Update on Prospects for Estate Tax Legislation

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I. THE TURBULENCE CREATED BY THE 2001 TAX ACT

The following timeline summarizes the state of the law year-by-year, under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA):

TABLE 1
Year-by-Year Summary of the Changes Made by EGTRRA

	2001	2002	2003	2004	2005	2006	**2007**	2008	2009	2010	2011 on
Estate Tax											
Exclusion	$675,000	$1 million		$1.5 million		**$2 million**			$3.5m		$1 million
Lowest rate	37%	41%		45%		46%	**45%**				41%
Top rate	55%	50%	49%	48%	47%						55%
5% bubble	Yes	**No**									Yes
QFOBI	Yes			**No**							Yes
State tax credit	100%	75%	50%	25%	**None. State taxes are deductible.**						100%
GST Tax											
Exemption	$1 million indexed (from 1998)			$1.5 million		**$2 million**			$3.5 million		$1m, indexed
Rate	55%	50%	49%	48%	47%	46%	**45%**				55%
Gift Tax											
Exclusion	$675,000	**$1 million**									
Lowest rate	37%	**41%**								35%	41%
Top rate	55%	50%	49%	48%	47%	46%	**45%**				55%
5% bubble	Yes	**No**									Yes

II. THE STATE DEATH TAX CREDIT

A. Under EGTRRA, the credit for state death taxes was reduced to 75% of its former level in 2002, 50% of its former level in 2003, and 25% of its former level in 2004. In 2005 the credit was repealed and replaced with a deduction for state death taxes paid. The result was a dramatic shift of revenue from states to the federal government in states that employ a "pick-up" estate tax in the amount of the federal credit ("coupled" states). For example, for a taxable estate of $10 million in a coupled state, the state revenue, of course, declined by 25% each year until it disappeared in 2005. Meanwhile, as shown in Table 2, the percentage loss

in *federal* estate tax revenue from an estate of this size does not even reach double figures until 2009. In 2005, the federal tax on such an estate was actually 3% *larger* than the net federal tax in 2001.

TABLE 2
Tax on a Taxable Estate of $10 Million
(assuming no adjusted taxable gifts and a pick-up state tax only)

Year	State Pick-Up Estate Tax		Net Federal Estate Tax		Gross Estate Tax	
	Tax	Change from 2001	Tax	Change from 2001	Gross Tax	Change from 2001
2001	$1,067,600	—	$3,852,650	—	$4,920,250	—
2002	$800,700	-25%	$3,629,300	-6%	$4,430,000	-10%
2003	$533,800	-50%	$3,821,200	-1%	$4,355,000	-11%
2004	$266,900	-75%	$3,798,100	-1%	$4,065,000	-17%
2005	0	-100%	$3,985,000	+3%	$3,985,000	-19%
2006	0	-100%	$3,680,000	-4%	$3,680,000	-25%
2007	0	-100%	$3,600,000	-7%	$3,600,000	-27%
2008	0	-100%	$3,600,000	-7%	$3,600,000	-27%
2009	0	-100%	$2,925,000	-24%	$2,925,000	-41%
2010	0	-100%	0	-100%	0	-100%
2011	$1,067,600	0	$3,727,400	-3%	$4,795,000	-3%

B. A few states have historically had a death tax in excess of the federal credit. Other states have a death tax that is tied inflexibly to the federal credit in effect in 2001, either historically or because they have "decoupled" from the federal tax since 2001. In such states, the tax "relief" from the Act was minimal in the early years, particularly before 2005 when the deduction for non-creditable state taxes took effect. Table 3 recapitulates the real top rates in a state with only a "pick-up" tax (a "coupled state") and in a state with a tax tied to the pre-2002 credit (a "decoupled state" or "uncoupled state"). (The state tax in 2010 in some states is hard to predict.)

TABLE 3
Real Effective Top Tax Rates

Year	"Coupled" State (Like Louisiana)			"Decoupled" State		
	Federal	State	**Total**	Federal	State	**Total**
2001	39%	16%	**55%**	39%	16%	**55%**
2002	38%	12%	**50%**	38%	16%	**54%**
2003	41%	8%	**49%**	41%	16%	**57%**
2004	44%	4%	**48%**	44%	16%	**60%**
2005	47%	0	**47%**	40.52%	13.79%	**54.31%**
2006	46%	0	**46%**	39.66%	13.79%	**53.45%**
2007	45%	0	**45%**	38.79%	13.79%	**52.59%**
2008	45%	0	**45%**	38.79%	13.79%	**52.59%**
2009	45%	0	**45%**	38.79%	13.79%	**52.59%**
2010	0	0	**0**	0	?	**?**
2011	39%	16%	**55%**	39%	16%	**55%**

C. The odd state tax rates in decoupled states after 2004 in Table 3 result from the fact that the state tax itself is deducted in calculating the taxable estate, which is the base for the state tax in most states. The statutes of some states, such as Maryland, explicitly exclude the deduction of the state tax from this calculation. As a result, in Maryland, the top rate is 16% for all years through 2009. But because the larger Maryland tax is still deducted in calculating the federal taxable estate, the effective net federal rate is reduced further, but not enough to completely offset the higher state tax. Table 4 is a remake of Table 3 to show these differences:

TABLE 4
Real Effective Top Tax Rates

Year	"Coupled" State			State Like Maryland		
	Federal	State	**Total**	Federal	State	**Total**
2001	39%	16%	**55%**	39%	16%	**55%**
2002	38%	12%	**50%**	38%	16%	**54%**
2003	41%	8%	**49%**	41%	16%	**57%**
2004	44%	4%	**48%**	44%	16%	**60%**
2005	47%	0	**47%**	39.48%	16%	**55.48%**
2006	46%	0	**46%**	38.64%	16%	**54.64%**
2007	45%	0	**45%**	37.80%	16%	**53.80%**
2008	45%	0	**45%**	37.80%	16%	**53.80%**
2009	45%	0	**45%**	37.80%	16%	**53.80%**
2010	0	0	**0**	0	?	**?**
2011	39%	16%	**55%**	39%	16%	**55%**

D. Form 706 has been redesigned to accommodate the calculation of tax in a state like Maryland, by providing a separate line 3a on page 1 for calculating a "tentative taxable estate" net of all deductions except state death taxes, a line 3b for separately deducting state death taxes, and a line 3c for the federal taxable estate (old line 3). The "tentative taxable estate" in effect *is* the taxable estate for calculating the state tax (but not the federal tax) in a state like Maryland.

E. States have historically depended on the IRS to do most of their auditing for them, and the IRS has obliged by requiring proof of payment of any *creditable* state death tax before allowing an increased state death tax credit in the event of any adjustment of the taxable estate. Presumably, the IRS will continue to require such proof of payment of any *deductible* state death tax before allowing an increased deduction in similar circumstances, and states will still be able to rely on IRS audit activity for the most part.

F. The landscape is further complicated by other departures from the federal model in various jurisdictions, such as jurisdictions which have decoupled their tax systems not only from the declining federal credit for state death taxes but also from the phased increases in the federal unified credit. Using Maryland as an example again, the exemption under Maryland law for decedents dying in 2006 is

$1,000,000, not $2,000,000. It is unclear how Maryland will enforce the filing of returns and the collection of tax in the case of estates greater than $1,000,000 and under $2,000,000 (which do not have to file a federal return).

G. In some states, however, the tide is flowing in the other direction. Virginia's decoupled estate tax, for example, has been repealed, effective July 1, 2007.

III. WATCHING A BYRD AT SUNSET

A. With reference to transfer taxes, section 901(a) of EGTRRA states that "[a]ll provisions of, and amendments made by, this Act shall not apply … to estates of decedents dying, gifts made, or generation skipping transfers, after December 31, 2010." Section 901(b) goes on to state that "[t]he Internal Revenue Code of 1986 … 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."

B. Section 901 is the only section in the ninth and last title of the Act, entitled "Compliance with Congressional Budget Act."

C. The Congressional Budget Act of 1974 (2 U.S.C. § 621 *et seq.*) prescribes the procedures by which Congress adopts spending and tax priorities in a budget resolution and implements those priorities in a streamlined process of budget reconciliation. In a 1985 amendment sponsored by Senator Robert Byrd (D-WV) (and hence known as "the Byrd rule"), section 313(f)(2) of the Budget Act (2 U.S.C. § 633(f)(2)) was added to make it out of order in the Senate to include in budget reconciliation "new budget authority or outlays" (which includes the reduction of tax receipts, *see* 2 U.S.C. § 622(2)(A)(iv)) beyond that provided for in the budget resolution. Since the budget resolution generally covers ten years, it would be out of order to reduce taxes beyond that ten-year budget window.

D. The Byrd rule can be waived by a vote of 60 Senators (just as a Senate filibuster against general legislation can be broken by a vote of 60 Senators). H.R. 1836 originally passed the Senate, on May 23, 2001, by a vote of 62-38. That Act, however, garnered 62 votes only with a "sunset" provision in it. The Senate was not asked to vote on a non-sunsetting repeal, and presumably the votes were just not there. In the Senate consideration of H.R. 1836, amendments to eliminate the estate tax repeal were defeated by votes of 43-56 and 42-57. Even an amendment to preserve the estate tax only for estates greater than $100 million was defeated by a vote of 48-51.

E. Thus, as written, the estate and GST tax repeal and carryover basis will be in effect for just one year! After 2010, the 2001 changes will "sunset" and the law will revert to the law that would have been in effect in 2006 under the Taxpayer Relief Act of 1997. The last year for which TRA '97 made changes was 2006, for which it prescribed a unified estate and gift tax credit resulting in an exemption

equivalent of $1 million, a top rate of 55% with a 60% "bubble," a QFOBI deduction, an indexed GST exemption, a full state death tax credit, and a full fair market value basis at death.

IV. THE COST OF REPEAL

A. In 2001, when the estate tax was "repealed" (albeit only for the year 2010), Congress anticipated large budget surpluses. There was debate over how large the surpluses might be, there was debate over how much of the projected surpluses should be "given back to taxpayers" in the form of tax cuts, and there was debate over what form those tax cuts should take. Congress decided on tax cuts, over a ten-year period, of one and one-third trillion dollars. Even that would not fund every tax cut Congress wanted to confer, however, and it was necessary to set priorities and make trade-offs – the equivalent of "spending political capital" – even in 2001.

B. Obviously Congress was able to "repeal" the estate tax in 2001, within its $1.35 trillion tax cut budget, in large part by postponing the complete repeal to the year 2010. See Table 1. In fact, since the estate tax is due nine months after death, the revenue effect of complete repeal will not be significantly felt until October 1, 2010, the first day of fiscal 2011. Thus, the 2001 estate, gift, and GST tax changes were projected to decrease revenue by a total of $84 billion for the ten fiscal years 2001 through 2010, but to reduce revenue by $54 billion in fiscal 2011 alone.

C. It is also well known that Congress mitigated the federal revenue loss from the 2001 Act by repealing the state death tax credit and thereby shifting a significant part of the burden to states whose estate taxes were tied to the federal credit and have therefore been phased out. See Table 2. Since the state death tax credit is now fully repealed, that is a technique that Congress cannot use again. Again, that means that estate tax repeal would be more expensive today than in 2001.

V. PAST REMINISCENCES

A. In the Revenue Act of September 8, 1916, as the United States entered World War I, Congress enacted the current estate tax, imposed at rates of 1% to 10% on taxable estates over $50,000. In the Act of March 3, 1917, the rates were generally increased by half, to levels of 1½% to 15%. In explaining the Senate bill, which would have doubled rates to 2%-20%, the Finance Committee said (S. REP. NO. 103, 65TH CONG., 1ST SESS. 14 (1917) (emphasis added)):

> *Such a tax, when used as an emergency measure, is necessarily unequal in operation.* Only if continued at the same rate for many years – the period of a generation – does it become equal for all persons in like situation. *If levied as a war tax, that is, as a temporary emergency measure, it falls only upon the estates of those who happen to die during the period of the emergency.* Particularly is it

> to be remembered that perhaps a majority of those dying during the war and leaving estates to be taxed will be soldiers and sailors dying in defense of our country. *On the other hand, as a permanent measure, such a tax, even at the rates already fixed by existing law, trenches in considerable degree on a sphere which should be reserved to the States.*

In its version of the Revenue Act of 1926, when the gross rates ranged from 1% to 20%, the House of Representatives raised the state death tax credit to 80% of the basic tax, while the Senate version would have repealed the estate tax. In support of repeal, the Finance Committee quoted the excerpts from its 1917 report that are italicized above. S. REP. NO. 52, 69TH CONG., 1ST SESS. 8 (1926). In short, the Finance Committee of 1917 and 1926 seems to have cited the same arguments in support of doubling the tax and in support of repealing the tax! The 1926 House-Senate conference, of course, accepted the House approach.

