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ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT OF 2001, H.R. 1836: SUMMARY OF SELECTED PROVISIONS
— by Neil E. Hart* and Roger A. McEowen**

Unified credit
The unified credit applicable exclusion amount was scheduled to increase from $675,000 in 2001, to $700,000 in 2002 and 2003, $850,000 in 2004, $950,000 in 2005 and $1,000,000 in 2006. I.R.C. § 2010. Under the 2001 Act, the unified credit applicable exclusion amount for federal estate tax purposes rises to $1,000,000 in 2002, $1,500,000 in 2004, $2,000,000 in 2006 and $3,500,00 in 2009. Act Sec. 521(a), amending I.R.C. § 2010.

For federal gift tax purposes, the unified credit applicable exclusion amount remains at $1,000,000 in 2002 and thereafter. Act Sec. 521(b), amending I.R.C. § 2505(a). The GST exemption amount for any calendar year is the same as the applicable exclusion amount under I.R.C. 2010(c). Act Sec. 521(c), amending I.R.C. § 2631(a). This GST provision is effective for estates of decedents dying and generation-skipping transfers after December 31, 2003.

Federal estate and gift tax rates
The top federal estate and gift tax rate has been 55 percent (of the excess over $3,000,000 of taxable estate) for deaths since 1983. I.R.C. § 2001(c) The 2001 Act drops the top rate to 50 percent in 2002, 49 percent in 2003, 48 percent in 2004, 47 percent in 2005, 46 percent in 2006 and 45 percent in 2007. Act Sec. 511, amending I.R.C. § 2001(c).

The maximum gift tax rate is reduced to the maximum individual rate of 35 percent after 2009 (35 percent of the excess over $500,000). Act Sec. 511(d), amending I.R.C. § 2502(a). This provision is effective for gifts after December 31, 2009. A transfer in trust is treated as a taxable gift unless the trust is treated as wholly owned by the donor or donor’s spouse. Act Sec. 511(e), amending I.R.C. § 2511(c). This provision is effective for gifts made after December 31, 2009. Act Sec. 511(f)(3).

Estate and gift surtax
The five percent surtax rates (which phase out the benefit of the graduated rates) are repealed effective for deaths after December 31, 2001. Act Sec. 511(b), amending I.R.C. § 2001(c). The five percent surtax rate is reduced to the maximum individual rate of 35 percent after 2009 (35 percent of the excess over $500,000). Act Sec. 511(d), amending I.R.C. § 2502(a). This provision is effective for gifts after December 31, 2009. A transfer in trust is treated as a taxable gift unless the trust is treated as wholly owned by the donor or donor’s spouse. Act Sec. 511(e), amending I.R.C. § 2511(c). This provision is effective for gifts made after December 31, 2009. Act Sec. 511(f)(3).

See the back page for details about the 2001 Agricultural Tax and Law Seminars by Dr. Neil E. Hart and Prof. Roger A. McEowen
The 2001 Act provides that Chapter 11 of the Internal Revenue Code (federal estate tax) is not to apply to the estates of decedents dying after December 31, 2009. Act Sec. 501(a) enacting I.R.C. § 2210.

Likewise, Chapter 13 of the Internal Revenue Code (generation skipping transfer tax) is not to apply to generation-skipping transfers made after December 31, 2009. Act Sec. 501(a),(b), enacting I.R.C. §§ 2210, 2664.

State death tax credit
A credit has been allowed for a portion of state inheritance, estate, legacy or succession taxes paid based on the taxable estate. I.R.C. § 2011.

Under the 2001 Act, the maximum estate death tax credit is decreased to 75 percent of the amount in 2002, to 50 percent in 2003 and to 25 percent in 2004. Act Sec. 531(a), amending I.R.C. § 2011(b). This provision is effective for deaths after December 31, 2001. Act Sec. 531(b).

In 2005, the state death tax credit is repealed and a deduction will be allowed for any estate, inheritance, legacy or succession taxes paid to any state or the District of Columbia in respect of property included in the gross estate of the decedent.

