

PENDING LEGISLATION TO CHANGE THE FEDERAL TRANSFER TAXES

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Currently, there appear to be four bills pending in Congress to deal with changes to the federal transfer taxes. Two of them, H.R. 96 and H.R. 173, appear to be focused on issues related to farmland. Another, H.R. 533, aims to repeal the estate tax entirely. But another has drawn more attention because it appears to dovetail with the announced intentions of newly elected President Obama.

That bill is H.R. 436 introduced by Representative Pomeroy [North Dakota] on January 9, 2009. The bill does 6 major things, most of which have to do with modifications of the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"):

1. Repeal is Repealed: Title V of EGTRRA, and particularly Subtitle A (included as part of the appendix), provided for the repeal of the estate and generation skipping tax rules for decedents dying December 31, 2009. That provision is to be repealed, and thus estate and GST taxes would continue to be imposed.

2. Carryover Basis is Carted Out: The carryover basis rules would not apply at death, and the provisions of Section 1014 (change in basis at death) would continue to apply. Subtitle E of Title V of EGTRRA provided for carryover basis for assets in the estates of decedents dying after December 31, 2009. This new bill would repeal that section.

3. Unified Rate and Credit: One of the big things EGTRRA did was to disconnect or "un-unify" the unified credit for estate and gift taxes, providing for different "applicable exclusion" amounts and rates. Under this bill, subsections (d) and (e) of section 511 of EGTRRA are repealed. In effect, that would re-unify the estate and gift tax rates and provide for a single credit to applied to both.

4. New Fixed Applicable Exclusion Amount and Rate: All transfer taxes would again have a unified "exemption" of \$3,500,000 and a unified tax rate of 45%. The new bill would fix the applicable exclusion about at \$3,500,000 and the rate for amounts in excess of that at 45%. The wording of the bill will have to be fixed because it seems to try to alter the first sentence of section 2010(c). But in doing so, it cuts the sentence off and makes it nonsensical. But enough is there to make clear the author's intent.

5. Modification of the Surtax Rate and Amount: The surtax rate for estates over \$10 million would still be 5% but the maximum amount of the

addition would be increased. Currently, the amount of the surtax is capped at the difference between tax at the maximum rate less tax computed at the graduated rate structure. The bill would provide a cap equal to “the sum of the applicable credit amount under section 2010(c) and \$119,200.” That would appear to be $\$1,455,800 + \$119,200 = \$1,575,000$.

6. Valuation Rules for Transfers of Entities with Passive Assets: Valuation discounts for entities, such as family limited partnerships, would be lost to the extent those entities have “passive” assets (as defined in the bill). And lack of control would no longer be considered in many cases.

These provisions are an obvious attempt to attack discounts in family limited partnerships and similar entities. The bill eliminates discounts for entities to the extent to which the entity owns “passive” assets. The mechanical application of the statute requires that the passive assets be treated as though they are owned, and transferred, directly by the transferor; and the entity is then valued as though it did not own the passive assets.

Passive assets are defined to include cash, cash equivalents, corporate stock, ownership interests in other kinds of entities, debt instruments, trading devices (options, forward and future contracts, notional principal contracts and derivatives), foreign currency, interests in REITs and RICs, publically traded partnerships, precious metals, annuities, real property (with exceptions), assets which pay royalties (other than patents and trademarks), commodities, collectibles and “any other asset specified in regulations prescribed by the Secretary.”

Pass-through rules add to the above by saying that if the entity in which an interest is transferred in turns owns at least a 10-percent of another entity, then the assets of the subsidiary entity are treated as though they are owned by the entity being transferred, up to the percentage of ownership. In other words, if A transfers an interest in FLP to B, and FLP owns a 10% interest in BigCo which owns \$100 in assets, \$10 of BigCo’s assets will be treated as though the FLP owned them directly.

