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Re: Statement of Policy Regarding Reform of Federal Wealth Transfer Tax

Dear Chairmen and Ranking Members:

On behalf of the Section of Taxation and the Section of Real Property, Trust and Estate Law of the American Bar Association, we are pleased to transmit the enclosed Statement of Policy Regarding Reform of Federal Wealth Transfer Tax. This statement represents the views of the Section of Taxation and the Section of Real Property, Trust and Estate Law. It has not been approved by the Board of Governors or the House of Delegates of the American Bar Association. Accordingly, it should not be construed as representing the position of the American Bar Association.

We appreciate your consideration of the enclosed statement. Representatives of the Sections would be pleased to discuss this statement with you or your respective staffs. Please contact Armando Gomez, the Section of Taxation's Vice Chair for Government Relations, at (202) 371-7868 if that would be helpful.

Sincerely,

Steve R. Akers  
Chair  
Section of Real Property, Trust and Estate Law

Stuart M. Lewis  
Chair- Elect  
Section of Taxation

Enclosure

cc: Honorable Timothy F. Geithner, Secretary, Department of the Treasury  
Honorable Douglas H. Shulman, Commissioner, Internal Revenue Service  
Mr. John L. Buckley, Chief Tax Counsel, House Ways and Means Committee  
Mr. Russell Sullivan, Staff Director, Senate Finance Committee  
Mr. Jon Traub, Republican Staff Director, House Ways and Means Committee  
Mr. Kolan Davis, Republican Staff Director, Senate Finance Committee  
Mr. Thomas A. Barthold, Chief of Staff, Joint Committee on Taxation

**AMERICAN BAR ASSOCIATION  
SECTION OF TAXATION AND  
SECTION OF REAL PROPERTY, TRUST AND ESTATE LAW**

**Statement of Policy Regarding Reform of Federal Wealth Transfer Taxes**

This white paper is submitted on behalf of the American Bar Association Section of Taxation (the “Section of Taxation”) and the American Bar Association Section of Real Property, Trust and Estate Law (the “RPTE Section”). It has not been approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, it should not be construed as representing the position of the American Bar Association.

The Section of Taxation has a long history of advocacy for simplicity, stability and transparency in our nation’s tax laws.<sup>1</sup> In the context of federal wealth transfer taxes – the estate tax, the gift tax and the generation-skipping transfer (“GST”) tax – the need to focus on these principles has become ever more pressing as a result of the amendments made by the Economic Growth and Tax Relief Reconciliation Act of 2001 (“EGTRRA”),<sup>2</sup> and the strong indications from the Obama Administration and Congressional leaders that certain of those amendments will be reversed (or amended prior to taking effect). In anticipation of these developments, a task force comprised of representatives from the Section of Taxation, the RPTE Section, the American College of Tax Counsel, the American College of Trust and Estate Counsel, the American Bankers Association, and the American Institute of Certified Public Accountants (the “Task Force”) published a report on the reform of federal wealth transfer taxes in 2004 (the “Task Force Report”).<sup>3</sup>

This paper draws upon the more detailed work set forth in the Task Force Report to summarize certain issues driving the need for prompt action in this area, and sets forth several considerations and views that, together with the more detailed analysis set forth in the Task Force Report, the Section of Taxation and the RPTE Section encourage policymakers to take into account as they consider reform of the federal wealth transfer taxes.

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<sup>1</sup> See American Bar Association Section of Taxation, Statement of Policy Favoring Tax Simplicity, Stability and Transparency, available at [http://www.abanet.org/tax/pubpolicy/papers/whitepaper\\_sopfavoringtaxsimplicitystabilityandtransparency.pdf](http://www.abanet.org/tax/pubpolicy/papers/whitepaper_sopfavoringtaxsimplicitystabilityandtransparency.pdf).

<sup>2</sup> Pub. Law No. 107-16, 115 Stat. 38 (2001).