Such state taxes must have been paid and claimed before the later of (1) four years after the filing of the federal estate tax return or (2) 60 days after a decision of the U.S. Tax Court becomes final which determines the estate tax liability, (3) the expiration of the period of extension to pay estate taxes under I.R.C. § 6166 or (4) 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 been filed becomes final. Act Sec. 532(a), repealing I.R.C. § 2011, adding I.R.C. § 2011(g) and enacting I.R.C. § 2058.

New income tax basis at death

The provisions authorizing a new income tax basis at death, I.R.C. § 1014(a), have generally allowed a basis equal to the fair market value (or value used for federal estate tax purposes) as of the date of death or as of the alternate valuation date up to six months after death. In a community property state, the surviving spouse’s one-half share of community property held by the decedent and the surviving spouse generally is treated as having passed from the decedent and thus is eligible for a new basis at death. This rule applies if at least one-half of the whole of the community interest is included in the decedent’s gross estate.

Under the 2001 Act, no change in income tax basis at death is made until repeal of the federal estate tax, effective for deaths after December 31, 2009. Act Sec. 541, adding I.R.C. § 1014(f) (“This section shall not apply with respect to decedents dying after December 31, 2009.”)

Thereafter, the provisions authorizing a new income tax basis at death are repealed and a system of carryover basis is implemented. Act Sec. 542(a), enacting I.R.C. § 1022.

Recipients of property transferred at the decedent’s death will receive an income tax basis equal to the lesser of the adjusted income tax basis of the decedent or the fair market value of the property as of the date of the decedent’s death. Act Sec. 542(a), adding I.R.C. § 1022(a)(2).

Property acquired from the decedent is treated as if acquired by gift. Act. Sec. 542(a), adding I.R.C. § 1022(a)(1).

The character of the gain on the sale of property received from a decedent’s estate is carried over to the heir. As the Committee Reports state as an example, “real estate that has been depreciated and would be subject to recapture if sold by the decedent will be subject to recapture if sold by the heir.” Conf. Committee Report p. ___.

Allowable increase in basis. The 2001 Act allows an executor to increase the income tax basis of assets owned by the decedent and acquired by beneficiaries at death by designated amounts. Act Sec. 542(a), adding I.R.C. § 1022(b)(1).

The 2001 Act allows an executor to increase the income tax basis in eligible assets transferred by up to a total of $1,300,000. The $1,300,000 is increased by the amount of unused capital losses, net operating losses and certain “built-in” losses of the decedent. Act Sec. 542(a), adding I.R.C. §§ 1022(b)(2)(B), (C).

In addition, the income tax basis of property transferred to a surviving spouse can be increased by an additional $3,000,000. Act. Sec. 542(a), adding I.R.C. § 1022(c). Thus, the total basis increase for an estate could be $4,300,000.

Non-residents who are not U.S. citizens are limited to an increase of basis of $60,000. Act Sec. 542(a), adding I.R.C. § 1022(b)(3).

The $60,000, $1,300,000 and $3,000,000 figures for basis increase are adjusted for inflation for decedents dying after 2011. Act Sec. 542(a), adding I.R.C. § 1022(d)(4).

Property eligible for increase in basis. To be eligible for a basis increase, the property must have been owned, or treated as owned, by the decedent at the time of the decedent’s death. Act. Sec. 542(a), adding I.R.C. § 1022(d)(1)(A).

For property held in joint tenancy or tenancy by the entirety with the surviving spouse, one-half of the property is treated as having been owned by the decedent (the so-called “fractional share” rule under I.R.C. § 2040(b)) and is, therefore, eligible for an increase in basis. Act Sec. 542(a), adding I.R.C. § 1022(d)(1)(B)(i)(I).

For property held jointly with a person other than the surviving spouse, the portion of the property attributable to the decedent’s consideration furnished (the so-called “consideration furnished” rule under I.R.C. § 2042(a)) is treated as having been owned by the decedent and is eligible for a basis increase. Act. Sec. 542(a), adding I.R.C. § 1022(d)(1)(B)(ii)(II).

The 2001 Act does not acknowledge the “Gallenstein” rule which allows the consideration furnished rule to be applied to joint interests created before 1976 where the owner dies after 1981. E.g., Gallenstein v. United States, 91-2 U.S. Tax Cas. (CCH) ¶ 60,088 (E.D. Ky. 1991), aff’d, 975 F.2d 286 (6th Cir. 1992) (entire value entitled to new income tax basis for husband-wife joint tenancy where husband provided consideration and preceded wife in death).