And finally, discounts for lack of control are eliminated entirely if the interest is not actively traded and the transferor and members of the family (as defined under section 2032A(e)(2)) have control of the entity. It is interesting to note that the definition of family members referred to is very restricted, and so a wide variety of people normally considered family members in common parlance are not included in the foregoing, such as aunts and uncles.

Currently, the bill is sitting in the House Ways and Means Committee. No action has been taken as of the writing of this note.

APPENDIX

Selected Sections of the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA")

These provisions are reproduced in the order in which they are referred to in HR 436. The result is that the last section copied herein is out of order from the text of EGTRRA.

TITLE V--ESTATE, GIFT, AND GENERATION-SKIPPING TRANSFER TAX PROVISIONS Subtitle A--Repeal of Estate and Generation-Skipping Transfer Taxes

SEC. 501. REPEAL OF ESTATE AND GENERATION-SKIPPING TRANSFER TAXES.

(a) ESTATE TAX REPEAL- Subchapter C of chapter 11 of subtitle B (relating to miscellaneous) is amended by adding at the end the following new section:

SEC. 2210. TERMINATION.

(a) IN GENERAL- Except as provided in subsection (b), this chapter shall not apply to the estates of decedents dying after December 31, 2009.

(b) CERTAIN DISTRIBUTIONS FROM QUALIFIED DOMESTIC TRUSTS- In applying section 2056A with respect to the surviving spouse of a decedent dying before January 1, 2010--

(1) section 2056A(b)(1)(A) shall not apply to distributions made after December 31, 2020, and

(2) section 2056A(b)(1)(B) shall not apply after December 31, 2009.'

(b) GENERATION-SKIPPING TRANSFER TAX REPEAL- Subchapter G of chapter 13 of subtitle B (relating to administration) is amended by adding at the end the following new section:

SEC. 2664. TERMINATION.

This chapter shall not apply to generation-skipping transfers after December 31, 2009.'

(c) CONFORMING AMENDMENTS-

(1) The table of sections for subchapter C of chapter 11 is amended by adding at the end the following new item:

Sec. 2210. Termination.'

(2) The table of sections for subchapter G of chapter 13 is amended by adding at the end the following new item:

Sec. 2664. Termination.'

(d) EFFECTIVE DATE- The amendments made by this section shall apply to the estates of decedents dying, and generation-skipping transfers, after December 31, 2009.

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Subtitle E--Carryover Basis at Death; Other Changes Taking Effect With Repeal

SEC. 541. TERMINATION OF STEP-UP IN BASIS AT DEATH.

Section 1014 (relating to basis of property acquired from a decedent) is amended by adding at the end the following new subsection:

`(f) TERMINATION- This section shall not apply with respect to decedents dying after December 31, 2009.'

SEC. 542. TREATMENT OF PROPERTY ACQUIRED FROM A DECEDENT DYING AFTER DECEMBER 31, 2009.

(a) GENERAL RULE- Part II of subchapter O of chapter 1 (relating to basis rules of general application) is amended by inserting after section 1021 the following new section:

SEC. 1022. TREATMENT OF PROPERTY ACQUIRED FROM A DECEDENT DYING AFTER DECEMBER 31, 2009.

`(a) IN GENERAL- Except as otherwise provided in this section--

`(1) property acquired from a decedent dying after December 31, 2009, shall be treated for purposes of this subtitle as transferred by gift, and

`(2) the basis of the person acquiring property from such a decedent shall be the lesser of--

`(A) the adjusted basis of the decedent, or

`(B) the fair market value of the property at the date of the decedent's death.

`(b) BASIS INCREASE FOR CERTAIN PROPERTY-

`(1) IN GENERAL- In the case of property to which this subsection applies, the basis of such property under subsection (a) shall be increased by its basis increase under this subsection.

`(2) BASIS INCREASE- For purposes of this subsection--

`(A) IN GENERAL- The basis increase under this subsection for any property is the portion of the aggregate basis increase which is allocated to the property pursuant to this section.