<sup>3</sup> 58 TAX LAW. 93 (Fall 2004); also available at [http://www.abanet.org/rppt/section\\_info/ttf/home.html](http://www.abanet.org/rppt/section_info/ttf/home.html).

## I. OVERVIEW AND BACKGROUND

The federal estate tax has been in effect since 1916, and the federal gift tax since 1932. Milestone changes to the estate and gift tax since 1916 have included the introduction of a limited marital deduction for transfers to spouses in 1948, the “unified” calculation of the gift and estate taxes as a single tax on cumulative lifetime and at-death transfers in 1976, the removal of quantitative limits on the marital deduction in 1981, and the addition of a short-lived GST tax in 1976 and the current GST tax in 1986.

### A. Before the 2001 Amendments

Before the amendments made by EGTRRA, the gift and estate taxes were subject to a cumulative “unified credit” subtracted from the calculated tax liability. The unified credit in general was equivalent to an exemption of the first \$675,000 of cumulative lifetime and at-death taxable transfers. The \$675,000 amount was scheduled under the Taxpayer Relief Act of 1997<sup>4</sup> to increase in increments to a level of \$1 million in 2006. While this amount is referred to in section 2010(c) as the “applicable exclusion amount,” from which the level of unified credit is calculated, it will be referred to in this paper by the more convenient and popular, though sometimes imprecise, term “exemption.”<sup>5</sup> Above the exemption, lifetime taxable gifts<sup>6</sup> (cumulative since 1977) and the decedent’s taxable estate<sup>7</sup> were subject to tax at rates that reached a marginal rate of 55% at a level of \$3 million.

There was also a 5% increase in the tax, producing an effective marginal rate of 60% for cumulative transfers from \$10 million to approximately \$17.2 million, designed to phase out the benefits of the unified credit and graduated rates, so that all taxable estates above the phase-out would be subject to a marginal rate and overall average rate that were both 55%.

In addition, under section 2011, there was a credit against the estate tax liability for estate, inheritance, legacy, or succession taxes paid to any state or the District of Columbia (collectively “state death taxes”), limited so as to reach a top rate of 16% for taxable estates over \$10.1 million. This resulted in a net marginal *federal* tax rate that was different from the stated statutory rate, ultimately 39% (55% less 16%) for the largest estates. The maximum state death tax credit prescribed in the table in section 2011 had been unchanged since the Revenue Act of 1926,<sup>8</sup> and over the years this had prompted all but a handful of states to conform their estate and inheritance taxes to the federal credit so as to collect exactly the maximum that could be collected without increasing the total federal and state tax liability of the estate.

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<sup>4</sup> Pub. Law 105-34, 111 Stat. 788 (1997)

<sup>5</sup> Unless otherwise indicated, all “section” references are to the Internal Revenue Code of 1986, as amended (the “Code”).

<sup>6</sup> Generally, total gifts, less per-donee “annual exclusions” (currently \$13,000), exclusions for certain payments of educational or medical expenses, and deductions for gifts to charities and spouses.

<sup>7</sup> Generally, the “gross estate” representing all the decedent’s property, less deductions for eligible debts, expenses, losses, and transfers to charities and surviving spouses.

<sup>8</sup> 44 Stat. 9 (1926).

The GST tax is imposed, in general, on transfers that benefit members of generations younger than the generation of the transferor's children.<sup>9</sup> The tax is imposed at a flat rate equal to the top regular estate tax rate. An exemption may be allocated to each transfer that is or may in the future be subject to the GST tax. That exemption, when the GST tax was enacted in 1986, was \$1 million, and since 1999 it was indexed for inflation. By 2001, it had risen to a level of \$1.06 million.

