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Legislative Paralysis

Every year in February, the Administration delivers a budget proposal to Congress. This multivolume document contains proposals for funding all government agencies for the coming fiscal year, but more importantly to tax professionals, it contains the President's tax proposals. At present, Congress seems to be paralyzed when it comes to the transfer taxes, and there are very few proposals for consideration in the estate, gift and generation-skipping transfer ("GST") tax area.

The release of the budget proposal each February is only the opening move in a complex process the object of which is to produce a budget under which our country will operate for the 12-month period beginning in October. In the ordinary course, Congress would first consider the budget in the form of a "budget resolution," which would include the rough terms of the 13 appropriation bills as well as the accompanying tax provisions. That resolution would be fleshed out in the budget reconciliation process, and would result in a series of bills passed by both houses of Congress to fund the operation of the federal government for the upcoming fiscal year.

Congress does not actually consider the tax provisions in the Administration's budget proposal unless and until those provisions are introduced as a legislative proposal by a member of Congress. In some years, the President's tax proposals are introduced as a package; in other years, Congressmen pick and choose the particular provisions they deem desirable, and sometimes the President's tax proposals are never formally introduced as legislation at all.

One of the peculiarities of considering tax legislation in the context of budget reconciliation is the applicability of the "Byrd Rule," which effectively requires budget bills under consideration in the Senate to pass with a 60-vote majority. The purpose of the Rule is to keep budget act provisions budget-related. Thus, any "extraneous" provision that has revenue effects outside the ten-year period of the budget is subject to removal from the bill upon chal-

lenge by any Senator. The challenge can be overcome only by a 60-vote majority.

Typically, budget acts do have extraneous provisions with long-term budgetary effect, so the Byrd Rule generally applies. The most notable recent exception was the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"),¹ in which all revenue-losing provisions were made subject to a ten-year sunset provision in order to prevent the triggering of the 60-vote requirement under the Byrd Rule. Although the sunset provision undoubtedly allowed EGTRRA to become law, it also left the tax cuts of EGTRRA under a cloud of uncertainty.

The Administration's budget proposals

The current Administration's tax proposals in the estate and gift area demonstrate only a single interest: making repeal of the estate tax and GST tax permanent. Starting with the Administration's budget for fiscal year 2003 (the first such proposal after the enactment of EGTRRA), and in every budget proposal since, the Administration has included a provision to make permanent all the tax cuts from

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EGTRRA that otherwise would sunset on 12/31/10.

The description of the proposal has remained fairly constant since fiscal year 2003: "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, provided additional incentives for education, eliminated the estate tax, increased IRA and pension incentives, reduced marriage penalties, and provided relief from the alternative minimum tax (AMT). These and a number of other provisions of EGTRRA sunset on December 31, 2010. The tax relief and incentives to work, save, and invest provided by EGTRRA 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 make long-term plans far beyond 2010 when saving for their children's education, when undertaking new business ventures, when planning for retirement, and when 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."²

The only other proposal concerning estate, gift or GST taxes included in the budget since EGTRRA was a proposed amendment of the transfer tax treatment of Section 529 qualified tuition plans. That proposal first appeared in the

¹ Pub. L. No. 107-16 (6/7/01).

² Department of the Treasury, General Explanations of the Administration's Fiscal Year 2003 Revenue Proposals (Feb. 2002).

³ Pub. L. No. 109-280 (8/17/06).

⁴ Department of the Treasury, General Explanations of the Administration's Fiscal Year 2008 Revenue Proposals (Feb. 2007).

fiscal year 2005 budget proposal, and was included again in fiscal years 2006 and 2007, prior to enactment of provisions with a similar purpose as part of the Pension Protection Act of 2006.³ With the 529 plan issues having been dealt with by Congress, the Administration's fiscal year 2008 budget returns to the pre-2005 pattern of including only the provision to make estate tax repeal permanent.⁴

Congressional proposals

A quick search of bills introduced during the 109th and 110th Congresses reveals hundreds of bills pertaining to the transfer taxes. They readily break down into two major groups, with a small remainder. The first group of bills calls for the permanent repeal of the estate, gift, and/or GST taxes. Although the bills vary in terms of effective date and which taxes are repealed, the theme is the same as the Administration's proposal: death to the death tax!

The second group of bills does not repeal the sunset provision, but instead gives permanent resolution to the transfer tax conundrum by fixing an exemption amount and a tax rate. While the exemption amounts vary from \$2.5 million to \$5 million or more, they all provide permanent relief and certainty. Estate and gift tax rates vary from a low of 15% (sometimes alternatively stated as a rate equal to the capital gains rate) and a high of 45%.

The search turned up only three bills outside of those two groups that proposed actual substantive changes to the current transfer tax provisions. Out of hundreds of bills, apparently only three propose to make substantive changes in the law, close (or create) loopholes, or improve present, technical, substantive law!