`(B) AGGREGATE BASIS INCREASE- In the case of any estate, the aggregate basis increase under this subsection is \$1,300,000.

`(C) LIMIT INCREASED BY UNUSED BUILT-IN LOSSES AND LOSS CARRYOVERS- The limitation under subparagraph (B) shall be increased by--

`(i) the sum of the amount of any capital loss carryover under section 1212(b), and the amount of any net operating loss carryover under section 172, which would (but for the decedent's death) be carried from the decedent's last taxable year to a later taxable year of the decedent, plus

`(ii) the sum of the amount of any losses that would have been allowable under section 165 if the property acquired from the decedent had been sold at fair market value immediately before the decedent's death.

`(3) DECEDENT NONRESIDENTS WHO ARE NOT CITIZENS OF THE UNITED STATES- In the case of a decedent nonresident not a citizen of the United States--

`(A) paragraph (2)(B) shall be applied by substituting '\$60,000' for '\$1,300,000', and

`(B) paragraph (2)(C) shall not apply.

`(c) ADDITIONAL BASIS INCREASE FOR PROPERTY ACQUIRED BY SURVIVING SPOUSE-

`(1) IN GENERAL- In the case of property to which this subsection applies and which is qualified spousal property, the basis of such property under subsection (a) (as increased under subsection (b)) shall be increased by its spousal property basis increase.

`(2) SPOUSAL PROPERTY BASIS INCREASE- For purposes of this subsection--

`(A) IN GENERAL- The spousal property basis increase for property referred to in paragraph (1) is the portion of the aggregate spousal property basis increase which is allocated to the property pursuant to this section.

`(C) PROPERTY INCLUDES INTEREST THEREIN- The term `property' includes an interest in property.

`(D) SPECIFIC PORTION TREATED AS SEPARATE PROPERTY- A specific portion of property shall be treated as separate property. For purposes of the preceding sentence, the term `specific portion' only includes a portion determined on a fractional or percentage basis.

`(d) DEFINITIONS AND SPECIAL RULES FOR APPLICATION OF SUBSECTIONS (b) AND (c)-

`(1) PROPERTY TO WHICH SUBSECTIONS (b) AND (c) APPLY-

`(A) IN GENERAL- The basis of property acquired from a decedent may be increased under subsection (b) or (c) only if the property was owned by the decedent at the time of death.

`(B) RULES RELATING TO OWNERSHIP-

`(i) JOINTLY HELD PROPERTY- In the case of property which was owned by the decedent and another person as joint tenants with right of survivorship or tenants by the entirety--

`(I) if the only such other person is the surviving spouse, the decedent shall be treated as the owner of only 50 percent of the property,

`(II) in any case (to which subclause (I) does not apply) in which the decedent furnished consideration for the acquisition of the property, the decedent shall be treated as the owner to the extent of the portion of the property which is proportionate to such consideration, and

`(III) in any case (to which subclause (I) does not apply) in which the property has been acquired by gift, bequest, devise, or inheritance by the decedent and any other person as joint tenants with right of survivorship and their interests are not otherwise specified or fixed by law, the decedent shall be treated as the owner to the extent of the value of a fractional part to be determined by dividing the value of the property by the number of joint tenants with right of survivorship.

`(ii) REVOCABLE TRUSTS- The decedent shall be treated as owning property transferred by the decedent during life to a qualified revocable trust (as defined in section 645(b)(1)).

`(iii) POWERS OF APPOINTMENT- The decedent shall not be treated as owning any property by reason of holding a power of appointment with respect to such property.

`(iv) COMMUNITY PROPERTY- Property which represents the 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 or possession of the United States or any foreign country shall be treated for purposes of this section as owned by, and acquired from, the decedent if at least one-half of the whole of the community interest in such property is treated as owned by, and acquired from, the decedent without regard to this clause.