## **B. The 2001 Changes**

EGTRRA, in phases beginning in 2002 and ending in 2009, increased the estate tax exemption to \$3.5 million but increased the gift tax exemption to only \$1 million, while decreasing the top rate to 45%. Effective in 2002, EGTRRA repealed the 5% increase in tax to phase out the benefits of the unified credit and graduated rates. This has resulted in a flat estate tax rate of 45% above the exemption amount since 2007. Because of the lower gift tax exemption, however, the gift tax still has effective rates of 41% from \$1 million to \$1.25 million and 43% from \$1.25 million to \$1.5 million, where the gift tax rate also becomes a flat rate 45%.

EGTRRA phased out the credit for state death taxes by 2005 and, beginning in 2005, replaced the credit with a deduction for state death taxes in calculating the federal taxable estate.

EGTRRA, beginning in 2004, made the GST exemption equal to the estate tax exemption – \$1.5 million in 2004 and 2005, \$2 million in 2006, 2007, and 2008, and \$3.5 million in 2009.

EGTRRA also repealed the federal estate and GST taxes, but not the federal gift tax, in 2010. Because EGTRRA was proceeding within the framework of budget reconciliation, its tax reductions, including the repeal of the estate tax, were designed to “sunset” in 2011, and thereby protected EGTRRA from a point of order in the Senate.<sup>10</sup> Thus, the estate and GST taxes are scheduled to expire in 2010, but to be restored in 2011 to their levels under pre-2001 law, with an estate and gift tax exemption of \$1 million, rates up to 55%, a credit for state death taxes, and so forth.

Despite frequent congressional debate about the estate tax since 2001, including efforts to make the repeal permanent or to enact a “compromise” tax structure,<sup>11</sup> the tax remains as left by EGTRRA, including the prospects of repeal in 2010 and revival in 2011.

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<sup>9</sup> Section 2601 *et seq.*

<sup>10</sup> See section 313(f)(2) of the Congressional Budget Act of 1974, as amended in 1985 and codified at 2 U.S.C. § 633(f)(2).

<sup>11</sup> The House of Representatives last passed a permanent repeal bill, the “Death Tax Repeal Permanence Act of 2005”, H.R. 8, 109<sup>th</sup> Cong., 1<sup>st</sup> Sess., on April 13, 2005, by a vote of 272-162. The House last passed a “compromise” bill, the “Estate Tax and Extension of Relief Act of 2006”, H.R. 5970, 109<sup>th</sup> Cong., 2d Sess., on July 29, 2006, by a vote of 230-180; on August 3, 2006, a cloture vote to take up consideration of H.R. 5970 in the Senate failed on a vote of 56-42.

## II. PREDICTABILITY AND STABILITY

### A. The Estate Tax in General

Instability has been the dominant cloud over the federal wealth transfer tax system since 2001. The scheduled uneven increases in the estate tax exemption throughout this decade have complicated estate planning, because the allocation of a person's estate under the tax law of one year might not serve that person's objectives under the tax law of a different year. In the case of married couples subject to estate tax, the size of the exemption determines the size of the bequest to or in trust for the surviving spouse on the one hand and the "credit shelter trust" or "bypass trust" on the other hand. In all cases, including the death of a surviving spouse, the amount that is available for distribution to family members and other selected beneficiaries is of course the amount remaining after the payment of taxes.

Thus, for example, the estate tax exemption and rate might affect: (i) allocations between a surviving spouse and children (who might be children from a previous marriage); (ii) allocations between needier children (such as those in public service or with large families) and wealthier children (such as those in well-paying professions or with smaller families); (iii) allocations between children and grandchildren; (iv) allocations between branches of a family such as a wife's family and a husband's family; and (v) allocations between individual beneficiaries and charity.

Because these allocations are affected by changing exemptions and rates, it has been necessary to deal with those changing rates and especially changing exemptions with formulas that create mystery and complexity, foster ambiguities and mistakes, and generally frustrate citizens who want to comply with the tax law but find it difficult, and who feel less and less autonomy in disposing of their own estates.

