severance.” A qualified severance is defined as the division of a single trust into two or more trusts if (1) the single trust was divided on a fractional basis, and (2) the terms of the new trusts, in the aggregate, provide for the same succession of interests of beneficiaries as are provided in the original trust. If a trust has an inclusion ratio of greater than zero and less than one, a severance is a qualified severance only if the single trust is divided into two trusts, one of which receives a fractional share of the total value of all trust assets equal to the applicable fraction of the single trust immediately before the severance.

The effective date for determining generation-skipping transfer tax exemption will be made after December 31, 2000. No inference is intended with respect to the availability of relief from late elections prior to the effective date of the provision.

Senate amendment.

The Senate amendment is the same as the provision in H.R. 8.

CONFERENCE AGREEMENT

The conference agreement follows the provision in H.R. 8 and the Senate amendment.

4. Modification of certain valuation rules (sec. 603 of H.R. 8, sec. 563 of the Senate amendment, and sec. 2622 of the Code)

PRESENT LAW

Under present law, the inclusion ratio is determined using gift tax values for allocations of generation-skipping transfer tax exemption made after gift tax returns. The inclusion ratio generally is determined using estate tax values for allocations of generation-skipping transfer tax exemption made on timely filed gift tax returns. Under the Senate amendment, a trustee can determine the inclusion ratio using estate tax values or, for purposes of determining estate tax values, the trustee may elect to sever a trust in a qualified severance at any time.

Effective date. The provision is effective for severances of trusts occurring after December 31, 2000.

Senate amendment.

The Senate amendment is the same as the provision in H.R. 8.

CONFERENCE AGREEMENT

The conference agreement follows the provision in H.R. 8 and the Senate amendment.

6. Substantial compliance (sec. 604 of the House bill, sec. 564 of the Senate amendment, and sec. 2624 of the Code)

PRESENT LAW

Under present law, there is no statutory rule which provides that substantial compliance with the statutory and regulatory requirements for allocating generation-skipping transfer tax exemption will suffice to establish that generation-skipping transfer tax exemption was allocated to a particular transfer or trust.

HOUSE BILL

No provision. However, H.R. 8, as passed by the House, provides that substantial compliance with the statutory and regulatory requirements for allocating generation-skipping transfer tax exemption will suffice to establish that generation-skipping transfer tax exemption was allocated to a particular transfer or a particular trust. If a taxpayer demonstrates substantial compliance, then so much of the transferor’s unused generation-skipping transfer tax exemption will be...
allocated to the extent it produces the lowest possible inclusion ratio. In determining whether there has been substantial compliance, all relevant circumstances will be considered, including evidence of intent contained in the trust instrument or instrument of transfer and such other factors as the Treasury Secretary deems appropriate.

Effective date.—The provision applies to transfers subject to estate or gift tax made after December 31, 2000. No inference is intended with respect to the availability of a rule of substantial compliance prior to the effective date of the provision.

SENATE AMENDMENT

The Senate amendment is the same as the provision in H.R. 8.

CONFERENCE AGREEMENT

The conference agreement follows H.R. 8 and the Senate amendment.

D. EXPAND AND MODIFY AVAILABILITY OF INSTALLMENT PAYMENT OF ESTATE TAX FOR CLOSELY-HEL D BUSINESSES (SEC. 701 OF H.R. 8, Secs. 571 AND 572 OF THE SENATE AMENDMENT, AND SEC. 6166 OF THE CODE)

PRESENT LAW

Under present law, the estate tax generally is due within nine months of a decedent’s death. However, an executor generally may elect to pay estate tax attributable to an interest in a closely-held business in two or more installments (but no more than 10). An estate is eligible for payment of estate tax in installments if the value of the decedent’s interest in a closely-held business exceeds 35 percent of the decedent’s adjusted gross estate (i.e., the gross estate less certain deductions). If the election is made, the estate may defer payment of principal and pay only interest for the first five years, followed by up to 10 annual installments of principal and interest. This provision effectively extends the time for paying estate tax by 14 years from the original due date of the estate tax. A special two-percent interest rate applies to the amount of deferred estate tax attributable to the first $1 million (adjusted annually for inflation occurring after 1998; the inflation-adjusted amount for 2001 is $1,090,000) in taxable value of a closely-held business. The interest rate applicable to the amount of estate tax attributable to the taxable value of the closely-held business in excess of $1 million is equal to 45 percent of the rate applicable to underpayments of tax under section 6622 (i.e., 45 percent of the Federal short-term rate plus 3 percentage points). Interest paid on deferred estate taxes is not deductible for estate or income tax purposes.

For purposes of these rules, an interest in a closely-held business is: (1) an interest as a proprietor in a sole proprietorship, (2) an interest as a partner in a partnership carrying on a trade or business if 20 percent or more of the total capital interest of such partnership is included in the decedent’s gross estate or the partnership had 15 or fewer partners, and (3) stock in a corporation carrying on a trade or business if 20 percent or more of the value of the voting stock of the corporation is included in the decedent’s gross estate or such corporation had 15 or fewer shareholders. The decedent may own the interest directly or, in certain cases, ownership may be indirect, through a holding company. If ownership is through a holding company, the stock must be non-readily tradable. If stock in a holding company is treated as business company stock for purposes of the installment payment provisions, the five-year deferral for principal and the 2-percent interest rate do not apply. The value of any interest in a closely-held business does not include the value of that portion of such interest attributable to passive assets held by such business.

HOUSE BILL

No provision. However, H.R. 8, as passed by the House, expands the definition of a closely-held business for purposes of installment payment of estate tax. The bill increases from 15 to 45 the number of partners in a partnership and shareholders in a corporation that is considered a closely-held business in which a decedent held an interest, and thus will qualify the estate for installment payment of estate tax.

Effective date.—The provision is effective for decedents dying after December 31, 2001.

SENATE AMENDMENT

The Senate amendment expands availability of the installment payment provisions by providing that an estate of a decedent with an interest in a qualifying lending and financing business is eligible for installment payment of the estate tax. The bill also provides that an estate with an interest in a qualifying lending and financing business that claims installment payment of estate tax must make installment payments of estate tax (which will include both principal and interest) relating to the interest in a qualifying lending and financing business over five years.

The Senate amendment also clarifies that the installment payment provisions require that only the stock of holding companies, not that of operating subsidiaries, must be non-readily tradable in order to qualify for installment payment of the estate tax. The bill also provides that an estate with a qualifying property interest held through holding companies that claims installment payment of estate tax must make all installment payments of estate tax (which will include both principal and interest) relating to a qualifying property interest held through holding companies over five years.

Effective date.—The provision is effective for decedents dying after December 31, 2001.

CONFERENCE AGREEMENT

The conference agreement includes the provision in H.R. 8 and the provisions in the Senate amendment.

No inference is intended as to whether one or more of the specified activities of a qualifying lending and financing business would be a trade or business eligible for installment payment of estate tax under present law.

54For example, assume estate tax is due in 2001. If interest only is paid each year for the first five years (2001 through 2005), and if 10 installments of both principal and interest are paid for the 10 years thereafter (2006 through 2015), then payment of estate tax would be extended by 14 years from the original due date of 2001.