B. On **February 5, 1969**, less than two weeks after the inauguration of President Nixon, Congress published a multi-volume Treasury Department work entitled "Tax Reform Studies and Proposals," reflecting work that had been overseen by Assistant Secretary of the Treasury for Tax Policy Stanley Surrey during the Kennedy and Johnson Administrations. It included a number of estate and gift tax proposals. The following list of the estate and gift tax proposals gives the date each proposal was eventually enacted in some form:

1. Taxation of appreciation at death or at the time of gifts (carryover basis enacted in 1976, repealed in 1980, and enacted again in 2001, effective 2010).

2. Unification of the gift and estate taxes.

   a. Same rates (1976).

   b. Same base – tax-inclusive (1976, for gifts within three years of death).

   c. Single exemption (1976 – until 2003).

   d. Abolition of the "gifts in contemplation of death" rule (1976).

3. Unlimited marital deduction, including income interests (1981).

4. Repeal of the exclusion of interests in qualified retirement plans (1984).

5. More explicit rules governing disclaimers (1976).

6. An "orphan exclusion" equal to the amount of the gift tax annual exclusion multiplied by the number of years by which the orphan is under 21 (roughly in 1976 – repealed in 1981).

7. Tightening of the deduction rules for transfers to charity (1969).

8. More rational allocation of deductions between estate tax and income tax returns (in part by the "*Hubert* regulations" in 1999).

9. Tax on generation-skipping transfers (1976 and 1986).

10. Liberalized extended payment of estate taxes (section 6166) (1976).

11. Discontinuance of "flower bonds" redeemable at par to pay estate tax (last issued 1971, last matured 1998).

C. "Blueprints for Basic Tax Reform" was published by the Treasury Department **January 17, 1977**, during the last week of the Ford Administration, in response to Secretary of the Treasury William Simon's lament that the United States should "have a tax system which looks like someone designed it on purpose." In the context of proposing a comprehensive model of income taxation that depended on a dramatically broader tax base, "Blueprints" assumed that transfers by gift or at death would be recognition events. Such capital gains, whether by gift, at death, or otherwise, would be fully taxed at ordinary income rates, with adjustments to the basis of corporate stock for retained earnings and to the basis of all assets for general price inflation. Pre-enactment gain would be excluded, following the precedent of the "carryover basis at death" rules that were enacted in 1976. "Blueprints" was not embraced by the incoming Carter Administration.

D. "Tax Reform for Fairness, Simplicity, and Economic Growth" (popularly called "Treasury I") was published by Treasury on **November 27, 1984**, just weeks after President Reagan's landslide reelection. It included the following:

1. Imposition of gift tax, like the estate tax, on a "tax-inclusive" basis.

2. Imposition of tax only once, when beneficial enjoyment ceases, ignoring retained powers (a proposal that kindled an "easy to complete"/"hard to complete" debate).

3. Treatment of all powers of appointment as general powers of appointment if the holder could benefit from them, without regard to complicating concepts such as "ascertainable standards" and "adverse interests."

4. Valuation of fractional interests in an asset at their pro rata share of the value of the asset owned or previously transferred by the transferor or the transferor's spouse.

5. A simplified GST tax (compared to the GST tax enacted in 1976) with a $1 million exemption and a flat rate (in this proposal equal to 80% of the top estate tax rate).

6. Elimination of the phase-out of the credit for tax on prior transfers from a member of the same or a younger generation.

7. Expansion of section 6166 deferral of the payment of estate tax to all cases where the estate lacks sufficient cash or marketable assets, without regard to whether it holds an interest in a business. Liquidity would be reevaluated annually on an "if you have it send it in" basis (or at least send in 75% of it).

8. Conversion of the IRD deduction under section 691(c) to a basis adjustment.

9. Replacement of the separate rate schedule for calculating the maximum state death tax credit with a maximum credit equal to a flat 5% of the taxable estate. This would have resulted in a substantially smaller state death tax credit in most cases.

10. Repeal of section 303, which provides for exchange treatment of stock redemptions to pay certain taxes and funeral and administration expenses.

E. "The President's Tax Proposals to the Congress for Fairness, Growth, and Simplicity" was published by the White House on **May 29, 1985**. It was popularly called "Treasury II" or "White House I" or sometimes "Regan II" in reference to the fact that Donald T. Regan was the Secretary of the Treasury who signed the transmittal letter for "Treasury I" and had become the White House chief of staff by May 1985. Based generally on Treasury I, it was the rough model for the Tax Reform Act of 1986. It contained no proposals affecting transfer taxes.

1. Ultimately, the Tax Reform Act of 1986 did enact a supposedly simpler GST tax (but at a rate equal to 100%, not 80%, of the top estate tax rate).

2. In the Omnibus Budget Reconciliation Act of 1987 ("OBRA"), the House of Representatives added a repeal of the state death tax credit, a rule valuing interests in family-owned entities at their pro rata share of the total value of all interests in the entity of the same class, and rules regarding "disproportionate" transfers of appreciation in estate freeze transactions. H. REP. NO. 100-391, 100TH CONG., 1ST SESS. 1041-44. The House-Senate conference retained only the estate freeze rules, as section 2036(c) (which in turn was repealed in 1990 and replaced with the supposedly more workable rules of chapter 14).

3. The other transfer tax suggestions of Treasury I have not been enacted.

F. The Clinton Administration's Budget Proposals

1. The Clinton Administration's budget proposals for fiscal 1999 included a proposal to "eliminate non-business valuation discounts," described as follows:

> The proposal would eliminate valuation discounts except as they apply to active businesses. Interests in entities would be required to be valued for transfer tax purposes at a proportional share of the net asset value of the entity to the extent that the entity holds readily marketable assets (including cash, cash equivalents, foreign currency, publicly traded securities, real property, annuities, royalty-producing assets, non-income producing property such as art or collectibles, commodities, options and swaps) at the time of the gift or death. To the extent the entity conducts an active business, the reasonable working capital needs of the business would be treated as part of the active business (i.e., not subject to the limits on valuation discounts). No inference is intended as to the propriety of these discounts under present law.

2. The Clinton Administration's budget proposals for fiscal 2000 and fiscal 2001 repeated this proposal, except that "readily marketable assets" was changed to "non-business assets" and "the propriety of these discounts under present law" was changed to "whether these discounts are allowable under current law."

3. Clinton Administration proposals will inevitably experience a bit of a revival now that Democrats control the Congress, and Democratic staff members have already publicly referred to them as a possible model for legislative drafting.

G. The "Death Tax Elimination Act of 2000" (H.R. 8) was passed in 2000 by large majorities in Congress, including 59 Senators, but it was vetoed by President Clinton. H.R. 8 would have –

1. reduced the top rate from 55% to 40.5% in annual steps from 2001 through 2009,

2. converted the "unified credit" to an exemption, thereby allowing the exemption to be applied to the top marginal rate rather than to the lower rates as the credit is,

3. eliminated the 5% surtax that results in the 60% "bubble" for taxable estates larger than $10 million,

4. repealed the estate tax, gift tax, and generation-skipping transfer tax (GST tax), beginning in 2010, and

5. replaced the estate, gift, and GST taxes with a carryover basis regime, beginning in 2010.

H. A substitute to H.R. 8 offered in the House Ways and Means Committee by the ranking Democratic member, Rep. Charles Rangel, would have –

1. lowered all rates by 20% (*e.g.*, lowering the top rate from 55% to 44%), beginning in 2001,

2. increased the "exemption equivalent" sheltered from tax by the unified credit to $750,000 in 2001 and to $1.2 million by 2006,

3. increased the $1.3 million deduction for qualified family-owned business interests ("QFOBIs") to $2 million, and

4. replaced the credit for state death taxes with a deduction.

I. The "Death Tax Relief Now Act of 2000" (H.R. 5315), introduced by Rep. John Tanner (D-Tenn.) after President Clinton had vetoed H.R. 8, would have –

1. lowered all rates by 20%, beginning in 2001,

2. increased the "exemption equivalent" to $1.3 million in 2001,

3. repealed the QFOBI deduction,

4. replaced the credit for state death taxes with a deduction,

5. reduced the top estate tax rate to 39.6% (to match the top income tax rate!) in 2010, and

6. indexed all rate brackets for inflation after 2010.

President Clinton reportedly was willing to sign H.R. 5315.

J. In the consideration of H.R. 2646, the Farm Security and Rural Investment Act of 2002, which President Bush signed on May 13, 2002, the Senate added an expression of the "sense of the Senate" that the estate tax repeal should be made permanent. Even though such an expression had no statutory or other binding effect whatsoever, it garnered only 56 votes, with 42 votes opposed, although the two Senators not voting (Senators Bennett of Utah and Domenici of New Mexico) were Republicans who had supported the repeal of the estate tax in the past.

K. As part of an agreement reached to facilitate consideration of certain tax provisions of the 2002 energy bill (H.R. 4), the leadership of the Senate agreed to allow consideration of a proposal to remove the "sunset" feature of the estate and GST tax repeal, so that the repeal scheduled under EGTRRA to take effect in

2010 would no longer be scheduled to sunset on January 1, 2011 – making the repeal, in effect, permanent. The vote was promised by the end of June 2002.

1. The repeal measure the Republican leadership agreed to consider would only make the repeal of the estate and GST taxes in 2010 permanent for the years 2011 and beyond. Until 2010, the rates would fall and the unified credit would rise, on the schedule enacted in 2001. The gift tax unified credit would continue to be limited, so as to shelter gifts only up to $1 million, and after 2009 the gift tax would continue in effect, with a 35% rate. The state death tax credit would be phased out by 2005, and carryover basis would be enacted as a permanent replacement for the estate tax, beginning in 2010.

2. This permanent repeal measure involved a suspension of the budget reconciliation rules under which EGTRRA was crafted, and therefore it required the vote of 60 Senators – the same 60-vote requirement that contributed prominently to the odd results in EGTRRA in the first place.

3. The vote was held on June 12, 2002. The vote was 54-44, and the measure therefore failed. (The two Senators not voting supported repeal.)

4. Before voting on permanent repeal, the Senate took up alternatives offered by Democratic Senators, including accelerated increases in the unified credit (which failed by a vote of 38-60) and expansion of qualified family-owned business interest (QFOBI) relief (which failed by a vote of 44-54).

L. The October 22, 2003, *Washington Post* reported that Senator Jon Kyl (R-AZ), an important member of the Senate Committee on Finance who has been a major player in actively advocating permanent repeal of the estate tax, was at that time considering abandoning that position in exchange for an increase in the estate tax exemption to $15 million per person and a decrease in the estate tax rate, above that exemption, to 15%, the current income tax rate on capital gains.

1. The *Post* report was silent as to what, if anything, Senator Kyl would do about the gift and GST taxes, about adjustment of basis at death, and about state death taxes. The *Post* also reported that Senator Kyl's proposal had gained the interest of several Democratic Senators and the support of several important lobbyists. The article implied that the impetus for Senator Kyl's proposal was the growth of the deficit and the risk that if a Democrat were elected President in 2004 permanent repeal or substantial reduction of the estate tax would be a dead letter.

2. Then, on October 23, 2003, one day after the *Post* report, Senator Kyl repudiated the article. As if to leave no doubt, on the same day Senator Kyl introduced S.J. Res. 20, to express "the sense of the Congress that the number of years during which the death tax … is repealed [that is, 2010] should be extended, pending the permanent repeal of the death tax."

M. On the day after his reelection in 2004, President Bush referred to the "political capital" that he had earned and intended to "spend." He also made it clear that one of the centerpieces of his domestic agenda was to make permanent the tax cuts enacted in 2001 and 2003, including the repeal of the estate and GST taxes.