The impending repeal of the estate and GST taxes in 2010 and their return in 2011 at a different level, coupled with various unsuccessful attempts over the years to produce a permanent resolution, have understandably added to the exasperation. Depending upon when a citizen dies during the period December 31, 2009 to January 1, 2011, the citizen's estate could be subject to three different estate tax exemptions (\$3.5 million, unlimited, or \$1.0 million). Estate planners and their clients have reacted to the coming repeal of the estate tax, and to the "carryover basis" regime that would replace it for one year, in very uneven ways – some with an elaborate second tier of formulas and triggers, and some with indifference, denial, or despair. If the 2010 regime of carryover basis took effect, the law implementing carryover basis would need considerable clarification,<sup>12</sup> but the Internal Revenue Service is not known to have committed any resources to this project.

As 2010 and 2011 draw nearer, the anxiety grows. Any short-term phenomenon, whether the 2010 "repeal" currently on the books, a patch such as a short-term freeze of current law, or any other non-permanent approach, would be difficult for individual taxpayers to deal with, and the resulting responses would inevitably be uneven, inconsistent, error-prone, and therefore

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<sup>12</sup> See Task Force Report, Part III, §§ 7-15, at 29-94.

unfair. Estate planning is a long-term proposition, and with respect to the estate tax, citizens do not plan from year to year, and they do not time the date of their deaths.

## **B. Aggravated Complexity with Respect to the Gift Tax**

The retention by EGTRRA of a gift tax even when the estate tax is repealed appears to have been directed toward protection of the income tax base, and the additional “decoupling” of the gift tax unified credit from the estate tax unified credit appears to have been done in 2001 with a view toward that time of estate tax repeal. In the absence of estate tax repeal, there appears to be no technical reason to maintain separate gift and estate tax exemption levels. Meanwhile, the absence of a fully “unified” federal credit/exemption structure creates unfairness for the citizen who wishes to transfer assets to children during lifetime (such as a family farm or business) valued at less than the estate tax exemption but more than the gift tax exemption. More convoluted techniques employed to avoid the problem (such as grantor retained annuity trusts or the widespread use of “Crummey powers”) increase complexity and unpredictability and probably reduce estate tax revenues in the end. Recoupling the gift tax exemption to the other transfer tax exemptions would simplify compliance with no apparent loss of technical integrity in the transfer tax system.

## **III. “PORTABILITY” OF THE EXEMPTION (UNIFIED CREDIT)**

### **A. Background of Portability**

Currently the estate tax exemption is personal to each decedent.<sup>13</sup> While it is convenient and popular to speak of the exemption as a total exemption (in 2009, for example, \$7 million) available to a married couple, strictly speaking that is not true. Assuming 2009 law and no changes in value, even if a husband and wife each owned exactly \$3.5 million, the first to die could place the \$3.5 million in a “credit shelter trust” or “bypass trust,” which would provide for the surviving spouse for life, but would not be taxed at the surviving spouse’s death. Meanwhile, the surviving spouse’s own \$3.5 million would also be exempt from tax. In that case, the oversimplified depiction of a \$7 million exemption would happen to prove accurate. But if the first spouse to die left the entire first estate to the survivor (a disposition many married individuals find natural and comfortable), the second spouse’s estate would be subject to tax on \$3.5 million (the total of \$7 million less one exemption of \$3.5 million). Ignoring any possible state tax, the estate tax unnecessarily incurred would be \$1,575,000.

This tax would be unnecessary because, in this example, it could easily have been avoided through careful planning, usually with professional assistance. But by rewarding sophisticated planning, current law in effect penalizes taxpayers who do not have the knowledge, time, tolerance for complexity, or good luck to seek such sophisticated planning, thereby treating similarly situated taxpayers very differently.