The decedent is also treated as the owner of property eligible for an increase in basis if the property was transferred to a qualified revocable inter vivos trust (as defined in I.R.C. § 645(b)(1)). Act Sec. 542(a), adding I.R.C. § 1022(d)(1)(B)(iii).

However, the decedent is not treated as owning property solely by reason of holding a power of appointment with respect to such property (even if it is a general power of appointment). Act Sec. 542(a), adding I.R.C. § 1022(d)(1)(B)(iii).

For community property, the decedent is treated as having owned the surviving spouse’s one-half share of community property, which is eligible for a basis increase if at least one-half of the property is owned by, and acquired from, the decedent. Act Sec. 542(a), adding I.R.C. § 1022(d)(1)(B)(iv).

Therefore, both the decedent’s share and the surviving spouse’s share of community property are generally eligible for a basis increase.
Thus, the legislation continues the differential treatment for community property and property subject to common law treatment which has been criticized in recent years.

**Property not eligible for basis increase.** Several categories of property are not eligible for an increase in income tax basis including –

- Property that was acquired by the decedent by gift (other than from the spouse unless the spouse acquired the property by gift) during the three-year period ending on the date of the decedent’s death: *Act Sec. 542(a)*, adding I.R.C. § 1022(d)(1)(C).
- Property that constitutes a right to receive income in respect of decedent (such assets do not receive a new basis at death under prior law): *Act Sec. 542(a)*, adding I.R.C. § 1022(f).
- Stocks or securities of a foreign personal holding company; *Act Sec. 542(a)*, adding I.R.C. § 1022(d)(1)(D)(i).
- Stock of a domestic international sales corporation (DISC) or former DISC: *Act Sec. 542(a)*, adding I.R.C. §1022(d)(1)(D)(ii).
- Stock of a foreign investment company, and Act Sec. 542(a), adding I.R.C. § 1022(d)(1)(D)(iii).
- Stock of a passive foreign investment company (except for which a decedent-shareholder had made a qualified electing fund election with respect to the decedent. *Act Sec. 542(a)*, adding I.R.C. § 1022(d)(1)(D)(iv).

**Applying the basis increase to assets.** In no event, can the basis of an asset be increased above the fair market value. *Act Sec. 542(a)*, adding I.R.C. § 1022(d)(2). The basis increase is allocated on an asset-by-asset basis, apparently down to the level of a share of stock. *Conference Committee Report, p. ___.*

If the amount of available increase in basis is less than the potential adjustment in basis up to fair market value, the executor of the estate is to determine which assets are to receive an adjustment in basis and the extent to which each asset is to receive a basis increase.

**Special rules for property passing to surviving spouses.** Property passing to a surviving spouse is eligible for a basis increase if it is “outright transfer property” or “qualified terminable interest property.” *Act Sec. 542(a)*, adding I.R.C. § 1022(c)(3).

The term “outright transfer property” means any interest in property acquired from the decedent by the surviving spouse but does not include an interest in property where, on the lapse of time, occurrence of an event or contingency or failure of an event or contingency to occur, the interest passing to the spouse will terminate or fail. *Act Sec. 542(a)*, adding I.R.C. § 1022(c)(4)(A), (B).

This provision parallels the terminable interest rule for purposes of the federal estate tax marital deduction. I.R.C. § 2056(b). An interest passing to a surviving spouse is not considered an interest that will terminate or fail on the death of the spouse if the death will cause a termination or failure only if it occurs within a period not exceeding six months after the decedent’s death, or only as result of a common disaster, and the termination or failure does not occur. *Act Sec. 542(a)*, adding I.R.C. § 1022(c)(4)(C).

This is similar to the rule in prior law. See I.R.C. § 2056(b)(3).