1. The following is from page 3 of the "General Explanations of the Administration's Fiscal Year 2006 Revenue Proposals" (emphasis added):

> **Current Law**
>
> The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) created a new 10-percent individual income tax rate bracket, reduced marginal income tax rates for individuals, doubled the child credit and extended its refundability, reduced marriage penalties, eliminated the phase-out of personal exemptions and the limitation on certain itemized deductions for higher-income taxpayers, provided additional incentives for education, increased IRA and pension incentives, provided relief from the alternative minimum tax (AMT), ***eliminated the estate and generation-skipping transfer taxes, and modified the gift tax***. These and several other provisions of EGTRRA sunset on December 31, 2010.
>
> The Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) increased the amount of qualifying property that can be expensed in the year of purchase rather than being depreciated and lowered the tax rates on qualifying dividends and on capital gains. The liberalized expensing provision, as extended, sunsets on December 31, 2007. The dividend and capital gains provisions sunset on December 31, 2008.
>
> **Reasons for Change**
>
> The tax relief and incentives to work, save, and invest provided by EGTRRA and JGTRRA are essential to the long-run performance of the economy. All taxpayers should have the certainty of knowing that the provisions of EGTRRA will extend beyond 2010. Taxpayers plan for periods far beyond the scheduled sunset dates of the EGTRRA and JGTRRA provisions when saving for their children's education, undertaking new business ventures, planning for retirement, and ***planning future contributions to charity and bequests for their children***. Taxpayers require the certainty that can be provided today by permanently extending the provisions of EGTRRA and JGTRRA. Permanent extension of the provisions is essential for promoting growth and higher levels of income in the future.
>
> **Proposal**
>
> The provisions of EGTRRA that sunset on December 31, 2010 would be ***permanently extended***. The provisions of JGTRRA that sunset on December 31, 2007 and December 31, 2008 would be permanently extended.

As the budget proposal worked its way through Congress, it did not *provide* for permanent estate tax repeal, but it was said that it would

"*accommodate* … a permanent extension of the death tax repeal." "CHAIRMAN'S MARK 2006 BUDGET PREPARED BY THE U.S. SENATE BUDGET COMMITTEE," March 9, 2005, at 22.

2. The President's proposed fiscal 2007 budget, released February 6, 2006, renewed the call for making permanent the tax cuts of the past five years, including the repeal of the federal estate and GST taxes.

3. The President's proposed 2008 budget, released February 5, 2007, repeated the same call, updated only to reflect the intervening temporary extensions. The "Proposal" section, from page 3 of the "General Explanations of the Administration's Fiscal Year 2008 Revenue Proposals," reads as follows:

> The provisions of JGTRRA that sunset on December 31, 2009 and December 31, 2010 (as extended) would be permanently extended. The provisions of EGTRRA that sunset on December 31, 2010 would be permanently extended.

4. Also in the 2004 election, the Republicans maintained control of the House and gained four seats in the Senate. Fifty-five was more Republicans than there had been in the Senate since Herbert Hoover was President. This gain in the Senate immediately triggered a lot of speculation about the new votes that might be available for permanent repeal of the estate tax.

   a. Extrapolating from the 59 Senate votes for H.R. 8 (which President Clinton vetoed) in 2000, the 58 votes for EGTRRA in 2001, and especially the 54 votes for the up-or-down repeal vote in June 2002 (with two absent Senators expressing support for repeal), some observers attempted to predict the likely votes for repeal in light of the intervening personnel changes. *See*, *e.g.*, Sullivan, "60-Vote Majority at Hand for Estate Tax Repeal," Tax Notes, Nov. 29, 2004, at 1174.

   b. Some also cited the intangible effect of the "Daschle factor" – the likelihood that Democrats in "red states" carried by President Bush, especially those up for reelection in 2006, would have second thoughts about opposing the supposedly popular repeal of the estate tax. *Id.*

   c. It is harder still to evaluate the intangible factor of weighing votes rather than counting them. A vote in 2000 for a measure everyone knew President Clinton would veto, a vote in 2001 for a repeal for only one year nine years in the future, and a vote in 2002 where the counting had already been done were not necessarily indicative of how lawmakers would vote on a measure with a realistic chance of

success, when it is actually necessary for them to take responsibility for their actions (as the 2006 votes were to show).

5. Ultimately, estate tax repeal or reform, like most other legislative possibilities, depends on congressional and Administration priorities, which in turn are affected by the competition from a host of other priorities:

    a. Iraq.

    b. Iran.

    c. The rest of the Middle East.

    d. Afghanistan.

    e. North Korea.

    f. Sudan.

    g. Relations with Russia.

    h. War on terror, homeland security, and domestic surveillance.

    i. Disaster preparedness and responsiveness.

    j. Immigration.

    k. Energy policy, alternative energy technology, and gas prices.

    l. Investigations and indictments.

    m. Confirmation of judicial and other appointments.

    n. Social Security, Medicare, and Medicaid reform.

    o. Making general income tax relief permanent, including –

        i. across-the-board income tax cuts,

        ii. individual AMT relief,

        iii. marriage penalty relief,

        iv. expanded child tax credit, and

        v. expensing and other small business relief.

    p. Making permanent or extending other temporary provisions, such as –

        i. the increased AMT exemption,

        ii. personal tax credits allowed against regular tax and AMT,

        iii. the deduction for sales taxes,

        iv. 15-year straight-line cost recovery for leasehold improvements,

        v. above-the-line deduction for tuition and related expenses,

vi. Archer medical savings accounts, and

vii. The 15% tax rate on capital gains and qualified dividends.

Many of these priorities affect a lot more voters, a lot more often, than does the estate tax. And all of these factors are affected by federal budget deficits!

VI. DRAMA IN THE 109TH CONGRESS

A. The repeal of the estate repeal was placed before the Senate when, by a more or less bipartisan vote of 272-162 on April 13, 2005, the House passed the 109th Congress's version of H.R. 8 (the "Death Tax Repeal Permanency Act of 2005"), which would eliminate the 2011 "sunset" that limits repeal to just the year 2010.

1. At the end of July 2005, just before the August recess, Senate Majority Leader Bill Frist of Tennessee filed a motion of "cloture" on H.R. 8, basically the Senate form of "calling the question," which requires approval of 60 Senators. When the Senate was scheduled to reconvene on September 6, the day after Labor Day, there was only one matter that might have been ahead of that cloture motion, a cloture motion on the "Native Hawaiian Government Reorganization Act of 2005."

2. Meanwhile, with full repeal lacking 60 votes, compromise efforts continued. The idea of a 15% rate, mentioned in the October 22, 2003, *Washington Post*, although quite a departure from the top 55% rate of just a few years ago and even the 45% top rate projected to arrive in 2007 under present law, had proved remarkably durable, and it remained the target rate openly discussed by Senator Kyl and others as the compromise discussions reached a public crescendo. In contrast, the $15 million exemption level reported in October 2003 was elusive. Following the 2004 elections, the most often mentioned aspiration was an exemption of $10 million. In mid-July, $8 million was mentioned in the press, and by the end of July it was $3.5 million.

3. By Labor Day, the pressures of dealing with Hurricane Katrina had become too much for the Senate, and the estate tax vote was postponed.

a. Opponents of repeal of the estate tax asked how Congress could possibly consider huge tax cuts for the nation's wealthiest families when multitudes on the Gulf Coast had been left with nothing.

b. Supporters of repeal asserted that now more than ever the economy needs the reassurance of stability in tax policy, especially regarding the taxation of saving and investment, which is so important in the Gulf Coast rebuilding effort.

B. By mid-February 2006, Senator Frist had publicly stated his intention to reschedule the estate tax vote for May 2006, which had been discussed at a retreat of Republican Senators in January 2006.

C. In an April 21, 2006 letter, Senator Frist reminded all Republican Senators of the May agenda. The letter had the following headings:

1. Winning the War on Terror.
2. Securing Our Border.
3. Improving the Quality of Life: Health Care.
4. Energy.
5. Governing Effectively: Judges, Who Interpret the Law, Not Make Law.
6. Keep Jobs and Growth.
7. Kill the Death Tax Forever. Under this heading, Senator Frist wrote:

> America is a nation taxed from the moment it awakes until the moment it sleeps. From the first cup of coffee you drink to the last water you sip when you brush your teeth, you pay a tax. We are an overtaxed nation, and hardworking Americans deserve a break.
>
> There's a lot of senseless taxes out there. But no tax seems to make less sense to me than taxing you after you're dead.
>
> Death tax is bad policy: it drives people to spend billions of dollars and create complicated tax structures for the sole purpose of avoiding payment. And it is immoral: the amounts subject to the death tax have already been taxed once. More to the point, death should not be a taxable event.
>
> Because of Katrina, we could not act on repealing the death tax last fall. Now is our time. Here is our moment. Let's end the death tax forever.

D. In April 2006, Public Citizen and United for a Fair Economy published "Spending Millions to Save Billions: The Campaign of the Super Wealthy to Kill the Estate Tax." This exposé named those said to be involved in a long-term campaign to repeal the estate tax and critiqued what it calls "myths" about the tax. See http://www.citizen.org/documents/EstateTaxFinal.pdf.

E. In May 2006, the Joint Economic Committee of Congress published "Costs and Consequences of the Federal Estate Tax." This study, similar to previous JEC studies on the same subject, discussed arguments for and against the estate tax and concluded generally that the estate tax is wasteful and hurts the economy. See http://www.house.gov/jec/press/2006/05-01-06.htm.

F. On May 2, 2006, a "Summit for Permanent Death Tax Repeal" convened at the National Press Club in Washington. It was sponsored by the Family Business Estate Tax Coalition, and participants included Senator Kyl, Ways and Means

Committee Member Congressman Kenny Hulshof (R-MO), and Al Hubbard, Assistant to the President for Economic Policy and Director of the National Economic Council. The consensus at the Summit was to support a compromise of a 15% rate, a $5 million exemption (indexed for inflation), and continued stepped-up basis for appreciated assets, all effective January 1, 2010.

G. On June 8, 2006, the Senate considered a cloture motion to take up H.R. 8, which the House had passed in April 2005, thus returning the debate to the posture that had been expected before the hurricanes of late August 2005. The motion was only to take up H.R. 8, not necessarily to approve it but possibly to amend it with something like Senator Kyl's 15%/$5 million proposal.

  1. Prior to the vote, however, Senator Kyl had floated the suggestion that he would agree to a second rate of, say, 30%, imposed on taxable estates over, say, $30 million. That made it unlikely that the last few necessary Democratic votes would support a 15% rate that did not include a 30% super-rate.

  2. The vote was 57-41 in favor of cloture, three votes short of the necessary 60. (The two Senators who did not vote would have voted no.)

H. On June 22, 2006, by a vote of 269-156, the House of Representatives passed a new bill, H.R. 5638, called the "Permanent Estate Tax Relief Act of 2006" ("PETRA").

  1. PETRA, effective January 1, 2010, would have provided

    a. a $5 million exemption equivalent (indexed for inflation after 2010),

    b. an initial rate tied to the top income tax rate on general capital gains under section 1(h)(1)(C) (currently 15%, but returning to 20% in 2011 if Congress does not act),

    c. a rate equal to double that rate on taxable estates over $25 million (not indexed),

    d. gift tax exemptions and rates conformed to the estate tax (rather than a special exemption of $1 million and a special rate of 35% as in 2010 under current law, see Table 1),

    e. repeal of the deduction for state death taxes (which itself replaced the phased-out credit for state death taxes in 2005),

    f. retention of a stepped-up basis at death for appreciated assets, and

    g. repeal of the 2011 "sunset" for the other transfer tax provisions of EGTRRA.

2. PETRA would also have provided a mechanism for a surviving spouse's estate and gift (but not GST) exemptions to be increased (but no more than doubled) by the amount of the exemption that was not used by that spouse's predeceased spouse.

   a. This in effect would have allowed a surviving spouse an exemption of up to $10 million (in 2015 and thereafter), indexed for inflation, if the first spouse to die did not use any exemption – if, for example, the estate of the first spouse to die were left entirely to the surviving spouse.

   b. This treatment would have to be elected on a timely estate tax return of the first spouse to die, and the Internal Revenue Service would have been authorized to reexamine that return at the time the surviving spouse died, no matter how much time had passed, for the purpose of determining the exemption available to the surviving spouse (but not for the purpose of changing the tax with respect to the first return).

   c. The $25 million level for the higher rate would not have been transferable between spouses.

3. In addition, PETRA included a relief provision for the timber industry, widely viewed as an effort to attract the votes of Senators from timber-growing states.

4. The Bush Administration, despite its official commitment to full and permanent repeal of the estate tax, announced on June 22 that it supported PETRA "as a constructive step toward full repeal of the death tax."

5. On June 27, Senator Frist announced that PETRA would not be brought to the Senate floor before the Fourth of July recess. His press release said:

   > The House of Representatives made tremendous progress last week toward achieving a permanent solution to the death tax. Now it's up to the Senate to decide whether it can improve upon the House bill or whether this is the bill that should be sent to the President for his signature. Everyone should be clear: The Senate will vote on a permanent reduction to this tax. The vast majority of my Democratic colleagues have so far refused to address this issue; it's my hope that their constituents will use the upcoming recess to explain the importance of supporting a reasonable and permanent solution to this unfair tax.

I. On July 29, 2006, by a somewhat less enthusiastic and less bipartisan vote of 230-180, the House of Representatives passed still another bill, H.R. 5970, called the "Estate Tax and Extension of Tax Relief Act of 2006" ("ETETRA").