Moreover, not every married couple own property equally. Community property can achieve that effect with proper planning, but not all property is necessarily community property

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<sup>13</sup> For gift tax purposes, section 2513 permits “gift-splitting” between spouses, but only while both of them are alive.

even in community property states, and in other states holding property as joint tenants is not a perfect substitute. Effective planning with jointly owned property would typically depend on post-death disclaimers under Regulation section 25.2518-2(c)(4), but the requirements are often hard to meet. In addition, it is obvious, especially today, that the assumption of unchanging values is unrealistic and irresponsible. This greatly aggravates the complexity and wastefulness of the planning needed to secure for a married couple the combined exemption the law appears to allow and references to the law often assume.

In this climate of frustrating and arbitrary results, the simple remedy of permitting a deceased spouse's unused exemption to be used by the surviving spouse is very attractive. This "portability" of the exemption was included in House-passed proposals in 2006,<sup>14</sup> is included fairly consistently in a wide variety of current legislative proposals,<sup>15</sup> and was supported in testimony before the Senate Finance Committee in April 2008.<sup>16</sup> While concerns for administrability and the complexity of multiple marriages (whether tax-motivated or not) have plagued the consideration of this idea over the years, the current legislative proposals eschew burdensome tracing for the simple expedient of a gross cap limiting the ultimate exemption in all cases to double the basic exemption. That choice makes portability – always a popular concept in theory – achievable.

## **B. Avoiding Reliance on Affirmative Elections**

The current statutory proposals generally contemplate that portability would be affirmatively elected on the estate tax return for the predeceased spouse's estate. Although the election is likely to always or almost always be desired, an election can be burdensome and a trap in many cases. A striking example is found in the qualified terminable interest property ("QTIP") election for estate tax purposes required by section 2056(b)(7)(B)(i)(III), added to the Code by the Economic Recovery Tax Act of 1981.<sup>17</sup> That requirement for an affirmative election caused enormous consternation and prompted several revisions of the federal estate tax return – all unsuccessful – until, *after ten years*, the October 1991 revision finally deemed the election to have been made to the full extent consistent with the numbers shown on the return. A repeat of that ten-year experience can be avoided by simply recognizing the filing of the first estate tax return (whether or not timely filed) showing no estate tax due as a portability election (at least absent an explicit election out of portability) or by specifically authorizing relief, similar to so-called "9100 relief," in the case of late elections.

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<sup>14</sup> *E.g.*, the "Estate Tax and Extension of Relief Act of 2006," *supra* note 10

<sup>15</sup> *E.g.*, the "Capital Gains and Estate Tax Relief Act of 2009", (H.R. 498, 111<sup>th</sup> Cong., 1<sup>st</sup>. Sess., which would make the 15% capital gains tax rate permanent and apply the same rate to taxable estates up to \$25 million; the "Sensible Estate Tax Act of 2009", (H.R. 2023, 111<sup>th</sup> Cong., 1<sup>st</sup>. Sess., which would lower the estate tax exemption back to \$2 million and increase the top rate back to 55%; and Chairman Baucus's "Taxpayer Certainty and Relief Act of 2009", (S. 722, 111<sup>th</sup> Cong., 1<sup>st</sup>. Sess., which would make 2009 estate tax law permanent.

<sup>16</sup> Testimony of Shirley L. Kovar, supporting portability on behalf of the American College of Trust and Estate Counsel, *available at* <http://finance.senate.gov/hearings/testimony/2008test/040308sktest.pdf>. *See also* Task Force Report § 17, at 99-101.

<sup>17</sup> Pub. Law 97-34, 95 Stat. 172 (1981).

Whatever form portability might take, it is understandably difficult to “think of everything” and “get everything right.” It is therefore important to give Treasury broad authority to promulgate what are often referred to as “legislative regulations,” relying on the more deliberative process of drafting regulations, with solicitations of public input through the notice-and-comment process and otherwise, for fleshing out such rules.