**Reporting requirements.**

Effective for decedents dying and gifts made after December 31, 2009, new reporting requirements will apply. *Act Sec. 542(b).*

Lifetime gifts. A donor will be required to report to the Internal Revenue Service the income tax basis and character of any non-cash property transferred by gift with a value in excess of $25,000 (except for gifts to charitable organizations). *Act Sec. 542(b)(2).* The donor is required to report to I.R.S. – (1) the name and taxpayer identification number of the donee; (2) an accurate description of the property; (3) the adjusted income tax basis of the property in the hands of the donor at the time of the gift; (4) the donor’s holding period for the property; (5) sufficient information to determine whether any gain on the sale of the property would be treated as ordinary income; and (6) any other information the Treasury Secretary may prescribe. *Act Sec. 542(b)(2)(B), adding I.R.C. § 6019(b).*

**Transfers at death.** For transfers at death of non-cash assets in excess of $1,300,000 and for appreciated property received by a decedent within three years of death, the executor of an estate or the trustee of a revocable inter vivos trust must report to IRS. *Act Sec. 542(b)(1), adding I.R.C. § 6018.*

The executor is to report to IRS – (1) the name and taxpayer identification number of the recipient of the property; (2) an accurate description of the property; (3) the adjusted basis of the property in the hands of the decedent and its fair market value as of death; (3) the decedent’s holding period for the property; (4) sufficient information to determine whether any gain on the sale of the property would be treated as ordinary income; (5) the amount of basis increase allocated to the property; and (6) any other information the Secretary of the Treasury may prescribe. *Act Sec. 542(b)(1), adding I.R.C. § 6018(c).*

**Penalties for failure to file.** Any donor required to report the income tax basis and the character of any non-cash property with a value in excess of $25,000 who fails to do so will be liable for a penalty of $500 for each failure to report the information to IRS and $50 for each failure to report the information to a beneficiary. *Act Sec. 542(b)(4), adding I.R.C. § 6716.*

Any person required to report to the IRS transfers at death of non-cash assets in excess of $1,300,000 in value who fails to do so is liable for a penalty of $10,000 for the failure to report such information. *Id.*

**Sunset provision.**

The 2001 Act, specifies that “all provisions of, and amendments made by the Act shall not apply . . . to estates of decedents dying, gifts made or generation-skipping transfers after December 31, 2010.” *Act Sec. 901.*

Therefore, unless amended further, the estate, gift and generation skipping transfer tax provisions will (1) be repealed after 2009 and (2) revert to the status of the provisions as of the date of enactment. It would appear that the unified credit applicable exclusion amount in 2011 would be $1,000,000 (the amount applicable after 2005) unless the sunset provision, Sec. 901 of the 2001 Act, is repealed. All of this means enormous uncertainty in estate planning for the next decade.

**Tax benefits surviving repeal of federal estate tax.**

If an estate has claimed a tax benefit which is subject to recapture, the recapture provisions survive repeal of the federal estate tax (if that, in fact occurs). *Conference Committee Report, p. ___.*

**Special use valuation.** The recapture provisions applicable to special use valuation continue to apply so that those who had claimed the benefit prior to repeal are subject to recapture if a disqualifying event occurs causing payments after repeal. *Id.*, I.R.C. § 2032A(c).

Family-owned business deduction. In a similar manner, the recapture provisions under the family-owned business deduction
statute (I.R.C. § 2057) continue to apply after repeal of FOBD and repeal of the federal estate tax if a disqualifying event occurs.  


Installment payment of federal estate tax. For estates electing 15-year installment payment of federal estate tax, payments due after repeal continue to be due and payable. Moreover, if dispositions or withdrawals occur such that payment of deferred tax is accelerated, any repayment continues to be an obligation which is due and payable as though the federal estate tax had not been repealed. Conf. Committee Report, p. ___; I.R.C. § 6166.

Conservation easements. The additional tax that could become due on failure to execute an agreement to extinguish development rights continues to be due after repeal of the federal estate tax. Conf. Committee Report, p. ___; I.R.C. § 2031(c).

Exclusion on sale of residence
The income tax exclusion on sale of the principal residence ($250,000, $500,000 on a joint return) is extended to estates and heirs. Act Sec. 542(c), adding I.R.C. § 121(d)(9).