1. ETETRA modified PETRA by

    a. phasing in the $5 million exemption equivalent in $250,000 annual increments from $3.75 million in 2010 (up from $3.5 million in 2009) to $5 million in 2015,

    b. delinking the top estate tax rate (but not the initial 15% rate) from the capital gains tax rate,

    c. phasing in the top 30% rate in 2% annual increments from 40% in 2010 (down from 45% in 2009) to 30% in 2015,

    d. extending the indexing for inflation (after 2015) to the $25 million bracket amount, and

    e. removing the "miscellaneous" provisions of EGTRRA from the repeal of the EGTRRA sunset, meaning that they again would be scheduled to expire in 2011.

2. Table 5 summarizes the federal estate tax exemptions and rates that would have been enacted by ETETRA:

TABLE 5
Estate Tax Exemptions and Rates under H.R. 5970

Year	Exemption (applied as a "unified credit")	Initial Rate	Rate Over $25,000,000*
Under Current Law			
2006	$2,000,000	46%	
2007	$2,000,000	45%	
2008	$2,000,000	45%	
2009	$3,500,000	45%	
Under ETETRA (H.R. 5970)			
2010	$3,750,000	15%**	40%
2011	$4,000,000	20%**	38%
2012	$4,250,000	20%**	36%
2013	$4,500,000	20%**	34%
2014	$4,750,000	20%**	32%
2015	$5,000,000*	20%**	30%

* The $5,000,000 and $25,000,000 numbers would be indexed for inflation after 2015.
** This rate would be equal to the highest income tax rate on general capital gains in section 1(h)(1)(C), permanently 20%, but 15% through 2010. There have been and will continue to be efforts to extend the 15% capital gains tax rate beyond 2010.

3. In addition to the estate tax provisions and the timber relief provision, ETETRA included two-year "extenders" of the research credit and other

expiring provisions, an increase in the minimum wage to $7.25 per hour by June 1, 2009, and a number of other tax changes not related to the estate tax. The estate tax provisions, extenders, and minimum wage increase were popularly referred to as the "Trifecta."

4. On August 3, the Senate cloture vote to take up consideration of H.R. 5970 failed by a vote of 56-42. Senator Frist changed his vote to no only to preserve his right to request reconsideration later in the year, and Senator Baucus (D-MT), who was expected to vote yes, was absent because of the recent death of his nephew in Iraq, thus suggesting that the total support for cloture might have been 58 votes. The only Senator to change from his vote on June 8 was Senator Byrd (D-WV).

J. After recessing for the November 7 elections and returning for a "lame duck" session, the 109th Congress adjourned without enacting ETETRA-like changes or any other significant changes to the estate, gift, and GST taxes.

1. Congress did, however, enact a number of the extenders that had been in ETETRA, but without estate tax changes, without an increase in the minimum wage, and without even the relief provisions for the timber industry that had originated in PETRA.

2. Meanwhile, section 901 of the Pension Protection Act of 2006 (P.L. 109-280) (PPA) made the 2001 modifications of section 529 permanent, by excepting those modifications from the January 1, 2011, sunset.

3. Section 1218 of the PPA added sections 170(o), 2055(g), and 2522(e) to the Code, limiting income tax and gift tax charitable deductions for undivided interests in tangible personal property (such as artwork).

a. The deductions would be denied unless all interests in the property are held by the donor, or by the donor and the donee, immediately before the contribution. Treasury may, by regulation, provide exceptions for situations where all persons who hold an interest in the property make proportional contributions of an undivided interest.

b. In the case of any subsequent contribution of additional interests in the property, the fair market value of the contribution will be the lesser of the fair market value of the property at the time of the initial contribution and the fair market value of the property at the time of the subsequent contribution. Similar rules apply for estate tax purposes where the decedent made fractional interest contributions before death.

c. The new rules require that any charity that receives a fractional interest in tangible personal property must take complete

ownership of the property within ten years or upon the death of the donor, whichever occurs *first*. In addition, the charity must have had substantial physical possession of the property during the ten-year period as long as the donor is living and must have used it in connection with its exempt purpose.

d. If these rules are violated, there will be recapture of the tax benefits associated with the contribution and imposition of a 10% penalty tax on the amount of the recapture. Recapture rules as well as a 10% penalty tax also apply for purposes of the gift tax.

4. Section 1219(b)(1) of the PPA added section 6695A to the Code, imposing a penalty on an appraiser of property equal to the lesser of (i) the greater of $1,000 or 10% of the tax underpaid by reason of an appraisal and (ii) 125% of the fee the appraiser received for the appraisal.

a. The penalty is imposed if the appraiser knew or should have known that the appraisal would be used in connection with a federal tax return or a claim for a federal tax refund and the appraised value is 150% or more of the correct value in the case of income tax or 40% or less of the correct value in the case of estate or gift tax.

b. The only apparent exception to the imposition of the penalty is where the appraiser establishes to the satisfaction of the Service that the appraised value was more likely than not the correct value. If Section 6695A of the Code is construed to provide that the penalty is waived only if the Secretary determines that the appraised value was "more likely than not the proper value" – a harsh standard to meet in a case where value is subjective anyway, especially when the appraised value is necessarily at least 50% higher or at least 60% lower than the value as finally determined.

c. The estate planning community generally hopes that regulations or other guidance will take a restrained approach in cases where the appraiser reasonably, honestly, and competently believed that the appraised value was proper.

5. Section 424 of the Tax Relief and Health Care Act of 2006 (P.L. 109-432) replaced the rule of section 664(c) of the Code that a charitable remainder trust (CRT) would lose its exemption from income tax if in any year it had unrelated business taxable income (UBTI) with a rule preserving tax exemption but imposing a 100% excise tax on any UBTI.

a. UBTI can arise from a CRT's investment in a partnership (or LLC) that conducts a business unrelated to the CRT's exempt purpose or from a CRT's direct or indirect investment in debt-financed

income-producing property. Loss of exemption is a real risk. For example, in *Leila G. Newhall Unitrust v. Commissioner*, 104 T.C. 236 (1995), *aff'd*, 105 F.3d 482 (9th Cir. 1997), a CRT lost its exemption because a public corporation in which it owned stock began operating as a publicly-traded partnership.

b. The amendment has been hailed as welcome relief from the effect of minor and inadvertent investment developments, and it has been criticized as harsh and confiscatory. A 100% tax is indeed harsh and warrants continued vigilance to avoid UBTI in CRTs, but many would prefer a stiff fine to a death sentence.

VII. REASSESSING THE LIKELIHOOD OF REPEAL

A. The history of the repeal movement has a number of milestones:

1. President Reagan's low-key interest in repeal, which produced only a reduction of the top rate from 70% to 50%, in a phased reduction that ultimately leveled off at 55%,

2. President Reagan's legacy of populist support for tax cuts of all kinds, coupled with increasing unrest among some economists and some leaders of public opinion with the economic and personal burden of the tax increasingly referred to as the "death tax,"

3. the Republican takeover of the House of Representatives in 1994, spurred by a "Contract with America" in which tax relief was prominent,

4. President Bush's presidential campaign of 2000, drawing on two decades of growing anti-tax sentiment in promising to return huge projected budget surpluses to the American people in "Tax Cuts with a Purpose," including repeal of the death tax,

5. the "repeal" itself in the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"), albeit only after nine years and then only for one year,

6. the immediate commitment from the 2001 Republican leadership to "make the tax cuts permanent," even as projected budget surpluses dwindled,

7. history-defying Republican mid-term election gains in 2002, followed by still more Republican gains in the presidential year of 2004,

8. an October 2003 Washington Post report – immediately denied but publicly affirmed after the 2004 election – that Senate Finance Committee member and repeal supporter Jon Kyl was working with other Senators to craft a bipartisan compromise proposal that would increase the exemption

to $15 million and decrease the rate, above that exemption, to 15%, the current income tax rate on capital gains,

9. the perennial endorsement of full repeal by the House of Representatives, culminating in a 272-162 vote in April 2005 for the current version of H.R. 8, the "Death Tax Repeal Permanency Act of 2005,"

10. the scheduling for just after Labor Day in 2005 of a Senate vote to take up H.R. 8, to either approve it or, more likely, to amend it along the lines of Senator Kyl's compromise,

11. the abrupt postponement of that vote after Hurricane Katrina,

12. the recommitment of the Senate Republican leadership to an estate tax vote in 2006, affirmed at a retreat of Republican Senators in January, announced by Senate Majority Leader Bill Frist (R-TN) in February, and reaffirmed in Senator Frist's call in an April 21 letter to Republican Senators to "end the death tax forever,"

13. a resolve by representatives of most pro-repeal constituencies at a May 2 "Summit for Permanent Death Tax Repeal" to get behind Senator Kyl's 15% compromise, with a $5 million exemption, as the most practical way to achieve at least a substantial measure of estate tax relief,

14. a 57-41 Senate vote on June 8 on a "cloture" motion to take up H.R. 8, which thereby failed for lack of the required 60 votes,

15. passage by the House of two new estate tax compromise bills customized to attract the support of 60 Senators – H.R 5638, the "Permanent Estate Tax Relief Act of 2006" ("PETRA") by a vote of 269-156 on June 22, and H.R. 5970, the "Estate Tax and Extension of Tax Relief Act of 2006" ("ETETRA") by a vote of 230-180 on July 29, and

16. a 56-42 Senate vote on August 3 on a cloture motion to take up consideration of H.R. 5970, which thereby also failed for lack of the required 60 votes.

B. We will probably never know how the Senate would have voted just after Labor Day in 2005, if Katrina had not intervened. But it is clear that the effort for total repeal has simply lost too much traction to have a meaningful chance of recovery. Consider the following:

1. In October 2003, Senator Kyl was publicly insisting on full and permanent repeal and denying rumors of compromise, but by the end of 2004 his push for a 15% rate instead of full repeal was a matter of general knowledge. Even before the June 8 cloture vote, it was understood in the Senate that Senator Kyl would accept a 30% rate for the largest estates –

an understanding that later was reflected in PETRA and ETETRA. Once willingness to compromise in this way is conceded, it is very hard to credibly reassert a "purist" position.

2. As late as his April 21 letter, Majority Leader Frist was calling on his Republican colleagues to "end the death tax forever," but by summer he was leading the effort to bring ETETRA to a vote, with its 15% and 30% rates.

3. The Bush Administration's official position has been to favor full and permanent repeal, but the White House called PETRA "a constructive step toward full repeal of the death tax." Again, once a compromise effort is dignified in that way, it becomes, *de facto*, the new agenda.

4. The opposition to repeal – indeed even the opposition to substantial reduction – is resolute and deep, as indicated by the failure of the ETETRA "sweeteners" to change more than one Senator's vote.

5. Meanwhile, the support for total repeal has been diluted both by the frustrations to date and by the realization that carryover basis would be a very unwelcome substitute.

6. Unlike 2001, the current fiscal climate of large budget deficits fuels the unease of politicians and voters with "tax cuts for the rich."

7. As a practical matter, estate tax repeal requires 60 votes in the Senate.

VIII. MORE DRAMA EARLY IN THE 110TH CONGRESS

A. Democrats, of course, control both Houses of the 110th Congress.

1. Democratic leaders, especially in the House of Representatives publicly cited "Six for '06" as the priorities of the "first hundred hours" (legislative hours, that is) of the new Congress:

a. Congressional ethics reform, including lobbying restrictions.

b. An increase in the minimum wage.

c. Implementation of the 9/11 Commission's recommendations.

d. Medicare, including the negotiation of prescription drug prices.

e. Roll-back of what are perceived as recent "tax breaks for Big Oil."

f. Reduction of the cost of college tuition (including relief through the tax system).

2. There may indeed be bipartisan support for some of these things. On the other hand, in light of the Republicans' recent history of resistance, there may be a lot of Republican unrest now if President Bush shows a disposition to make deals with congressional Democrats. Meanwhile, it is the House (which has passed legislation addressing these six topics) and Senate that are at odds.

3. The election has not changed the fact that both Republicans and Democrats are probably weary of the estate tax as a campaign issue and a legislative distraction. But the estate tax was not an important part of the campaign, it did not fit in the "first hundred hours" priorities, and there is no other reason to see it as an important part of the near-term Democratic agenda. Moreover, estate tax legislation with any significant revenue cost will be impeded if the Democrats stick to their commitment to a "pay-go" discipline that requires revenue losses to be offset with revenue enhancements or cost savings. This is especially true in light of House Ways and Means Committee Chairman Rangel's aggressive commitment to individual alternative minimum tax relief (an objective Senator Baucus shares).