### **C. Portability of the GST Exemption**

The current statutory proposals apply portability to the estate and gift taxes, but not to the GST tax. Extension of portability to the GST exemption would be a simplification “targeted” to the relatively few people with estates large enough to employ effective generation-skipping. But it would remove a disconnect from the law that does not have a compelling technical or policy justification. Moreover, because it would generally apply only after both parents with generation-skipping estate plans and one of their children had all died, it is hard to imagine that it would have much of a reportable revenue effect within a five-year or ten-year budget window.

## **IV. FAMILY-OWNED BUSINESSES**

A number of provisions of the Code offer relief specifically to the estates of owners of family-owned businesses. Section 303 relieves an estate from what otherwise might be dividend treatment for income tax purposes when it redeems closely held stock to pay estate taxes and estate administration expenses. Section 2032A permits real estate used in a family business, farm, or ranch to be valued for estate tax purpose at its value for that use, not necessarily its highest and best use if, for example, the land happens to be in the path of development.<sup>18</sup> Section 2057, until it was superseded in 2004 by the changes made by EGTRRA, excluded from estate tax up to \$675,000 of the value of a family-owned business. Section 6166 permits the estate tax attributable to a family-owned business to be paid in installments over ten or fifteen years. And section 6601(j) provides a lenient rate of interest on a portion of that deferred tax. All of these provisions include rules – sometimes very elaborate rules – for eligibility, limitations, recapture, and the like.

Often, an entrepreneur who owns and operates a successful family business reinvests heavily in the business and does not accumulate a significant estate outside of the business that would be available to pay estate tax. It is not unusual for the success of the business to be attributable in large part to that lifestyle choice of putting the business first. As a result, the only realistic source for payment of estate tax on the value of an interest in such a business is often the business itself, through payment of earnings or redemption of interests. This, in effect, imposes a cost of doing business on that family enterprise that is not borne by its publicly-owned competitors. This paper assumes that, for that reason or other reasons, Congress has historically made a policy judgment to give special protection to the estates of family business owners, and is not inclined to significantly back away from that judgment.

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<sup>18</sup> It could be argued that special use valuation does not so much extend a tax break to family businesses as it does avoid or mitigate a tax penalty for businesses that happen, for example, to own land in the path of development but choose for business reasons not to move.

The April 2008 Senate Finance Committee hearing also focused on the liquidity problems of family-owned businesses.<sup>19</sup> Section 6166, in particular, was examined for ways in which it might be improved to better serve its intended purposes. The idea of an extension of time to pay the estate tax attributable to certain closely held business interests originated in the 1950s. The chief criticisms of section 6166 heard over the years are variations on the theme that the statute has not evolved to match the evolution of structures used by family businesses.

The statute provides only haphazardly for multi-tiered structures. Section 6166(b)(2)(C) appears to provide a universal look-through rule for all types of entities. But its effectiveness in that role is diluted by the enactment over the years of very specialized look-through rules such as the holding company rule of section 6166(b)(8). The results of such a patchwork approach to tiered entities and other modern business structures are that section 6166 is available for some businesses but not to others, even though they might be very similar businesses, and that in many cases the applicability of section 6166 is simply unclear. This might drive some families to adopt business structures designed to qualify under section 6166 even if those structures are not optimal for the business. Business structures are selected to facilitate acquisitions and management, to make it easier to obtain debt, to protect assets, to accommodate dispositions of divisions of a business to family members most interested in those divisions, and for a number of other non-tax reasons. There does not appear to be any fundamental policy reason why those choices should produce different results under section 6166.

It is entirely possible that the amendments of section 6166 have unfolded as they have because the fiscal constraints applicable at the time of any amendment dictate the extent of the relief that can be offered, and that, in an effort within those fiscal constraints to cover the particular kind of fact pattern in view when the amendment is conceived, other very similar fact patterns must be excluded. It is well known that the federal government and federal budgets are on a very rigid cash basis, so that any tax deferred under section 6166 within any given fiscal measurement period is treated the same as lost revenue, even if the receivable is fully secured and bears interest. That constraint is doubtless not unique to section 6166 or the estate tax, but, if it hinders the rational comprehensive updating of this 50-year-old statute, determined and resourceful efforts to overcome it would seem to be appropriate.