`(C) PROPERTY ACQUIRED BY DECEDENT BY GIFT WITHIN 3 YEARS OF DEATH-

`(i) IN GENERAL- Subsections (b) and (c) shall not apply to property acquired by the decedent by gift or by inter vivos transfer for less than adequate and full consideration in money or money's worth during the 3-year period ending on the date of the decedent's death.

`(ii) EXCEPTION FOR CERTAIN GIFTS FROM SPOUSE- Clause (i) shall not apply to property acquired by the decedent from the decedent's spouse unless, during such 3-year period, such spouse acquired the property in whole or in part by gift or by inter vivos

transfer for less than adequate and full consideration in money or money's worth.

`(D) STOCK OF CERTAIN ENTITIES- Subsections (b) and (c) shall not apply to--

- `(i) stock or securities of a foreign personal holding company,
- `(ii) stock of a DISC or former DISC,
- `(iii) stock of a foreign investment company, or
- `(iv) stock of a passive foreign investment company unless such company is a qualified electing fund (as defined in section 1295) with respect to the decedent.

`(2) FAIR MARKET VALUE LIMITATION- The adjustments under subsections (b) and (c) shall not increase the basis of any interest in property acquired from the decedent above its fair market value in the hands of the decedent as of the date of the decedent's death.

`(3) ALLOCATION RULES-

`(A) IN GENERAL- The executor shall allocate the adjustments under subsections (b) and (c) on the return required by section 6018.

`(B) CHANGES IN ALLOCATION- Any allocation made pursuant to subparagraph (A) may be changed only as provided by the Secretary.

`(4) INFLATION ADJUSTMENT OF BASIS ADJUSTMENT AMOUNTS-

`(A) IN GENERAL- In the case of decedents dying in a calendar year after 2010, the \$1,300,000, \$60,000, and \$3,000,000 dollar amounts in subsections (b) and (c)(2)(B) shall each be increased by an amount equal to the product of--

- `(i) such dollar amount, and
- `(ii) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year, determined by substituting `2009' for `1992' in subparagraph (B) thereof.

`(B) ROUNDING- If any increase determined under subparagraph (A) is not a multiple of--

- `(i) \$100,000 in the case of the \$1,300,000 amount,
- `(ii) \$5,000 in the case of the \$60,000 amount, and
- `(iii) \$250,000 in the case of the \$3,000,000 amount,

such increase shall be rounded to the next lowest multiple thereof.

`(e) PROPERTY ACQUIRED FROM THE DECEDENT- For purposes of this section, the following property shall be considered to have been acquired from the decedent:

`(1) Property acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent.

`(2) Property transferred by the decedent during his lifetime--

- `(A) to a qualified revocable trust (as defined in section 645(b)(1)), or
- `(B) to any other trust with respect to which the decedent reserved the right to make any change in the enjoyment thereof through the exercise of a power to alter, amend, or terminate the trust.

`(3) Any other property passing from the decedent by reason of death to the extent that such property passed without consideration.

`(f) COORDINATION WITH SECTION 691- This section shall not apply to property which constitutes a right to receive an item of income in respect of a decedent under section 691.

`(g) CERTAIN LIABILITIES DISREGARDED-

`(1) IN GENERAL- In determining whether gain is recognized on the acquisition of property--

- `(A) from a decedent by a decedent's estate or any beneficiary other than a tax-exempt beneficiary, and
- `(B) from the decedent's estate by any beneficiary other than a tax-exempt beneficiary,

and in determining the adjusted basis of such property, liabilities in excess of basis shall be disregarded.

`(2) TAX-EXEMPT BENEFICIARY- For purposes of paragraph (1), the term `tax-exempt beneficiary' means--

`(A) the United States, any State or political subdivision thereof, any possession of the United States, any Indian tribal government (within the meaning of section 7871), or any agency or instrumentality of any of the foregoing,

`(B) an organization (other than a cooperative described in section 521) which is exempt from tax imposed by chapter 1,

`(C) any foreign person or entity (within the meaning of section 168(h)(2)), and

`(D) to the extent provided in regulations, any person to whom property is transferred for the principal purpose of tax avoidance.

