WikiLeaks Document Release

http://wikileaks.org/wiki/CRS-RS20989
February 2, 2009

Congressional Research Service

Report RS20989

Federal Estate, Gift, and Generation-Skipping Transfer Taxes: Modification, Phase Out and Repeal Under the Economic Growth and Tax Relief Reconciliation Act of 2001

John R. Luckey, American Law Division

Updated August 14, 2001

Abstract. Title V of the Economic Growth and Tax Relief Reconciliation Act of 2001 generally amends the Internal Revenue Code to repeal the federal estate and generation-skipping transfer taxes at the end of the year 2009, provide for the phase out of these taxes over the period 2002 to 2009, lower and modify the gift tax, provide new income tax carry-over basis rules for property received from a decedent, and make other general amendments which will be applicable in the phase out period.

WikiLeaks

Order Code RS20989
August 14, 2001

CRS Report for Congress
Received through the CRS Web

Federal Estate, Gift, and Generation-Skipping Transfer Taxes: Modification, Phase Out and Repeal Under the Economic Growth and Tax Relief Reconciliation Act of 2001

John R. Luckey
Legislative Attorney
American Law Division

http://wikileaks.org/wiki/CRS-RS20989

Summary

Title V of the Economic Growth and Tax Relief Reconciliation Act of 2001 generally amends the Internal Revenue Code to repeal the federal estate and generation-skipping transfer taxes at the end of the year 2009, provide for the phase out of these taxes over the period 2002 to 2009, lower and modify the gift tax, provide new income tax carry-over basis rules for property received from a decedent, and make other general amendments which will be applicable in the phase out period.

Title V of the Economic Growth and Tax Relief Reconciliation Act of 2001 addresses the federal transfer taxes (the estate, gift and generation-skipping transfer taxes) in five ways. First, the Act repeals the federal estate and generation-skipping transfer taxes at the end of the year 2009. Second, it provides for the phase out of these taxes over the period 2002 to 2009. Third, it lowers and modifies the gift tax. Fourth, the Act provides new income tax carry-over basis rules for property received from a decedent. Fifth, it makes other general amendments which will be applicable in the phase out period.

Repeal of The Estate and Generation-Skipping Transfer Taxes

The federal estate tax and the generation-skipping transfer tax shall not be applied to decedents dying or generation-skipping transfers made after December 31, 2009.[1]

[1] P.L. 107-16, § 501. It should be noted that for purposes of compliance with the Congressional Budget Act, P.L. 107-16, § 901 provides for sunset of its provisions at the end of the year 2010. Therefore, absent Congressional action in the interim, the law governing the estate, gift and generation-skipping transfer taxes would revert to the law which was in place on June 7, 2001.

Phase Out of The Estate and Generation-Skipping Transfer Taxes

The phase out of the estate tax is to be accomplished primarily by adjusting three features of the tax. The top rate is to be gradually lowered.[2] The applicable exclusion amount is to be gradually raised.[3] The credit for death taxes (estate or inheritance taxes) paid to a State is to be gradually lowered and replaced by a deduction for such taxes.[4] Also, the 5% surtax used to recapture the benefits of the graduated tax rates on taxable estates of over $10,000,000 is repealed,[5] and, after the applicable exclusion amount has surpassed the $1,300,000 level used to protect family owned businesses, the family owned business deduction is repealed.[6]

Applicable exclusion amount: The applicable exclusion amount is a unified amount which can be exempted from the gift and/or estate tax. To the extent it is used to offset taxable gifts, it is unavailable to offset the taxable estate.[7] After the applicable exclusion amount surpasses $1,000,000 in the year 2004, the amount which may be exempted from gifts is limited to $1,000,000, with the remainder of the exempt amount reserved to the taxable estate.

Credit for State taxes: An estate is allowed a credit for State death taxes, including estate, inheritance, legacy, or succession taxes, actually paid by the estate or any heir with respect to property included in the Federal gross estate. The Internal Revenue Code contains a table setting out the limits for the allowable State death tax credit, graduated by the size of the adjusted taxable estate (the taxable estate less $60,000). Currently the maximum allowable credit is the lesser of the net tax paid to the State or the statutory ceiling. The maximum state death tax credit would be $1,082,800 plus 16% of the adjusted taxable estate above $10,040,000.[8] Most States use the maximum credit allowed under § 2001(b) to constitute the State's estate tax. The Act gradually reduces this credit and then replaces it with deduction.

