

V. Estate Tax Repeal



One of the more contentious issues in the House and Senate Committee discussions was repeal of the estate tax. There was strong support among both the Republican members of the House and Senate and the administration for a full repeal of the estate tax. However, the cost of immediate repeal presented obvious budget problems. Thus EGTRRA 2001 language attempts to include preferred provisions from both the Democratic and Republican plans. Predictably, the results are quite complex.

Under existing law, there is a \$10,000 annual gift exclusion per donor-per donee, and an exemption from gift or estate taxes of \$675,000 in 2001, \$700,000 in 2002 and 2003, \$850,000 in 2004, \$950,000 in 2005 and \$1,000,000 in 2006 and thereafter. There also is a 5% surtax on taxable estates between \$10,000,000 and \$17,184,000.

Deductions are permitted for marital and charitable transfers, for costs and debts and other items. Transfers at death provide the recipient with a "stepped-up basis" to fair market value for capital assets. There are provisions for special-use valuation of farms and ranches. There is also a specific gift exclusion for non-resident citizens.

Under EGTRRA 2001, nearly all of those provisions would change dramatically. By 2010, the estate tax would be fully repealed. The exemption equivalent is expanded from \$1 million to \$3.5 million over that time. The top rate is reduced to 50% in 2002, and then lowered to 45% by the year 2007. After 2009, there will be no estate tax, but a 35% gift tax will continue to be applicable.

The estate exemption, GSTT exemption, gift exemption and top tax rates would be as follows:

2002 \$1 million 50% \$1 million 75% Present 5% Surtax Repealed

2003 \$1 million 49% \$1 million 50% Present

2004 \$1.5 million 48% \$1 million 25% Present QFOBI 2057 Repealed

2005 \$1.5 million 47% \$1 million 0%--Deduction

2006 \$2 million 46% \$1 million 0%--Deduction

2007 \$2 million 45% \$1 million 0%--Deduction

2008 \$2 million 45% \$1 million 0%--Deduction

2009 \$3.5 million 45% \$1 million 0%--Deduction

2010 Estate/GSTT Tax repealed 35% (Gift tax) \$1 million NA Modified Basis Step-up

Retained Gift Tax in 2010

After 2009, the gift tax is retained at the top income tax rate for the applicable year. Under EGTRRA 2001, this would be 35%, but if this rate changes, the maximum gift tax rate will change. The retention of the gift tax is for the purpose of discouraging transfers to lower income beneficiaries to minimize capital gains taxes. Several commentators have suggested that some very creative new tax shelters might be created in order to avoid capital gains tax, if estate taxes were repealed. This provision is designed to minimize what Treasury views as excessively-creative planning.

Modified Step-up In Basis

After 2010, estate and generation-skipping taxes are fully repealed. There is then a modified carryover basis plan. Under the modified plan, an estate is permitted to have an asset base of \$1.3 million that will be stepped up to fair market value. The \$1.3 million is potentially increased by net operating losses and unused capital losses. Furthermore, transfers to a spouse will entitle the spouse to an additional stepped-up basis of \$3 million. The basis step-up will be allocable to specific assets within the estate.

The basis step up exclusions include property acquired within 3 years of death, property that is income in respect of decedent, stock of a personal holding company, stock of a domestic international sales corporation and stock of a foreign investment company. To assist the Service in tracking the basis of assets, there are extensive reporting requirements for estate executors. Executors who fail to report potentially could be subject to a \$10,000 penalty.

Qualified Family-Owned Business Exemption Repealed in 2004

Several changes impact special business exemptions. In 2004, the qualified family-owned business deduction would be repealed. However, the 10-year recapture period for special use valuation could apply even after repeal of the estate tax until the expiration of the 10-year period. Installment payment rules for estate taxes would be retained.



Nationwide Conservation Easements

Under current law, an estate may exclude 40% of the value of land subject to a qualified conservation easement, with a maximum excluded conservation property value of \$500,000 in 2002. EGTRRA 2001 would allow qualified conservation easements to apply to any property in the United States that meets applicable requirements. The previous requirements for a specific geographic location were deemed too complex.

Generation Skipping Tax Law Improvements

Generation skipping tax is generally applicable when there is a direct skip, a taxable termination or taxable distribution to a grandchild. The exemption of \$1,060,000 (in 2001 and an amount equal to the exemption equivalent in 2002-

2009) is available to reduce or eliminate generation skipping tax. EGTRRA 2001 would simplify generation skipping transfer tax rules by automatically allocating GST exemption to any trust created during life that is an "indirect skip." Another helpful provision in the GSTT section would be an allowance for a "qualified severance" of a trust into an exempt trust and a non-exempt trust subject to GSTT. A further proposal is to allow a "substantial compliance" exception that could enable Treasury to permit potential reallocations of GSTT in order to produce the lowest possible inclusion ratio.



[Installment Payment Expansion](#)

Under present law, when a closely-held business exceeds 35 percent of the adjusted gross estate, an executor generally may elect to pay estate tax in 2 or more installments (but no more than 10). 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. 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) in taxable value of a closely-held business.

EGTRRA 2001 expands the 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 increases from 15 to 45 the number of partners or shareholders in an entity eligible for installment payments of estate tax.