One of the bills, H.R. 3523, introduced in the 1st session of the

109th Congress by Timothy Bishop (D-N.Y.), proposed to provide an unlimited exclusion from the value of an estate for the full value of any farmland owned and farmed by the decedent or a member of his family. The bill contained several restrictive provisions similar to those found in Code Section 2032A (special-use valuation). In addition, the bill would have eliminated the dollar limitation on the exclusion from the value of an estate for land subject to a conservation easement.

H.R. 5884, introduced in the 2nd Session of the 109th Congress by Jim Ramstad (R-Minn.), proposed to allow Section 9100 relief for failed lifetime QTIP elections. This change would put gift tax QTIP elections on equal footing with estate tax QTIP elections and failures to allocate GST exemption, for which Section 9100 relief is already available. With the bill applicable to all petitions for relief

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“pending on, or filed after, the date of enactment,” the bill offered hope for relief to all those who have missed gift tax QTIP elections.

H.R. 5488, introduced in the 2nd Session of the 109th Congress by Robert Aderholt (R-Ala.), proposed to extend the period of limitations in which to claim a refund of estate tax where the overpayment was due to an expense incurred by the estate, after the estate tax return was filed, and in connection with litigation that continued after the return was filed. In such a case, the period for filing a claim was to be extended by one year, from three years to four years. Oddly, the proposal applied only to decedents dying after 10/1/98 and before the date that is one year after the date of enactment. The limited scope of this amendment piques the curiosity as to whom it was intended to help.

Other ideas for improvement

Surely the transfer tax law is not perfect. In fact, several reports exist that offer myriad suggestions for improvement. In January 2005, the staff of the Joint Committee on Taxation published a report entitled “Options to Improve Tax Compliance and Reform Tax Expenditures.”⁵ That report included five transfer tax proposals, all designed to close loopholes, address areas of non-compliance, and raise revenue.

Included were proposals to limit the use of perpetual dynasty trusts, determine valuation discounts more accurately, curtail the use of *Crummey* powers to inflate the gift tax annual exclusion amount, provide for consistency between the value of property reported on the

estate tax return and the basis of the property used by the heirs for income tax purposes, and modify the transfer tax provisions applicable to Section 529 plans. With the exception of the proposal pertaining to 529 plans, Congress has taken no action on any of these options, nor has there even been legislation introduced for Congress to consider.

Similarly, the ABA Task Force on Federal Wealth Transfer Taxes produced a 227-page report on possible reforms of the federal wealth transfer taxes.⁶ The result of thousands of hours of thought and discussion by 34 members of the bar, accountants, bankers and professors, the Task Force report is a veritable treasure trove of possible transfer tax reforms. Ideas explored by the Task Force range from portability of the unified credit between spouses to whether it makes sense for the gift tax to be a tax-exclusive tax while the estate tax is a tax-inclusive tax to ideas for improvement of the provisions for an extension of time to pay the estate tax. Why has no Congressman found these proposals sufficiently interesting and valuable to propose them in the form of a bill?

The paralyzing effect of EGTRRA

The answer lies in the paralysis that results from the uncertainty of the future of the EGTRRA tax cuts in the transfer tax arena. More typically discussed is the paralyzing effect on the planning ability of individuals due to the uncertainty of the law. The point here is that the uncertainty in the law also has a negative effect on the development of the law itself. Under ordi-

nary circumstances, estate planning professionals and professors produce a more-or-less constant stream of ideas on how to improve the law. These ideas trickle through journals and law reviews and come to the attention of legislators and their staffs. Some of the ideas present real and practical solutions that would close loopholes, make the law more workable, or increase the fairness of the tax system. Those proposals are advocated by interest groups and individuals, and ultimately are introduced as legislation, to be debated, discussed, modified and eventually adopted.

With the single-minded focus in the transfer tax area on the necessity to avoid the “train wreck” scheduled to occur when the clock strikes midnight on 12/31/10, all efforts by Congress to improve the law seem to have ceased. In fact, the most damaging long-term effort of the “repeal” of the estate tax in EGTRRA may be its chilling effect on considerations of tax policy and improving the law.

With the inability to repeal the estate tax a virtual certainty at this point, Congress should return to the business of improving the law, closing loopholes, and increasing fairness. Failure to address the transfer taxes for years will only further deteriorate the integrity of the transfer tax system, at a time when the transfer taxes need all the help they can get. ■

⁵ “Options to Improve Tax Compliance and Reform Tax Expenditures,” JCS-02-05, Joint Committee on Taxation (1/27/05).

⁶ Report on Reform of Federal Wealth Transfer Taxes, American Bar Association (2004), available online at www.abanet.org/tax/publicpolicy/2004/04fwt.pdf.