Phase out of graduated rates: Under current law, the effect of the graduated rates is phased out for estate and gift transfers exceeding $10,000,000. This phase out is accomplished by adding a 5% tax to the tax on taxable transfers over this amount until the benefit of the graduated rates has been recaptured and the average rate for the entire taxable estate is 55%. Once the recapture is complete, 55% again becomes the tax rate.[9] This provision is repealed for estates of decedents dying after December 31, 2001.

---

[2] P.L. 107-16, § 511.

[3] P.L. 107-16, § 521.

[4] P.L. 107-16, § 531 and § 532.

[5] P.L. 107-16, § 511(b).

[6] P.L. 107-16, § 521.

[7] 26 U.S.C. § 2010.

[8] 26 U.S.C. § 2011.

[9] 26 U.S.C. § 2001(c)(2).

http://wikileaks.org/wiki/CRS-RS20989

Family owned business deduction: The family owned business deduction allows $625,000 in value of a qualified family owned business to be deducted from the estate. If an estate opts to use this deduction, the estate is limited to a $675,000 applicable exclusion amount, giving a total of $1,300,000 which is deducted from the estate.[10] Therefore, when the applicable exclusion amount exceeds the $1,300,000 level, it will no longer be utilized and thus is repealed

Schedule of Phase Out Changes

Year	Top Rate on Taxable Estate in Excess of	Applicable Exclusion Amount	Credit for State Death Tax	Other Scheduled Changes
2002	50% over $2,500,000	$1,000,000	75% of current allowable credit.	Repeal of 5% surtax.
2003	49% over $2,000,000	$1,000,000	50% of current allowable credit.	
2004	48% over $2,000,000	$1,500,000	25% of current allowable credit.	Repeal of family owned business deduction.
2005	47% over $2,000,000	$1,500,000	Credit repealed. Deduction for tax paid to State.	
2006	46% over $2,000,000	$2,000,000	Deduction for tax paid to State.	
2007	45% over $1,500,000	$2,000,000	Deduction for tax paid to State.	
2008	45% over $1,500,000	$2,000,000	Deduction for tax paid to State.	
2009	45% over $1,500,000	$3,500,000	Deduction for tax paid to State.	

The phase out of the generation-skipping tax is accomplished primarily through lowering the rates and increasing the lifetime exemption. The generation-skipping transfer tax is imposed at the top rate of the estate tax.[11] Therefore, when the top rate of the estate tax is lowered under the Act, it has the effect of lowering the generation-skipping tax as well. The lifetime exemption is increased by making the exemption equal to the estate tax applicable exclusion amount.[12]

http://wikileaks.org/wiki/CRS-RS20989

---

[10] 26 U.S.C. § 2057.

[11] 26 U.S.C. § 2641.

[12] P.L. 107-16, § 521(c).

Modification of The Gift Tax

The gift tax was not repealed as originally proposed in order to protect the integrity of the income tax. It was felt that, absent a gift tax, income producing property could be gifted to taxpayers in lower brackets, sold, the taxes paid, and the proceeds gifted back to the higher bracket taxpayer, thus avoiding great amounts of income tax on the sale of capital assets.

The gift tax was modified by lowering the rates and increasing the applicable exclusion amount. The top rate of the gift tax declines with the top rate of the estate tax.[13] After the repeal of the estate tax, the top gift tax rate is lowered to 35% of the excess over $500,000.[14] The applicable exclusion amount is raised to $1,000,000 in the year 2002. This amount remains constant through the phase out period of the estate tax and after the repeal of the estate tax.[15] Thus, when the unified applicable exclusion amount increases for the estate tax in the phase out period, only $1,000,000 may be used to cover lifetime transfers, i.e. gifts.

The tax on a taxable gift[16] is measured initially by the value of the transferred property, and is cumulative in nature.[17] The applicable rate of tax on a taxable gift is determined by the total of the donor's lifetime taxable gifts. The applicable rate of tax on each successive lifetime taxable gift is higher than on previous gifts.[18]

http://wikileaks.org/wiki/CRS-RS20989

---

[13] P.L. 107-16, § 511(c), see discussion above.

[14] P.L. 107-16, § 511(d).

[15] P.L. 107-16, § 521.

[16] All of the gift tax exemptions and deductions are preserved including the exemption of gifts to one's spouse (26 U.S.C. § 2523), the charitable deduction (26 U.S.C. § 2522), the $10,000 per donee annual exemptions (26 U.S.C. § 2503(b)), and the exemption for educational and medical gifts (26 U.S.C. § 2503(e).

[17] 26 U.S.C. § 2501.