`(h) REGULATIONS- The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this section.'

(b) INFORMATION RETURNS, ETC-

(1) LARGE TRANSFERS AT DEATH- So much of subpart C of part II of subchapter A of chapter 61 as precedes section 6019 is amended to read as follows:

* * *

TITLE IX--COMPLIANCE WITH CONGRESSIONAL BUDGET ACT

SEC. 901. SUNSET OF PROVISIONS OF ACT.

(a) IN GENERAL- All provisions of, and amendments made by, this Act shall not apply--

(1) to taxable, plan, or limitation years beginning after December 31, 2010, or

(2) in the case of title V, to estates of decedents dying, gifts made, or generation skipping transfers, after December 31, 2010.

(b) APPLICATION OF CERTAIN LAWS- The Internal Revenue Code of 1986 and the Employee Retirement Income Security Act of 1974 shall be applied and administered to years, estates, gifts, and transfers described in subsection (a) as if the provisions and amendments described in subsection (a) had never been enacted.

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Subtitle B--Reductions of Estate and Gift Tax Rates

SEC. 511. ADDITIONAL REDUCTIONS OF ESTATE AND GIFT TAX RATES.

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(d) MAXIMUM GIFT TAX RATE REDUCED TO MAXIMUM INDIVIDUAL RATE AFTER 2009- Subsection (a) of section 2502 (relating to rate of tax) is amended to read as follows:

`(a) COMPUTATION OF TAX-

`(1) IN GENERAL- The tax imposed by section 2501 for each calendar year shall be an amount equal to the excess of--

`(A) a tentative tax, computed under paragraph (2), on the aggregate sum of the taxable gifts for such calendar year and for each of the preceding calendar periods, over

`(B) a tentative tax, computed under paragraph (2), on the aggregate sum of the taxable gifts for each of the preceding calendar periods.

`(2) RATE SCHEDULE-

`If the amount with respect to which the tentative tax to be computed is:

The tentative tax is:

Not over \$10,000

18% of such amount.

Over \$10,000 but not over \$20,000

\$1,800, plus 20% of the excess over \$10,000.

Over \$20,000 but not over \$40,000

\$3,800, plus 22% of the excess over \$20,000.

Over \$40,000 but not over \$60,000

\$8,200, plus 24% of the excess over \$40,000.

Over \$60,000 but not over \$80,000

\$13,000, plus 26% of the excess over \$60,000.

Over \$80,000 but not over \$100,000

\$18,200, plus 28% of the excess over \$80,000.

Over \$100,000 but not over \$150,000

\$23,800, plus 30% of the excess over \$100,000.

Over \$150,000 but not over \$250,000

\$38,800, plus 32% of the excess over \$150,000.

Over \$250,000 but not over \$500,000

\$70,800, plus 34% of the excess over \$250,000.

Over \$500,000

\$155,800, plus 35% of the excess over \$500,000.'. .

(e) TREATMENT OF CERTAIN TRANSFERS IN TRUST- Section 2511 (relating to transfers in general) is amended by adding at the end the following new subsection:

(c) TREATMENT OF CERTAIN TRANSFERS IN TRUST- Notwithstanding any other provision of this section and except as provided in regulations, a transfer in trust shall be treated as a taxable gift under section 2503, unless the trust is treated as wholly owned by the donor or the donor's spouse under subpart E of part I of subchapter J of chapter 1.

(f) EFFECTIVE DATES-

(1) SUBSECTIONS (a) AND (b)- The amendments made by subsections (a) and (b) shall apply to estates of decedents dying, and gifts made, after December 31, 2001.

(2) SUBSECTION (c)- The amendment made by subsection (c) shall apply to estates of decedents dying, and gifts made, after December 31, 2002.

(3) SUBSECTIONS (d) AND (e)- The amendments made by subsections (d) and (e) shall apply to gifts made after December 31, 2009.