4. Ironically, there apparently is still a lot of residual support for repeal of the estate tax. In April 2005, H.R. 8, the "Death Tax Repeal Permanency Act of 2005," was approved by the House of Representatives by a somewhat bipartisan vote of 272-162. Of the 272 who voted yes, 227 are back in the 110th Congress, nine more than a bare majority. Likewise, 52 Senators returning to the 110th Congress were in the majority in the 57-41 cloture vote in June 2006 to take up consideration of H.R. 8. One could theorize that a majority in both Houses of the 110th Congress favor repeal of the estate tax. That would not be entirely unreasonable, but neither would it matter. Repeal is opposed by a majority of the Democratic caucuses, which control the agenda now.

B. The change in control and other changes in leadership may permit a type of "new beginning" of collegiality and bipartisanship in arenas that matter to the prospects for short-term or long-term estate tax legislation.

1. In the House Ways and Means Committee, Chairman Charlie Rangel (D-NY) and Ranking Minority Member Jim McCrery (R-LA) have proven to be friends who work together.

2. In the Senate Finance Committee, Chairman Max Baucus (D-MT) and Ranking Minority Member Chuck Grassley (R-IA) have a long history of swapping leadership roles and of working together in a bipartisan way.

3. In the full Senate, Majority Leader Harry Reid (D-NV) and Minority Leader Mitch McConnell (R-KY) started the 110th Congress speaking to

one another about the Senate's agenda, more so than Senators Reid and Frist accomplished in previous Congresses.

4. All working relationships are fragile, however, in light of the suspicion and bitterness that can be created so easily by the large issues of the time, particularly the conduct of the war in Iraq.

C. On March 21, 2007, in the context of finalizing the fiscal 2008 budget resolution (S. Con. Res. 21), the Senate, by a vote of 97-1 (with only Senator Fiengold (D-WI) opposed), approved an amendment offered by Senator Baucus joined by Senators Mary Landrieu (D-LA), Mark Pryor (D-AR), Evan Bayh (D-IN), and Bill Nelson (D-FL)) that in effect would make the $132 billion surplus projected for 2012 available for tax cuts in both 2011 and 2012, including selective extension of the tax cuts enacted in 2001 and 2003.

1. Senator Baucus stated that under this amendment "the Senate's highest priority for any surplus should be American families." 153 CONG. REC. S3469 (daily ed. March 21, 2007). Accordingly, the first priority Senator Baucus cited was improving children's health care coverage under the Children's Health Insurance Program (CHIP). Senator Baucus continued:

> Then our amendment takes the rest of the surplus and returns it to the hard-working American families who created it. Our amendment devotes the rest of the surplus to the extension and enhancement of tax relief for hard-working American families.
>
> Here are the types of tax relief about which we are talking. We are talking about making the 10-percent [income] tax bracket permanent.…
>
> We are talking about extending the child tax credit.…
>
> We are also talking about continuing the marriage penalty relief.…
>
> We are also talking about enhancing the dependent care credit.…
>
> We are talking about improving the adoption credit.…
>
> We are talking about [taking] combat pay [into account] under the earned-income tax credit, otherwise known as the EITC.…
>
> We are talking about reforming the estate tax. We want to try to give American families certainty. We want to support America's small farmers and ranchers, and in this amendment, we have allowed room for estate tax reform that will do that.
>
> And we talk about returning surplus revenues to hard-working American families.

2. Senator Kent Conrad (D-ND), the Chairman of the Senate Budget Committee (and a former North Dakota Tax Commissioner), responded:

> Madam President, I thank very much Senator Baucus for his leadership on this very important amendment. This amendment is to reassure all those who have benefited from the middle-class tax cuts that those tax cuts will go forward, that those children who are not now currently covered under the CHIP legislation will have the opportunity to be covered.
>
> The Senator has also provided for small business because we have a number of provisions that are critically important to small business and, of course, to prevent the estate tax from having this bizarre outcome, which is now in the law, where the exemption would go down to $1 million from $3.5 million just two years before. That makes no sense. So the Senator provides for room in this amendment to deal with estate tax reform.
>
> The precise contours of that will be up to, obviously, the Finance Committee.

3. In response to the ensuing discussion of several of the points he had made, Senator Baucus subsequently said (*id.* at S3470):

> There is an underlying answer to all these questions; namely, these are questions the Finance Committee is going to address and find the appropriate offsets and deal with the pay-go when it comes up at that time.

4. After being asked specifically about the estate tax, Senator Baucus stated that the amendment "contemplates extending the estate tax provisions that are in effect in 2009 permanently."

   a. In the context of this budget resolution, of course, "permanently" means only through 2012 (or perhaps only through 2011, since the tax from 2011 estates would generally be payable in *fiscal* 2012, which begins October 1, 2012).

   b. The prospect of extending 2009 law through 2011 or 2012 is intriguing. It reflects some thoughtful attention to the concerns about the instability of the current estate tax law, especially as 2010 approaches.

   c. Moreover, by eliminating the repeal year of 2010, an extension actually picks up some revenue to offset the revenue lost in 2011 and 2012. The revenue loss in 2011 and 2012, when the exemption would increase from $1 million (under current law) to $3.5 million), would be complicated by the fact that the top federal rate would go from 39% (net of the state death tax credit) under current law to something like 37.8%, 38.8%, or 45% (see Tables 3 and 4). In Louisiana, for example, the largest estates will pay more federal tax under current 2009 law (at a rate of 45%) than under current 2011 law (at a top rate of 39%).

d. Since the revenue gain from 2010 is a one-time gain, it will not be available again to mitigate revenue losses, meaning that permanent estate tax reduction will become even more expensive if this extension were enacted.

5. On March 23, by a vote of 25-74, the Senate rejected an amendment offered by Senator Ben Nelson (D-NE) that he described as follows (*id.* at S3667 (March 23, 2007)):

> Like the Kyl amendment, our amendment will allow us to accommodate the Landrieu proposal of a $5 million [exemption] and 35 percent [rate] with a surcharge for the largest estates. Unlike the Kyl amendment, this amendment is fiscally responsible and deficit neutral [that is, it will be paid for].

Only four Republicans (Senators Susan Collins and Olympia Snowe of Maine, Richard Lugar of Indiana, and George Voinovich of Ohio) voted for Senator Nelson's amendment.

6. On the same day, the Senate rejected a variation of Senator Kyl's proposal to direct the tax-writing committees to report an estate tax exemption of $5 million (indexed for inflation) and a top rate no higher than 35%. The vote was 48-51. The vote was severely partisan; no Democrat voted for it, and only one Republican (Senator Voinovich) voted against it. The four Senators who voted for cloture on H.R. 8 in June 2006 but not for Senator Kyl's March 2007 amendment were Senators Baucus, Lincoln, Bill Nelson, and Ben Nelson.

7. Thus, with only Senators Collins, Lugar, and Snowe voting for both the Nelson amendment and the Kyl amendment, it might be said that 70 Senators voted on March 23 for an exemption of $5 million and a top rate no greater than 35% (at least if it can be "paid for" and depending on what Senators Nelson and Landrieu meant by "a surcharge for the largest estates").

8. The Senate approved the overall budget resolution on March 23 by a largely partisan vote of 52-47.

IX. CLUES FOR THE FUTURE: PETRA AND ETETRA

A. Although the models of 2006 – H.R. 5638 and H.R. 5970, PETRA and ETETRA – could be abandoned in favor of a totally new start, that rarely happens. The experience of 2006 has taught us the following lessons about the "permanent" estate tax fix, if and when it comes.

B. Regardless of when Congress acts, the **effective date** will be no earlier than January 1, 2010. For years there has been no serious talk of making anything effective sooner. Thus, current law will continue through 2009, including the

$3.5 million estate tax and GST exemption in 2009. If Congress cannot complete work on a permanent replacement before the end of 2009, we should expect a one-, two-, or three-year extension of the 2009 law. (The budget resolution the Senate approved in March 2007 would apparently accommodate a three-year extension of the 2009 law, through 2012.)

C. The changes that begin on January 1, 2010, will be **phased in** over a number of years, in order to contain the cost by pushing the revenue losses out as far as possible in the ten-year "budget window." One of the most striking differences between PETRA and ETETRA was the phase-in of the reduced top rate from 2010 through 2015.

D. Exemptions and brackets may be **indexed for inflation** after they are fully phased in. Another significant difference between PETRA and ETETRA was the indexing of the top $25 million bracket, not just the $5 million exemption.

E. The **GST exemption and rate** will remain tied to the estate tax exemption and rate, whatever they are.

F. The **gift tax exemption and rates** may be **recoupled** with the estate tax and GST exemptions and rates, although this is instinctively a feature that could be jettisoned.

G. The credit for **state death taxes** is not coming back, and retention of the deduction for state death taxes is doubtful. Restoration of the credit would be too expensive, unless it were redesigned as an addition to the regular federal tax that is forgiven in the case of an offsetting state tax, in which case it would amount to a politically unpalatable tax increase in "coupled" states.

H. **Portability between spouses** of the exemption/unified credit seems to have caught on as a concept and, subject to resolution of technical issues, is likely to be a part of any package. It is particularly compelling as a way to provide relief at the low end and middle of the range of taxable estates.

I. A **stepped-up basis** at death (for appreciated assets) will continue to be the general rule.

J. Since "sweeteners" with no direct connection with the estate tax (extension of expired provisions, increase in the minimum wage, relief for the timber industry, and the like) failed to attract the necessary 60 votes in the Senate, some "sweeteners" more directly related to the estate tax might be considered. It is a time-honored tactic to **combine rate relief with "base-broadeners."** Drawing from the January 2005 report of the staff of the Joint Committee on Taxation (see Part X.B beginning on page 36 *infra*), the 1999, 2000, and 2001 budget proposals of the Clinton Administration (see Part V.F beginning on page 9 *supra*), and "Tax Reform for Fairness, Simplicity, and Economic Growth" published in the Reagan Administration (see Part V.D.4 on page 7 *supra*), Congress might find rules

limiting valuation discounts to be appealing. Congressional staffs must know that the state of the case law in this area is unsatisfactory (although that is no guarantee that Congress would deal with valuation discounts comprehensively and supersede ad hoc case law where it should). Other ideas such as limiting Crummey powers and GST-exempt perpetual trusts may not be as compelling.

K. There may still be suspense over **rates and exemptions**.

1. At one time in the summer of 2006, Senator Baucus offered to go as low as 35%, although it is not clear how many Democrats would have agreed with him, while the Republicans led by Senator Kyl were offering 30%. But those offers were farther apart than it might have seemed when one considers that the 30% rate would have applied only to taxable estates over $25 million, which might not match the Democrats' view of "the rich" who should pay the top rate.

2. If the law indeed remains as it is through 2009 (no matter when Congress acts), then it will be politically difficult to make the "permanent" exemption any lower than $3.5 million, or even to refuse to raise it above $3.5 million. Thus the initial exemption level of $5 million in both PETRA and ETETRA might be prophetic, even if the top bracket level of $25 million is lowered to something more modest that would attract sixty Senate votes for a top rate close to 30%.

3. In March 2007, 70 Senators voted in effect for an exemption of $5 million and a top rate no higher than 35%, although those votes occurred in the context of a budget resolution that did not necessarily command the resolve or even attention that would probably be required to deal definitively with the estate tax.

L. If legislation like PETRA or ETETRA ever became law –

1. Once again the review of estate plans would be needed.

a. Clients will need to review their estate planning documents to make sure their documents are appropriate in light of their financial situation and the new legislation. Some clients may no longer be subject to estate tax, and the burden may be less for those clients who are still subject to the tax.

b. In reviewing their situations, clients should remember that Congress (as it has in the past) can always change the law – for example, to defer or decrease the post-2009 estate tax exemptions and increase the post-2009 tax rates. Those clients with assets in excess of the ultimate estate tax exemption (say, $5 million) will still need tax-influenced estate planning documents.

c. Clients with assets greater than the present estate tax exemption of $2 million but less than the ultimate exemption should have tax-influenced estate planning documents because of the possibilities of death before their estates are wholly exempt, increases in asset values, or future congressional action.

d. If any new legislation does not begin to take effect until 2010 or some other future time, currently effective estate plans should not be dismantled or abandoned on the assumption that the provisions in the new legislation are guaranteed.

e. If the estate tax rate is tied in any way to the income tax rate on capital gains, the apparent relief provided by the new legislation may prove to still be unreliable and volatile. For example, in 2011, the capital gains tax rate is scheduled under current law to increase from 15% to 20%, which would, under ETETRA, for 2011, make the federal estate tax rate 20% for estates up to $25 million (and 38% over $25 million).

