8-13-2010

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Federal Estate Tax and Generation-Skipping Transfer Tax: What’s Ahead?

-by Neil E. Harl

It would be impossible to put together a more improbable scenario in the realm of taxation than what has happened since 2001 with the transfer taxes – federal estate tax, generation-skipping transfer tax and the federal gift tax. Legislation was enacted in 2001 to repeal the federal estate tax and the generation-skipping transfer tax (but not until 2010) with the applicable exclusion amount rising from $675,000 in 2001 to $3,500,000 in 2009; decouple the federal gift tax effective in 2002, set the applicable exclusion amount for the federal gift tax at $1,000,000 in 2002 and thereafter with no inflation adjustment and with not even talk of repeal and eliminate the new basis at death after 2009, but only for one year. With 2010 slipping away, the question on many minds is: what is the Congress thinking now?

In this article, we examine the bills vying for attention in the House of Representatives and the United States Senate. Each proposal has its supporters and critics. Usually, the legislative skirmishing before passage of a major piece of legislation provides some insight into what is likely to emerge. That is hardly the case with the transfer taxes in 2010.

Continuation of the 2009 transfer tax system

Although it certainly was not what the majority anticipated in 2001, the most likely scenario continues to be the enactment yet in 2010 (either permanently or on a one-year patch basis), of legislation to continue the tax regime in place in 2009. The legislation would likely be retroactive to January 1, 2010. H.R. 4154 (by Pomeroy of North Dakota) would accomplish that result with the federal estate tax emerging at a 45 percent rate, a $3.5 million applicable exclusion amount and a new basis at death. None of the proposals being considered seriously would impose a carryover basis at death.

The Taxpayer Certainty and Relief Act of 2009

That legislation, S. 722, authored by Sen. Baucus of Montana, has received a great deal of attention inasmuch as Sen. Baucus chairs the Senate Finance Committee. The bill would extend, permanently, the federal estate tax and generation-skipping transfer tax as in effect in 2009 with the tax rate (45 percent) and applicable exclusion amount ($3.5 million for each decedent) frozen at 2009 levels. The legislation, if enacted, would re-unify the estate and gift tax; allow the remaining, unused applicable exclusion amount of a predeceased spouse to be used at the death of the surviving spouse, referred to as “portability” (although...
the details of how that would be done with multiple marriages is not clear); index amounts for inflation; increase the special use valuation allowance from the present level to $3.5 million for 2009 and 2010; and repeal the family-owned business deduction recapture rules.7

The Responsible Estate Tax Act of 2010

This proposal, S. 3533, introduced by Sen. Sanders and others, would leave the applicable exclusion amount at $3,500,000, would impose limits on discounts and place a 10-year minimum term on grantor retained annuity trusts. The bill would set the federal estate tax rate at 45 percent up to $10 million of taxable estate, rising to 50 percent for taxable estates of $10 million to $50 million and 55 percent over $50 million of taxable estate. A 10 percent surtax (making the top rate 65 percent) would be imposed on taxable estates over $500,000,000. The proposal would also raise the special use valuation limit from its present level (inflation adjusted to $1,000,000 for deaths in 2010) to $3,000,000.

So what is the political landscape on this issue?

Without much question, the federal budget deficit is providing buoyancy to those arguing for continuation of the transfer taxes and providing support for those urging higher rates for upper tax bracket estates. The outcome, however, will be a compromise and in all likelihood will not embrace any of the proposals in their entirety.

ENDNOTES

2 Id.
3 Id.
6 I.R.C. § 2032A.
8 I.R.C. § 469(c)(7)(C).
9 I.R.C. § 2032A(e)(2).

The Sensible Estate Tax Act of 2009

This bill, H.R. 2023, authored by Rep. McDermott of Washington State, would set the applicable exclusion amount at $2,000,000 per decedent ($4,000,000 for a decedent and spouse) on an inflation-adjusted basis; authorize “portability” of the applicable exclusion amount; set the federal estate tax rate at 45 percent, rising to 50 percent over $5,000,000 of taxable estate and 55 percent over $10,000,000 of taxable estate; and restore the credit for state death tax.

The Certain Estate Tax Relief Act of 2009

This proposal, H.R. 436, also authored by Rep. Pomeroy of North Dakota, would set the applicable exclusion amount ($3,500,000) and rate (45 percent) at the 2009 levels; re-unify the estate and gift taxes; and impose limitations on some types of discounting in valuing assets. The bill would set valuation rules for “non-business” assets with no discount allowed except for hedges, real property used in the active conduct of one or more trades or businesses where there is material participation under the passive activity loss rules and working capital reasonably required for a trade or business. The proposal would also bar discounts for non-actively traded interests in entities if the transferee and members of the family have control of the entity.

The Estate Tax Relief Bill of 2009

This bill, H.R. 3905, was introduced by four members of the House of Representatives late in 2009 on a bi-partisan basis. The proposal would increase, gradually, the applicable exclusion amount from $3,500,000 to $5,000,000 by 2019 and index the amounts for inflation. The bill would also reduce the rate from 45 percent to 35 percent over the same 10-year period.

Cases, Regulations and Statutes

by Robert P. Achenbach, Jr

Bankruptcy

Federal Tax Automatic Stay. The debtor had filed an action the Tax Court and reached a settlement with the IRS on March 22, 2005. Two days later, the debtor filed for Chapter 7. The Tax Court entered a stipulated decision on April 12, 2005, after the filing of the bankruptcy petition. The Tax Court held that the decision was voided by operation of the automatic stay in the bankruptcy case and vacated the stipulated decision. Shutts v. Comm’r, T.C. Memo. 2010-160.

Discharge. The debtor filed for Chapter 13 on October 4, 2007 and the IRS filed claims for 2002 and 2003 unpaid taxes based on a Tax Court ruling in May 2007 and assessments made in August 2007. The debtor sought to have the taxes declared dischargeable under Section 523(a)(1)(A). Although the IRS issued a Notice of Deficiency in 2005, the debtor challenged the notice by appealing to the Tax Court, prohibiting any assessment until conclusion of the Tax Court case. The IRS made the assessments in 2007 after the conclusion of the Tax court case and within 240 days before the