## V. NON-BUSINESS VALUATION DISCOUNTS

The Task Force Report led off a discussion of the valuation of interests in entities by noting that “[t]he rules that have evolved for valuing interests in entities ... are inconsistent, create uncertainty, and cause controversy.”<sup>20</sup> Proposals for curbing entity-based valuation discounts for non-business assets have been described in “Treasury I” in the Reagan

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<sup>19</sup> See Testimony of Dennis I. Belcher available at <http://finance.senate.gov/hearings/testimony/2008test/040308dbtest.pdf>. See also Task Force Report §§ 25-26, at 136-42; Steven B. Gorin, E. Burke Hinds, Benjamin H. Pruett, Donald D. Kozusko & Michael Patiky Miller, “Internal Revenue Code Section 6166: Comments to Tax Counsel for the Senate Finance Committee,” 41 REAL PROPERTY, PROBATE & TRUST J. 73 (Spring 2006) (reprinted as an appendix to Dennis Belcher’s Finance Committee testimony).

<sup>20</sup> Task Force Report at 102. See *id.* §18, at 101-13.

Administration,<sup>21</sup> legislation passed by the House but not the Senate in the Omnibus Budget Reconciliation Act of 1987,<sup>22</sup> section 2036(c) enacted by the Omnibus Budget Reconciliation Act of 1987 but repealed three years later, chapter 14 enacted by the Omnibus Budget Reconciliation Act of 1990,<sup>23</sup> the Clinton Administration's budget proposals for fiscal 1999-2001, a 2005 Joint Committee report,<sup>24</sup> and the Certain Estate Tax Relief Act of 2009 in the current Congress.<sup>25</sup> More recently, the Obama Administration proposed certain modifications to the valuation rules for transfer tax purposes as part of its Fiscal Year 2010 budget proposal.<sup>26</sup> The use of entity-based discounts has also been the subject of much litigation, mostly involving extreme facts, producing very little consensus in the estate planning community that the rules are clear or predictable.

The value of property for estate and gift tax purposes is its "fair market value," which "is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts."<sup>27</sup> Although the *use* that is made of entity-based valuation discounts in estate planning is controversial, there is little disagreement that a hypothetical unrelated buyer of an interest in an entity subject to restrictions on participation in management, on distributions, and on transferability that an owner of that interest cannot change would insist on paying less for that interest by reason of those restrictions. The questions are typically whether the restrictions in any particular entity justify the *size* of the discount that is claimed, whether those restrictions should be disregarded because the parties themselves disregard them, whether the transfer of property subject to those restrictions is tantamount to a transfer in trust with a retained interest that causes includibility in the transferor's gross estate, or whether it violates a public policy to respect a restriction that the transferor self-imposed. These are genuine questions, and it is possible that they cannot be predictably and evenhandedly answered without legislation.

The following are principles that many would expect legislation about valuation discounts to observe:

- Valuation rules should be as objective as possible.
- Valuation rules should respect as much as possible the principle that similarly situated taxpayers (such as, in this context, taxpayers with equivalent amounts of wealth) should receive similar tax treatment.

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<sup>21</sup> U.S. TREAS. DEP'T, TAX REFORM FOR FAIRNESS, SIMPLICITY, AND ECONOMIC GROWTH, ch. 19.03, at 386-88 (Nov. 1984).

<sup>22</sup> Pub. Law 100-203, 101 Stat. 1330 (1987). See H. REP. NO. 100-391, 100TH CONG., 1ST SESS. 1041-44.

<sup>23</sup> Pub. Law 101-508, 104 Stat. 1388 (1990)

<sup>24</sup> STAFF OF THE JOINT COMMITTEE ON TAXATION, OPTIONS TO IMPROVE TAX COMPLIANCE AND REFORM TAX EXPENDITURES, JCS-02-05, at 396-404 (2005).