2. The ownership of assets between spouses should also be reviewed.

a. With an increased estate tax exemption, the ways and proportions in which a husband and wife own property between them will continue to be important for many clients.

b. Although transferability of a predeceased spouse's exemption to the surviving spouse, along the lines of ETETRA, will simplify estate planning for some married couples, it will involve both the forfeiture of the opportunity to shelter intervening growth in value and accumulated income from estate tax and the potential for reconsidering previous valuations. This and other complexities will still make the affirmative use of the first spouse's exemption, probably through the use of a trust, more advantageous in some cases. This will be especially likely in cases involving illiquid assets that the family does not expect to sell, such as an interest in a family business.

c. On the other hand, for many assets, income tax basis will become a much more important factor. For example, with an estate tax rate equal to the federal capital gains tax rate for most taxable estates (under ETETRA, those under $25 million), there will be more incentive to include appreciating assets in the surviving spouse's estate to obtain the stepped up basis and reduce the income tax burden on sale. This will be especially likely in states with an income tax of their own but no estate tax of their own.

d. In addition, although the federal estate tax rate above the exemption amount has been relatively flat for the past few years and will be completely flat from 2006 through 2009 (at a rate of 46% in 2006 and 45% in 2007-2009), a jump from 15% to 40% (as under ETETRA in 2010 at a level of $25 million) would, for married persons with estates at, near, or above that level, revive interest in so-called "estate equalization" techniques to subject some of the combined estates to a lower tax at the death of the first spouse to die.

e. Techniques that once were viewed with skepticism for estate planning purposes, such as owning property jointly with right of survivorship, may become more important, while less settled techniques such as using joint trusts in non-community property states may warrant more attention.

3. The use of the gift and estate tax exemptions will still be challenging.

a. Even PETRA and ETETRA would not have changed the gift tax exemption of $1 million until 2010, even though the estate tax exemption will be $2 million through 2008 and $3.5 million in 2009. Thus, under this kind of legislation, the challenges in passing wealth to children and other beneficiaries through 2009 (or any deferred effective date) would remain. While large gifts that remove wealth from the donor's estate will continue to be an important estate planning tool, careful planning will demand that the gift tax exemption be used wisely.

b. Both before and after any such legislation takes effect, there will continue to be a premium on early planning and the use of leveraged gift strategies (for example, GRATs, sales to grantor trusts, and charitable lead trusts).

c. Because what are popularly called the gift and estate tax "exemptions" are really the effect of a cumulative "unified credit," calculations will not always be what they seem. For example, it is natural to assume that a person who has used $800,000 of the $1,000,000 gift tax "exemption" can now make another $200,000 of gifts tax-free, or that, under ETETRA, beginning in 2015, a person who has made $2,000,000 of gifts could leave an additional $3,000,000 free of estate tax. Those types of generalizations have never been universally true and can create unpleasant surprises.

4. Attention to state death taxes will continue to be important.

a. The state death tax credit, phased out from 2002 through 2005, is not likely to be reinstated. As a result, state estate taxes in the over

20 states that have an estate tax will be a greater proportion of the overall tax burden, and the differences from state to state and mismatches between state and federal taxes will become more dramatic and frustrating. For example, under ETETRA, the federal tax rate over $25 million would have been 40% in 2010 and the state tax (typically at a top rate of 16%) would not have been deductible, making the overall top estate tax rate in those states 56%. (Before the "tax cuts" of 2001, the top rate was 55%.)

b. Therefore, well-informed planning for mobility among states and ownership of property in several states will probably be as important as ever, or more important than ever.

5. Lifetime GST planning will still be challenging, at least until 2010.

a. With the gap between the gift tax exemption of $1 million and the GST exemption of $2 million through 2008 and $3.5 million in 2009, it can be expensive to implement effective lifetime GST tax planning techniques. It will still be important to be alert for opportunities to create, update, merge, divide, or extend generation-skipping trusts.

b. Under ETETRA, beginning in 2010, with a GST tax rate of 40% and an estate tax rate of 15%, it would have been more important than ever to avoid GST tax by subjecting assets in generation-skipping trusts to the estate tax in estates below $25 million. But state taxes must again be considered, because above $25 million a combined estate tax rate of 56% (in states with a 16% tax) would be considerably greater than the 40% GST tax rate.

c. The traditional assumption that a trust should distribute all its income, as well as traditional notions of "income" and "principal" themselves, will continue to serve some families well, but in many cases will have to be reexamined and refined to accommodate the large tax exemption amounts and the passage of more significant wealth that will be a part of the estate planning landscape.

6. Legislation might be an occasion for Congress to examine structural issues such as those identified in the 2004 report of the Task Force on Federal Transfer Taxes, comprised of representatives from the American Bankers Association, the American Bar Association Section of Real Property, Probate and Trust Law and Section of Taxation, the American College of Tax Counsel, the American College of Trust and Estate Counsel, and the American Institute of Certified Public Accountants. The 191-page Task Force Report is reprinted at 58 TAX LAWYER 93 (Fall 2004) and may be viewed on-line at http://www.abanet.org/rppt/section_info/tttf/home.html. The Report includes discussion of issues arising under present law (long

phase-out, one-year repeal, and sunset), carryover basis, the retention of the gift tax, and alternatives to a transfer tax system. The Report also discusses "portability" of the unified credit (or exemption) between spouses, a concept which was reflected in PETRA and ETETRA.

7. Non-tax estate planning will become more and more important. See Part XI, beginning at page 40 *infra*.

8. ETETRA contained surprises and traps, which would have to be watched if ETETRA were the model for any permanent reform.

    a. While the initial estate tax rate would be the capital gains income tax on the date of the decedent's death, the initial gift tax rate would be the capital gains income tax rate *at the end of the calendar year in which the gift is made*. This means that it might be impossible to determine the tax consequences of a gift when it is made.

    b. The rule of section 2511(c) is retained, treating a transfer in trust as a taxable gift unless the trust is treated as wholly owned by the grantor for income tax purposes, meaning that all future income of the trust is taxed to the grantor. It is clear that this provision was originally intended to reinforce the effectiveness of the gift tax as a backstop to the income tax after the repeal of the estate and GST taxes, and that its justification would be questionable if the estate tax is continued.

    c. Various miscellaneous changes made by EGTRRA would continue to be "sunsetted" on January 1, 2011.

        i. A number of these changes involve the rules governing allocations of the GST exemption and the consequences of such allocations – expanding the deemed allocation rules with respect to gifts (section 2632(c)), permitting retroactive allocation in certain cases (section 2632(d)), permitting severance of trusts that are partly but not wholly protected by allocations (section 2642(a)(3)), clarifying valuation rules applicable to allocations (section 2642(b)), authorizing relief from late allocations when appropriate (section 2642(g)(1), and recognizing substantial compliance in making allocations (section 2642(g)(2)).

        ii. Other changes expanded the estate tax rules relating to conservation easements (section 2031(c)(2) & (8)), increased from 15 to 45 the number of shareholders in a corporation or partners in a partnership that is considered closely-held and therefore eligible for installment payment

of estate tax (section 6166(b)(1) & (9)), and clarified the installment payment of estate taxes in the case of certain holding companies and certain lending and finance businesses (section 6166(b)(8) & (10)).

d. The proposed portability of the unified credit between spouses –

i. would apply to estate and gift taxes, but not GST tax,

ii. would apply to the unused credit of more than one deceased spouse, but not so as to provide any surviving spouse with more than double the regular exemption,

iii. would apply even to the spouses of spouses (for example, Husband 2, who survives Wife, who survived Husband 1), with the same double-the-regular-exemption limit, and

iv. would require an affirmative election, despite the bad experience with such elections, for example in the context of the QTIP election from 1981, when the QTIP rule was enacted, until the estate tax return was finally revised in October 1991 to deem the election to have been made to the full extent consistent with the numbers shown on the return.

X. "OPTIONS" PRESENTED BY THE JOINT COMMITTEE STAFF

On January 27, 2005, the Staff of the Joint Committee on Taxation published a 430-page Report entitled OPTIONS TO IMPROVE TAX COMPLIANCE AND REFORM TAX EXPENDITURES, as requested in February 2004 by Chairman Grassley and Ranking Member Baucus of the Senate Finance Committee. The Report may be viewed at http://www.house.gov/jct/s-2-05.pdf. Under the heading of Estate and Gift Taxation, it presents five proposals estimated to raise revenue by $4.2-4.7 billion over ten years.

A. "Limit Perpetual Dynasty Trusts (secs. 2631 and 2632)."

1. The purpose of this proposal is described as follows:

> Perpetual dynasty trusts are inconsistent with the uniform structure of the estate and gift taxes to impose a transfer tax once every generation. In addition, perpetual dynasty trusts deny equal treatment of all taxpayers because such trusts can only be established in the States that have repealed the mandatory rule against perpetuities.

2. The proposal would prohibit the allocation of GST exemption to a "perpetual dynasty trust" that is subject either to no rule against perpetuities or a significantly relaxed rule against perpetuities. If an

exempt trust were moved to a state that had repealed the rule against perpetuities, the inclusion ratio of the trust would be changed to one. (Presumably this latter rule would apply only if the relocation of the trust produced a change in the governing law, and a similar rule would also apply if the situs state changed its governing law.)

3. The details, not disclosed in the Report, will be important.

   a. For example, the proposal states that it would apply in a state that relaxes its rule against perpetuities to permit the creation of interests for individuals more than three generations younger than the transferor. Presumably, the statutory language would be drafted so as not to be harsher than present law under a classical rule against perpetuities, which easily allows transfers to great-great-grandchildren.

   b. Likewise, rather than an outright prohibition on allocation of GST exemption, as the proposal says, it seems more appropriate to simply limit allocation of the transferor's GST exemption to a one-time use (permitting a tax-free transfer to grandchildren) and then allow the allocation of GST exemption, again for one-time use, by members of each successive generation also.

   c. An overall objective of tax-neutrality among jurisdictions would be salutary, but elusive.

B. "Determine Certain Valuation Discounts More Accurately for Federal Estate and Gift Tax Purposes (secs. 2031, 2512, and 2624)."

1. The purpose of this proposal is described as follows:

> The proposal responds to the frequent use of family limited partnerships ("FLPs") and LLCs to create minority and marketability discounts. … The proposal seeks to curb the use of this strategy frequently employed to manufacture discounts that do not reflect the economics of the transfers during life and after death.

2. The proposal would determine valuation discounts for transfers of interests in entities by applying aggregation rules and a look-through rule. The aggregation rules are what the Report calls a "basic aggregation rule" and a "transferee aggregation rule."

   a. The basic aggregation rule would value a transferred interest at its pro rata share of the value of the entire interest owned by the transferor before the transfer. For example, a transferred 20% interest would be valued at one-fourth the value of an 80% interest if the transferor owned an 80% interest and at one-half the value of a 40% interest if the transferor owned a 40% interest.

b. The transferee aggregation rule would take into account the interest already owned by the transferee before the transfer, if the transferor does not own a controlling interest. For example, if a person who owns an 80% interest transfers a 40% interest by gift and the other 40% interest at death to the same transferee, the gifted 40% interest would be valued at one-half the value of the 80% interest originally owned by the donor and the bequeathed 40% interest would be valued at one-half of the value of the 80% interest ultimately owned by the donee/legatee.

c. Interests of spouses would be aggregated with the interests of transferors and transferees. The proposal explicitly (and wisely) rejects any broader family attribution rule "because it is not correct to assume that individuals always will cooperate with one another merely because they are related."

3. The look-through rule would require the portion of an interest in an entity represented by marketable assets to be valued at its pro rata share of the value of the marketable assets, if those marketable assets represent at least one-third of the value of the assets of the entity.

4. The proposal takes a measured approach which appears designed to avoid the uncertain and overbroad reach of previous legislative proposals. Nevertheless, the successive focus on what the transferor originally owned and on what the transferee ends up with – in contrast, for example, to the simple aggregation with the *transferor's* previous transfers – could produce some curious results.

a. Transferors with multiple transferees – *e.g.*, parents with two or more children – will apparently have more opportunities to use valuation discounts than transferors with only one transferee.

b. Transfers over time can apparently be treated more leniently than transfers at one time.

c. The results illustrated in the examples, based on the assumption that a majority (*i.e.*, more than 50%) represents control, will apparently be easier to avoid in an entity like a limited partnership or LLC, where a 99% interest is often a noncontrolling interest.

d. Testing valuation discounts ultimately against what the transferee ends up with will encourage successive transfers (retransfers) or transfers split, for example, between a child and a trust for that child's descendants.

e. In "fixing" these anomalies, it is crucial not to expand family attribution rules beyond spouses and thereby undo one of the most

commendable examples of restraint in the proposal and jeopardize the public acceptance of the proposal.