Gain can be excluded under the provision if the decedent used the property as the principal residence for two or more years during the five year period prior to sale. If an heir occupies the property as the principal residence, the decedent’s period of ownership and occupancy of the property as the 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 the principal residence. The exclusion applies to property sold by a trust that was a qualified revocable trust (under I.R.C. § 645) immediately prior to the decedent’s death. The decedent’s period of occupancy as the principal residence can be added to an heir’s subsequent ownership and occupancy in determining whether the property was owned and occupied for two or more years as the principal residence, regardless of whether the residence was owned by the trust during the decedent’s occupancy. Act Sec. 542(c), adding I.R.C. § 121(d)(9). See Conf. Committee Report, p. ___. The provision is effective for deaths after December 31, 2009.  

Liability in excess of basis
The 2001 Act clarifies that, after 2009, gain is not recognized at the time of death if an estate or heir acquires from the decedent property subject to a liability that exceeds the decedent’s income tax basis in the property. Act Sec. 542(a), adding I.R.C. § 1022(g).

Likewise, gain is not recognized by an estate on distribution of such property to a beneficiary of an estate by reason of the liability exceeding the basis. Id.

Conservation easements
The availability of qualified conservation easements is expanded by eliminating the requirement that the land be located within a designated distance from a metropolitan area, national park, wilderness area or Urban National Forest. Act Sec. 551(a), amending I.R.C. § 2031(c)(8)(A)(i).

Under the legislation, a qualified conservation easement can be claimed with respect to any land located in the United States or its possessions. Id.

The legislation also clarifies that the date for determining easement compliance is the date the donation is made. Act Sec. 551(b), amending I.R.C. § 2031(c)(2).

The changes are effective for decedents dying after December 31, 2000. Act Sec. 552(c).

Installment payment of federal estate tax
Number of owners. The 2001 Act increases from 15 to 45 the number of partners in a partnership or shareholders in a corporation (under the tests for what is an interest in a closely-held business) for purposes of so-called 15-year installment payment of federal estate tax. Act Sec. 571, amending I.R.C. § 6166(b). The provision is effective for deaths after December 31, 2001. Act Sec. 571(b).

Lending and financing business. The 2001 Act also expands the availability of the installment payment provisions by allowing an interest in a qualifying lending and financing business to be eligible for installment payment of federal estate tax. Act Sec. 572(a), adding I.R.C. § 6166(b)(10).

The installment payments (including both principal and interest) for the interest in a qualifying lending and financing business, can be made over five years with no deferral of principal for five years as under I.R.C. § 6166 generally. Act Sec. 572(a), adding I.R.C. § 6166(b)(10)(A)(ii), (iii).

The term “lending and financing business” means a trade or business of making loans; purchasing or discounting accounts receivable, notes or installment obligations; engaging in rental and leasing of real and tangible personal property, including entering into leases and purchasing, securing and disposing of leases and leased assets; rendering services or making facilities available in the ordinary course of a lending or financing business; or rendering services or making facilities available in connection with the preceding list of activities by a corporation rendering services or making facilities available or by another corporation which is a member of the same affiliated group. Act Sec. 572(a), adding I.R.C. § 6166(b)(10)(B)(ii).

A “qualifying lending and financing business” means a lending and financing business if – (1) there was substantial activity immediately before the decedent’s death in the lending and financing business or (2) during at least three of the five taxable years ending before the date of the decedent’s death, the business had at least one full-time employee substantially all of the services of whom were in the active management of the business, 10 full-time non-owner employees substantially all of the services of whom were directly related to the business and $5,000,000 in gross receipts from the lending and financing business. Act Sec. 572(a), adding I.R.C. § 6166(b)(10)(B)(i).

The provision is effective for deaths decedents dying after December 31, 2001. Act Sec. 572(b).

Stock of holding companies. The 2001 Act clarifies that the installment payment provisions require only the stock of holding companies, not that of operating subsidiaries, to be non-readily tradable in order to qualify for installment payment. Act Sec. 572(a)*, amending I.R.C. § 6166(b)(8)(B).

The Act also specifies that an estate with a qualifying property interest held through holding companies that claim installment payment of federal estate tax (both principal and interest) for an interest held through a holding company can make the payments only over five years. Act Sec. 572(a)*, amending I.R.C. § 6166(b)(8)(B)(ii).

The provision is effective for deaths after December 31, 2001. Act Sec. 572(b)*.

*The Act contains two sections 572.