<sup>25</sup> H.R. 436, 111<sup>th</sup> Cong., 1<sup>st</sup> Sess. (2009).

<sup>26</sup> See U.S. TREAS. DEP'T, GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2010 REVENUE PROPOSALS (May 2009), available at: <http://www.ustreas.gov/offices/tax-policy/library/grnbk09.pdf>.

<sup>27</sup> Reg. § 20.2031-1(b). Cf. Reg. § 25.2512-1.

- Valuation rules should as much as possible be the same for all transfers any particular transferor makes.
- Valuation rules should not penalize taxpayers with harsh valuations in disregard of restrictions those taxpayers themselves did not create. For example, in the absence of collusion or other compelling circumstances, a parent’s transfer to a child might disregard a restriction self-imposed by the parent, but the child’s subsequent transfer might properly be valued with regard to that restriction if the child is powerless to change it.
- Great care should be taken in imposing “family attribution” rules, which frequently do not reflect the reality of family dynamics.
- Valuation rules should operate mutually and for all purposes. For example, the rules for estate and gift tax purposes should generally be the same as the rules for income tax deduction purposes.
- Valuation rules that apply to the valuation of transfers should generally also apply to the calculation of deductions. For example, if the rules would prevent the fractionalization of an interest in property from producing valuation discounts for gift or estate tax purposes, then the rules should also prevent fractionalization by bequests to different recipients from producing valuation discounts in calculating charitable or marital deductions.<sup>28</sup>
- As much as possible, valuation rules prescribed through legislation should be the exclusive legal basis for analyzing the valuation discounts they address. As much as possible, the statutory rules should limit both taxpayers’ aggressive use of entities or other shared ownership techniques to justify discounts and the government’s invocation of aggressive use of legal theories to indirectly attack discounts.

Observing these principles may not be easy and may require thoughtful and time-consuming effort. Despite the availability of many existing proposals to draw from, it may be that none of them are refined enough to be simply dropped into a bill format. As with the portability of transfer tax exemptions, it may be important to give Treasury broad authority to elaborate, clarify, expand, or limit the rules by regulation.

## VI. THE GENERATION-SKIPPING TRANSFER TAX

The Tax Force Report discusses a number of possible concerns with the GST tax, including the preemption of the GST tax if an estate or gift tax applies, other issues of coordination of the GST tax with the estate and gift taxes, the allocation and effect of the GST exemption, and the treatment of transfers to persons outside the transferor’s family.<sup>29</sup> These

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<sup>28</sup> This would reverse the harsh (but apparently appropriate under current law) result seen in Technical Advice Memoranda 9050004 (Aug. 31, 1990) and 9403005 (Oct. 14, 1993) (all stock owned by decedent valued as a control block for purposes of the gross estate, but a marital bequest valued separately for purposes of the marital deduction), relying on *Estate of Chenoweth v. Commissioner*, 88 T.C. 1577 (1987) (estate of a decedent who owned all the stock of a corporation entitled to prove a control premium for a 51-percent block of stock bequeathed to spouse), and *Ahmanson Foundation v. United States*, 674 F.2d 761 (9<sup>th</sup> Cir. 1981).

<sup>29</sup> Task Force Report, § 27, at 143-69.

discussions are straightforward, and, while it is arguable that no issue alone is monumental, the sum of all outstanding issues render the GST tax more unsettled than it ought to be. This paper therefore commends reference to the Task Force Report.

In addition, apart from rates and exemptions, EGTRRA made a number of changes to the procedures for allocating and administering the GST exemption, as well as technical amendments affecting section 6166 and conservation easements. These changes will also sunset in 2011, unless they are made permanent. The changes are all welcome, have been the subject of significant Treasury and IRS guidance, and should be made permanent.