5. An appropriate legislative structure built around a comprehensive *transferor* aggregation rule would permit a number of helpful collateral results.

   a. There would be no aggregation (except from a spouse) beyond what the transferor once controlled. As a result, the measure would be limited to its intended purpose of curbing the application of valuation discounts resulting from entities, structures, or fractionalization *created* by the transferor.

   b. There would be no need for a look-through rule, which otherwise might unfairly catch interests in holding companies which the transferor never controlled and deny appropriate discounts which the transferor never created.

   c. The aggregation rule should apply to the calculation of gift and estate tax *deductions* as well as the value included in the gift or the gross estate, thereby reversing 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 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 (9th Cir. 1981).

   d. A clear statutory rule of this sort should put an end to the haphazard development of case law on an ad hoc basis in cases with extreme facts.

6. The proposal does not indicate that it would be the exclusive legal basis for evaluating and challenging the use of the valuation discounts it addresses. For example, if such statutory rules were enacted, it would be appropriate for Congress to repudiate an aggressive use by the Service of section 2036(a)(2) to try to achieve indirectly what these rules would accomplish directly (although such holistic legislation is rare). See also the discussion of the similar potential of Treasury regulations in Part XII.A.8.b on page 48 *infra*.

C. "Curtail the Use of Lapsing Trust Powers to Inflate the Gift Tax Annual Exclusion Amount (sec. 2503)."

1. The purpose of this proposal is described as follows:

> Recent arrangements involving Crummey powers [i.e., lapsing powers of withdrawal from a trust] have extended the "present interest" concept far beyond what the Congress likely contemplated in enacting the gift tax annual exclusion, resulting in significant erosion of the transfer-tax base.

2. The proposal offers three options for curbing the use of lapsing Crummey powers.

   a. Limit Crummey powers to "direct, noncontingent beneficiar[ies] of the trust." This would repudiate the broad use of Crummey powers sustained in *Cristofani v. Commissioner*, 97 T.C. 74 (1991).

   b. Limit Crummey powers to powers that never lapse. As the proposal acknowledges, "[t]his option effectively eliminates Crummey powers as a tax planning tool."

   c. Limit Crummey powers to cases where "(1) there is no arrangement or understanding to the effect that the powers will not be exercised; and (2) there exists at the time of the creation of such powers a meaningful possibility that they will be exercised. This option requires a facts-and-circumstances analysis of every Crummey power."

3. Again curiously, the proposal does not explore the possibility of making "tax-vesting" (includibility in the powerholder's gross estate), rather than actual non-lapsing, the test, even though a tax-vesting test is already used for trusts for minors under section 2503(c) and for all GST tax purposes under section 2642(c)(2).

4. Indeed, if lapsing Crummey powers were ever eliminated, Congress might at the same time recognize the desirability of allowing section 2503(c) trusts to extend beyond age 21, even for life, subject to a tax-vesting requirement patterned after section 2642(c)(2).

5. The proposal is silent about its possible application to lapsing rights of withdrawal at age 21 to qualify a trust under section 2503(c), although the principles seem to be the same.

D. "Provide Reporting for a Consistent Basis Between the Estate Tax Valuation and the Basis in the Hands of the Heir (sec. 1014)."

1. The idea here is that an heir will be required to use as the income tax basis the same value that is used for estate tax purposes, with the rather noncontroversial objective of consistency. To implement this rule, the executor would be required to report the basis to each recipient of property and to the IRS.

2. In addition, consideration might be given to a vehicle analogous to Form 8082 (by which beneficiaries of an estate can report an income tax position that is inconsistent with the Form K-1 received from the executor) to permit the use of a different basis by the heir if the inconsistency is disclosed and explained to the IRS.

E. "Modify Transfer Tax Provisions Applicable to Section 529 Qualified Tuition Accounts (sec. 529)."

1. This proposal would essentially subject 529 plans to the transfer tax rules that are generally applicable.

2. An exception is the special rule allowing the use of five annual gift tax exclusions for a single transfer, which apparently would not be changed.

3. Note that the special tax rules of section 529 have now been made permanent. See Part VI.J.2 on page 20 *supra*.

XI. THE PRESIDENT'S ADVISORY PANEL ON FEDERAL TAX REFORM

A. Even though the President's victory speech on the day after the 2004 election was relatively brief, it included an affirmation that it is his goal to "transform the tax system." To that end, he appointed a bipartisan advisory panel on tax reform, charged with developing recommendations to make the tax law simpler, fairer, and supportive of economic growth and job creation, while taking account of the historically favorable tax treatment of home ownership and charitable giving.

B. On November 1, 2005, after ten months of study, twelve public meetings in five states and Washington, D.C., and the input of nearly a hundred witnesses and thousands of written comments, the Panel published its Report. The Report is available at http://www.taxreformpanel.gov/final-report.

C. The Report's letter of transmittal to the Secretary of the Treasury complains that "[o]ur tax code is rewritten so often that it should be drafted in pencil." It calls the environment in which most taxpayers contend with the tax law a "fog of ignorance." Eight of the Report's nine chapters and its technical appendix begin with a cartoon ridiculing the tax code for its obscurity, instability, and intrusiveness. On one page it pictures 35 tax forms and worksheets (none more

than an inch high) that contribute to completion of the second page of Form 1040. Complementing its illustrations, the Report is written in a simple and reader-friendly style, pausing often to define such terms as "gross income" and "marginal rate" and posing examples such as "Let's say you are just offered a great job…" (page 6) and "Imagine that the government imposed a special tax on ice cream…" (page 29).

D. In its nearly 300 pages, the Report criticizes the current tax law, especially for its complexity, explores a number of alternative approaches, and recommends two of those approaches as alternative solutions. An alternative labeled the "Simplified Income Tax Plan" seems to be offered with the most enthusiasm and is probably the only alternative with serious prospects of acceptance. It would compress nearly all features of the current income tax, including the return itself, into fewer, simpler, and more comprehensible features. The other alternative is the "Growth and Investment Tax Plan," which, while avoiding adoption of a true consumption tax model, would move the income tax law closer to such a model than the current admittedly "hybrid" system.

1. The two alternatives differ mainly in their taxation of businesses. Many of the purely individual aspects of the tax law would be the same or similar under the two approaches. Where individual and business tax regimes most commonly intersect – in the treatment of stock ownership – the Simplified Income Tax Plan would exclude from individual taxation the dividends paid from domestic earnings of U.S. corporations and 75% of the capital gain on the sale of corporate stock held longer than a year, while interest (other than interest from municipal bonds) would be taxed at regular income tax rates. Under the Growth and Investment Tax Plan, all those forms of income – dividends, interest, and capital gains – would be taxed at a rate of 15%.

2. Under both the Simplified Income Tax Plan and the Growth and Investment Tax Plan, the individual and corporate alternative minimum tax (AMT) would be repealed. As to individuals, the regular income tax would then be transformed to more closely resemble the AMT, by repealing or limiting deductions that are disallowed tax preferences under the AMT, and by lowering and simplifying rates.

3. For example, both the Simplified Income Tax Plan and the Growth and Investment Tax Plan would repeal the deduction for state and local taxes, which may be the single most common reason that otherwise simple returns get thrown into the AMT regime.

4. The Report also recommends the repeal of the deduction for home mortgage interest. In the executive order creating the Panel, however, President Bush had encouraged recommendations that recognize "the importance of home ownership and charity in American society." As a substitute for the mortgage interest deduction that the Panel viewed as

available to more homeowners, the Report recommends a Home Credit against the tax, equal to 15% of the interest paid on home mortgages up to a limit equal to 125% of the median home sale price in the county, based on data used by the Federal Housing Administration.

5. With respect to charity, the Report recommends a deduction available to all taxpayers for charitable contributions in excess of 1% of income, tax-free rollovers from IRAs to charity, and tax-free sales of property if the sale proceeds are donated to charity within 60 days (which is intended to reduce uncertainty and controversy over valuation).

6. The Panel's recommendations would both broaden and narrow the exclusion for health insurance, extending it to individual policies but limiting it to the national average cost of health insurance.

7. Other tax-free fringe benefits would be eliminated, except for certain benefits provided in-kind at the workplace, such as an on-site cafeteria.

8. The tax treatment of Social Security benefits would be simplified.

9. Fifteen forms of tax-preferred saving (other than defined benefit plans) would be consolidated into just three vehicles – Save at Work Plans, Save for Retirement Accounts, and Save for Family Accounts.

10. The personal exemption, standard deduction, and child tax credit would be consolidated into a simple Family Credit.

11. The "marriage penalty" would be reduced by making every tax benefit for a married couple exactly twice the corresponding benefit for a single taxpayer.

E. The benefits of the Panel's recommendations for individuals are largely in the form of simplification. The major substantive changes that are recommended are largely aimed at businesses, including small businesses and entrepreneurs. For the largest, multinational businesses, the most important recommendations are likely to be those abandoning U.S. taxation of worldwide income.

F. The President's executive order of January 7, 2005, creating the Panel expressed its mandate in terms of the "Internal Revenue Code," the "Federal tax laws," and the "Federal tax structure." It did not single out the income tax, except in its directive that "[a]t least one option submitted by the Advisory Panel should use the Federal income tax as the base for its recommended reforms" (which the Report does in its Simplified Income Tax Plan). Nevertheless, the Panel interpreted its mandate as limited exclusively to the federal income tax, at one point (on page 192) explicitly declaring even payroll taxes to be "beyond the scope of the panel's mandate, which focused only on income taxes." As a result, while some of the Panel's public meetings included testimony about the estate

tax, the Report offers no analysis or recommendations regarding the estate, gift, and GST taxes.

G. Perhaps the closest the Report comes to touching estate planning professionals directly is the recommendation under the Simplified Income Tax Plan (at pages 123-24) that the "inside buildup" in life insurance policies be subject to income tax annually, unless the policy cannot be cashed out. The currently tax-free growth on deferred compensation would also be taxed. The Report states that "[a]nnuities, life insurance arrangements, and deferred compensation plans that are currently in existence would continue to be taxed under current-law rules." (This highlights one of the principal difficulties with this kind of simplification. In effect it requires the long-term maintenance of dual systems of rules – the new simplified rules and the old rules for grandfathered arrangements.)

H. There are other passing references in the Report of which estate planners might take special notice.

   1. The Report singles out valuation as a problem in administering the income tax charitable deduction and in response proposes clearer standards for appraisals, new information reporting by appraisers, expanded information reporting by charities, and new penalties for appraisers (as well as the provision for tax-free sales and rollover of sale proceeds). The Report does not mention the problem valuation is in administering the estate tax and falls short of recommendations, such as improved procedures for avoiding or settling valuation disputes, that could be most useful in the estate and gift tax context.

   2. The Report also strikes a chord familiar to estate planners by pointing out the difference between a "tax-exclusive" sales tax rate and a "tax-inclusive" income tax rate (page 208), a distinction between the gift tax and the estate tax that has influenced planning since the beginning.

I. The Panel's recommendations adhere strictly to a goal of revenue-neutrality, using conventional revenue estimating (although the Report reveals some support on the Panel for more "dynamic" estimates) and the conventional ten-year "budget window."

   1. The Panel's recommendations might be characterized as more favorable to savings, investment, and capital than is current law. In the view of many economists, that is the way to encourage economic growth. These economists would agree with the Panel's Report that "[o]nly people can bear the burden of taxation" (page 34), and that a tax nominally on capital or the income from capital can be borne by investors, workers, customers, or a combination of the three (page 29). (Ironically, in illustrating the current distribution of tax burdens, the Report notes that in the statistics compiled by Treasury "[t]he estate and gift tax is assumed to be borne by decedents" (page 32). That is obviously just a working convention; it

can't be true. But whether the ultimate burden of the estate tax in fact falls on the decedent's heirs, or elsewhere in the economy, is one of the great debates the estate tax fosters in some circles.)

2. Some politicians, supported by other economists, view favoring capital the same as favoring the rich, because wealthier people, almost by definition, control more capital. It is plausible if not inevitable that "tax cuts for the rich" in a regime of enforced revenue-neutrality produce real or perceived tax increases for the middle class. The Panel's recommendations have therefore been criticized for their unfriendliness to working people. Whether fair or not, such perceptions make it hard to marshal the necessary bipartisan support in an already bitterly partisan Washington.

3. If the Panel's recommendations go nowhere, that could be the reason.

4. On the other hand, the current unavoidable attention to the pervasiveness of the AMT and anxiety about tax cuts to be rolled back in 2009 and 2011 may create a climate in which these fundamental reform proposals have the best chance in decades.

5. In any event, to the extent the political reaction to the Report reaches the plane of debating the incidence of taxes on capital, it might provide some clues about the viability of significant estate tax reform as a continuing item on the post-Katrina national agenda.