[18] 26 U.S.C. § 2001(c).

Gift tax rate schedule for gifts made after December 31, 2009

Tentative Tax amount	Tentative Tax
not over $10,000	18% of such amount
$10,000 to $20,000	$1,800 + 20% of the excess over $10,000
$20,000 to $40,000	$3,800 + 22% of the excess over $20,000
$40,000 to $60,000	$8,200 + 24% of the excess over $40,000
$60,000 to $80,000	$13,000 + 26% of the excess over $60,000
$80,000 to $100,000	$18,200 + 28% of the excess over $80,000
$100,000 to $150,000	$23,800 + 30% of the excess over $100,000
$150,000 to $250,000	$38,800 + 32% of the excess over $150,000
$250,000 to $500,000	$70,800 + 34% of the excess over $250,000
over $500,000	$155,800 + 35% of the excess over $500,000

http://wikileaks.org/wiki/CRS-RS20989

Basis Rules for Property Received from a Decedent

Technically the new basis rules are income tax rules, not estate tax rules. Basis is used to determine gain on the sale of capital assets for income tax purposes. Often basis and cost are equivalent. Generally, to determine taxable income from sale of a capital asset, the basis in that asset is subtracted from the sale price. Currently, the basis in property received from a decedent is a "stepped-up" basis.[19] The inheritor of property, instead of having the basis of the one from which he received the property (a carry-over basis), has a basis in the property of the fair market value of the property at the date of death of the decedent. The purpose of the stepped-up basis rule was to avoid double taxation. The property had been subject to the estate tax. If the property had a carry-over basis and was sold after inheritance, there would be a capital gain subject to the income tax. The use of the stepped-up basis eliminates this capital gain and thus the income tax on the sale. With the repeal of the estate tax, this need for the stepped-up basis rules will be removed.

The Act repeals the stepped-up basis rule at the end of the year 2009 (when the estate tax is repealed).[20] The new basis rule will be that the basis in property received from a decedent is the lesser of carry-over basis or the fair market value of the property on the date of death of the decedent.[21]

---

[19] 26 U.S.C. § 1014.

[20] P.L. 107-16, § 541.

[21] P.L. 107-16, § 542.

Under the estate tax and the income tax stepped-up basis rules, an amount of the gross estate was not subject to either tax.[22] To compensate for the loss of the exempt property with the repeal of the estate tax and the change to carry-over basis, the Act provides for two amounts of property which may still receive stepped-up basis. Every estate may allocate $1,300,000 basis increase to property in the taxable estate.[23] In addition to this general step-up, property passing to the spouse of the decedent may be allocated up to $3,000,000 basis increase.[24] Each of these amounts is to be indexed for inflation.

The spousal property basis increase will be generally available for any property which would have qualified for the estate tax marital deduction, i.e. all property passing to the decedent's surviving spouse. Interests which may terminate in favor of another person upon the lapse of time, the occurrence of an event or contingency, or the failure of an event or contingency to occur, generally do not qualify. The interest of the spouse in the property receiving the basis increase must be a non-terminable interest passing to the surviving spouse. These interests may pass to the spouse under the terms of the decedent's will, by law of intestacy, by contract, by operation of law, or otherwise. Special exceptions to the terminable interest rule are made for certain transfers in trust of a lifetime income interest if the executor elects to include the value of the trust property in the surviving spouse's gross estate, and for certain life estates coupled with a general power of appointment, as well as for certain life insurance settlement options and certain interests conditioned upon survivorship for a reasonable period not exceeding six months.

Other Amendments

The Act requires certain new returns to be filed to provide information for administration of the new basis rules.[25]

The Act removes the mileage restrictions for the estate tax rule for creation of conservation easements. This amendment applies to the estates of decedents dying after December 31, 2000.[26]

The Act modifies the generation-skipping transfer tax allocation rules for certain lifetime transfers to a trust.[27]

http://wikileaks.org/wiki/CRS-RS20989

---

[22] The applicable exclusion amount and all property passing to the spouse under the unlimited marital deduction would not be subject to the estate tax while still receiving the stepped-up basis and thus avoiding the income tax on the subsequent sale of the property.

[23] P.L. 107-16, § 542. A decedent who is a nonresident not a citizen is limited to a $60,000 step-up.

[24] P.L. 107-16, § 542.

[25] P.L. 107-16, § 542, amending 26 U.S.C. §§ 6018 & 6019.

[26] P.L. 107-16, § 551.

[27] P.L. 107-16, §§ 561 to 563.