J. In a speech on May 19, 2006, Secretary of the Treasury (now former Secretary of the Treasury) John Snow affirmed that fundamental tax reform was needed, but said that its time has not yet come. Meanwhile, the development of Treasury's recommendations to the President was not helped by the fact that there was no confirmed Assistant Secretary of the Treasury for Tax Policy from February 17, 2004, until Eric Solomon was sworn in on December 12, 2006. There now appears to be little appetite for fundamental tax reform before 2009 the earliest.

XII. TREASURY-IRS PRIORITY GUIDANCE PLAN

A. The Treasury-IRS Priority Guidance Plan for the 12 months beginning July 1, 2006, released on August 15, 2006, listed the following eight projects under the heading "Gifts, Estates and Trusts":

1. "Guidance under section 67 regarding miscellaneous itemized deductions of a trust or estate."

   a. Section 67, added to the Code in 1986, is the source of the limitation of "miscellaneous itemized deductions" to 2% of adjusted gross income. In the case of an estate or trust, section 67(e)(1) exempts from the 2% floor "costs which are paid or incurred in connection with the administration of the estate or trust

and which would not have been incurred if the property were not held in such trust or estate."

b. Although there may be other issues this guidance project might address, a logical subject would be the conflict between *O'Neill Irrevocable Trust v. Commissioner*, 994 F. 2d 302 (6th Cir. 1993) (holding that section 67(e)(1) exempts the investment advice expenses of multi-generation trusts) from the opposite holdings in *Mellon Bank v. United States*, 265 F.3d 1275 (Fed. Cir. 2001), *Scott v. United States*, 328 F.3d 132 (4th Cir. 2003), and now *William L. Rudkin Testamentary Trust v. Commissioner*, 467 F.3d 149 (2d Cir. 2006), *petition for cert. filed* March 23, 2007.

c. Most estate planners experienced with the challenges of balancing the interests of successive beneficiaries of multi-generation trusts recognize that such balancing of interests arises only when property is held in such a trust and therefore the costs of investment advice customized to such balancing of interests are "costs … which would not have been incurred if the property were not held in such trust…."

2. "Final regulations pursuant to Notice 2006-30 under section 671 regarding the reporting requirements for widely-held fixed investment trusts."

   a. Final and temporary regulations were published on August 3, 2006. The temporary regulations were replaced with final regulations on December 29, 2006.

   b. In general, this type of trust is not widely used or widely known by estate planners.

3. "Guidance regarding the consequences under various estate, gift, and generation-skipping transfer tax provisions of using a family-owned company as the trustee of a trust."

   a. Privately owned and operated trust companies are becoming an option that families with large trusts are turning to in increasing numbers, and state law authority for such private trust companies is being continually refined. When a trustee with broad discretion, especially over trust distributions, is owned by one or a few families of beneficiaries, the potential tax issues include grantor trust status by reason of section 672(c), inclusion in the gross estate under section 2036 or 2038, and general powers of appointment under sections 2041 and 2514. Occasional sets of letter rulings reveal the Service's thinking about some of these issues, although the Service is now reluctant to issue such rulings pending publication of this contemplated guidance.

b. When this project first appeared, as the fifth item on the 2004-05 Priority Guidance Plan, it was described as "Guidance regarding family trust companies." The omission of income tax issues from the current formulation is important, because income tax issues have frequently been addressed in the letter rulings. Indeed, in the first such letter rulings, Letter Rulings 9841014 and 9842007 (July 2, 1998), the only issue was whether a family-owned trust company was a "related or subordinate party" with respect to the living grantors of various trusts, within the meaning of section 672(c), an income tax rule. The omission of income tax from the current Priority Guidance Plan might be inadvertent and insignificant, but for some estate planners it recalls previous guidance and IRS rulings that address some but not all tax issues.

4. "Proposed regulations under sections 2036 and 2039 regarding the amount of a split-interest trust that is includible in a grantor's estate in certain circumstances in which the grantor retains an annuity or other payment for life."

a. Although a reference to "split-interest" trusts typically brings to mind a charitable remainder trust, the availability of a charitable deduction usually diminishes the importance of estate inclusion in the case of a CRT.

b. The more interesting question is presented by a grantor retained annuity trust (GRAT), where there can be a large difference, for example, between the present value of the unpaid annuity amounts, the amount needed to generate the prescribed annuity without depleting the principal (*cf.* Rev. Rul. 82-105, 1982-1 C.B. 133, describing the portion of a CRT that is included in the gross estate), and the entire value of the trust assets that the Service has viewed as included in the gross estate under section 2039 (Letter Ruling 9345035).

5. "Guidance under section 2053 regarding the extent to which post-death events may be considered in determining the value of a taxable estate."

a. This project, which originally appeared in the 2003-04 Priority Guidance Plan, addresses the valuation of claims against the estate, especially claims being pursued in litigation pending at the date of the decedent's death. Guidance under this project will address the current conflicts among the federal courts of appeals, with the Fifth, Tenth, and Eleventh Circuits unwilling to consider post-death events and the Eighth Circuit apparently more willing to do so. *Estate of Smith v. Commissioner*, 198 F.3d 515 (5th Cir. 1999); *Estate of McMorris v. Commissioner*, 243 F.3d 1254 (10th Cir.

2001); *O'Neal v. United States*, 258 F.3d 1265 (11th Cir. 2001); *Estate of Sachs v. Commissioner*, 856 F.2d 1158 (8th Cir. 1988).

b. Proposed regulations (REG-143316-03) were published in the Federal Register on April 23, 2007. In general, the proposed regulations will allow a deduction of otherwise deductible (that is, existing at the date of death and legally enforceable) claims only if and when they are paid or ascertainable with reasonable certainty. If that does not occur before the estate tax statute of limitations runs, the executor's recourse is to file a protective claim for refund.

i. A court decree will be respected if the court reviews the relevant facts and its decision is consistent with applicable law.

ii. A consent decree will be respected if the consent is a bona fide recognition of the validity of the claim and is accepted by the court as satisfactory evidence upon the merits.

iii. A settlement will be respected if it resolves an active and genuine contest, is the product of arm's length negotiations by parties with adverse interests, and is within the range of reasonable outcomes under applicable law.

iv. Claims by family members will be presumed to be nondeductible. This presumption may be rebutted by evidence of circumstances that would reasonably support a similar claim by unrelated persons.

v. The new rules will apply to the estates of decedents dying on or after the date that final regulations are published in the Federal Register.

vi. The notice of proposed rulemaking solicits comments from the public and announces a hearing for August 6, 2007.

6. "Revenue procedures under sections 2055 and 2522 containing sample charitable lead trust provisions."

7. "Final regulations under section 2642 regarding the definition of, and procedures for making, a qualified severance of a trust."

a. The proposed regulations published on August 24, 2004, raised some concerns.

b. For example, Proposed Reg. § 26.2642-6(b)(1) respects a severance for GST tax purposes if it is accomplished "pursuant to the terms of the governing instrument, or pursuant to applicable

local law," while Proposed Reg. § 1.1001-1(h)(1)(i) relieves a severance from possible capital gain consequences if "[a]n applicable state statute or the governing instrument authorizes the trustee to sever the trust." The switch from "local law" to "state statute" was viewed by many as reflecting a continued disposition to apply the so-called "*Cottage Savings* doctrine" (*see Cottage Savings Ass'n v. Commissioner*, 499 U.S. 554 (1991)) to find a beneficiary-level taxable exchange in trust modifications, creating the possibility of costly ambushes for unwary trustees and beneficiaries.

c. Most estate planners regard the role of *Cottage Savings* notions in the administration of trusts as bogus and look forward to the time when Treasury and the Service will repudiate those notions once and for all.

8. "Guidance under section 2704 regarding restrictions on the liquidation of an interest in a corporation or partnership."

a. This item, which is carried over from the 2003-04, 2004-05, and 2005-06 plans, might be intended to address section 2704(b)(4), which states:

> The Secretary may by regulations provide that other restrictions shall be disregarded in determining the value of the transfer of any interest in a corporation or partnership to a member of the transferor's family if such restriction has the effect of reducing the value of the transferred interest for purposes of this subtitle but does not ultimately reduce the value of such interest to the transferee.

Arguably, this is what estate planners *do*!

b. As stated previously with reference to potential legislation (Parts X.B.5.c and X.B.6 on page 38), the proposal does not indicate that it would apply to estate tax *deductions* as well as the value included in the gift or the gross estate, or that it would be the exclusive legal basis for evaluating and challenging the use of the valuation discounts it addresses. For example, if such regulations were adopted, it would be appropriate for them to repudiate an aggressive use by the Service of section 2036(a)(2) to try to achieve indirectly what the regulations would accomplish directly. It is rare, however, for regulations to constrain the litigating positions the Service might take in the Tax Court and the Justice Department might take in the courts of appeals.

B. In addition, item 38 under the heading of "Tax Administration" in the 2006-07 Priority Guidance Plan is "Proposed regulations under section 7477 regarding declaratory judgments relating to gift tax valuations."

1. Section 7477 was enacted in the Taxpayer Relief Act of 1997 (P.L. 105-34) as the third part of the trilogy of welcome relief provisions, accompanying the imposition of the gift-by-gift statute of limitations disclosure rules of section 6501(c)(9). The relief trilogy included –

a. Addition of a new section 2001(f) to deny revaluation for estate tax purposes of all gifts adequately disclosed on a gift tax return once the gift tax statute of limitations has run.

b. Amendment of section 2504(c) to drop the requirement that a current gift tax must have been paid to achieve this finality of valuation, thus extending the finality of valuation provided by that statute to gifts that merely use some or all of the donor's unified credit.

c. The addition of section 7477 to empower the Tax Court to issue declaratory judgments regarding the value of gifts, including use of the unified credit, if the donor has first exhausted the available administrative remedies with the Service.

2. These provisions are effective for gifts made after August 5, 1997.

3. The greatest significance of these "relief" provisions is that they will help persons with middle-sized estates, who cannot afford to make gifts of such magnitude that they are in the top bracket, and who cannot necessarily even afford to make gifts that use up their unified credits and generate some current tax. Such a person will now be able to make a moderate-sized gift and know that three years after filing a gift tax return reporting that gift the Service will not be able to revalue the gift for purposes of computing the tax on future gifts or the tax on that person's estate. If the gift does not use all of the donor's unified credit, the credit which the donor assumes will be available for future transfers really will be. If the Service disagrees with that, it must say so currently – *i.e.*, within three years – and the donor can appeal such a determination to the Tax Court even if no gift tax deficiency is actually assessed.

XIII. LONG-TERM IMPACT OF SUBSTANTIAL ESTATE TAX REDUCTION

A. Areas of practice that will be affected include:

1. Planning to pay federal estate and GST taxes.

2. Planning to qualify for the marital deduction for estate tax purposes.

3. Planning to qualify for the charitable deduction for estate tax purposes.

4. Planning to make gifts and dispositions at death to avoid the federal estate and GST taxes, including using the annual gift tax exclusion and applicable exclusion, as well as other techniques, such as GRATs, QPRTs, FLPs, and dynasty trusts designed to minimize transfer taxes.

B. Areas of practice that should not be affected include:

1. Planning for the disposition of the client's assets upon death.

2. Asset protection planning.

3. Planning for marital and other dissolutions.

4. Planning for physical disability.

5. Planning for incompetence.

6. Business succession planning (without the estate tax to blame for failure of a business!).

7. Using business entities to accomplish non-tax objectives.

8. Charitable giving (for its own sake, and also because income tax considerations will still be relevant, and techniques such as lifetime charitable remainder trusts to facilitate diversification will not be affected at all).

9. Retirement planning.

10. Planning for life insurance protection.

11. Fiduciary litigation (perhaps more so if there is more to fight over).

12. Planning to pay state death taxes (in many states).

13. Planning for clients with property in more than one state.

14. Planning to minimize gift taxes (especially if the applicable exclusion amount for gift tax purposes remains less than it is for estate tax purposes, and the client wants to give a larger amount).

15. Planning for children with disabilities.

16. Planning for spendthrift children.

17. Planning for clients who are U.S. citizens or resident aliens who own property in other countries.

18. Planning for nonresident aliens with assets in the United States or who plan to move to the United States.

19. Planning for clients who intend to change their citizenship.

20. Planning to live with non-tax regulatory regimes, including Sarbanes-Oxley, the Patriot Act, HIPAA, and charitable governance reform.

21. Planning for possible increases in the estate, gift, and GST taxes.

C. See also the discussion of specific actions to consider if legislation like PETRA or ETETRA ever became the model for permanent changes in the law, in Part IX.L, beginning on page 30 *supra*.