Congressional Research Service
Informing the legislative debate since 1914

Recent Changes in the Estate and Gift Tax Provisions

Jane G. Gravelle
Senior Specialist in Economic Policy

January 11, 2018

Congressional Research Service
7-5700
www.crs.gov
R42959

CRS REPORT
Prepared for Members and
Committees of Congress

Summary

The American Taxpayer Relief Act (ATRA; P.L. 112-240) established permanent rules for the estate and gift tax for 2013 going forward. The tax revision of 2017 (P.L. 115-97) doubled the exemption levels. This increase expires after 2025.

The estate tax is imposed on bequests at death as well as inter-vivos (during life) gifts. A certain amount of each estate, $5 million in 2011, indexed for inflation, is exempted from taxation by the federal government. With indexation, the value was $5.49 million in 2017 and with the temporary doubling of the exemption and inflation adjustments, is $11.2 million in 2018. The taxable estate is taxed at 40%. The exemption applies to total bequests and gifts (separate from the annual inter-vivos gift exemption of $15,000 per donee for 2018). Transfers between spouses are exempted, and any unused exemption can be inherited by a surviving spouse. Other elements of the tax remain, including deductions for charitable bequests and a number of special provisions for farms and small businesses.

The permanent tax treatment of estates and gifts had been uncertain for some time. The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA; P.L. 107-16), among other tax cuts, provided for a gradual reduction and elimination of the estate tax. Under EGTRRA, the estate tax exemption rose from $675,000 in 2001 to $3.5 million in 2009, and the rate fell from 55% to 45%. In 2010, the estate tax was eliminated. There was general agreement that some sort of estate tax would be retained. A proposal to make the 2009 rules ($3.5 million exemption and 45% rate) permanent was included in President Obama's 2010 and 2011 budget outlines and was passed by the House in December 2009. In addition, in 2009, Senate Democratic leaders supported the plan to enact the 2009 rules permanently. The Senate Republican leadership proposed a $5 million exemption and 35% rate. This latter provision was eventually adopted for a two-year period, through 2012. For estates of decedents in 2010, either the 2010 or 2011 rules could have been elected. Spouses can inherit unused exemptions. The permanent provisions retain most of the rules adopted for 2011 and 2012, but with a higher rate.

Compared with the $1 million exemption and 55% rate under pre-EGTRRA law, the new permanent rules were estimated to lose an average of about $37 billion over the next 10 years, a two-thirds reduction in estate tax revenues. The increase in the exemption level costs around $10 billion per year, a further reduction of about 40% of projected revenues.

Regardless of the exemption levels considered, few estates are affected by the tax. The estate tax is a highly progressive tax, with about three-fourths collected from estates in which decedents are in the top 1% of the income distribution. At a $5 million exemption, less than 0.2% of estates will be subject to the tax. Although concerns have been raised about the effects of the tax on small businesses and farmers, estimates indicate that only a small share of these decedents would be affected.

Budget proposals during the Obama Administration proposed a return to the 2009 rates and exemptions. They also proposed a variety of structural reforms, including restricting Grantor Retained Annuity Trusts (GRATs), providing consistent valuation for estate tax and basis for capital gains, limiting the duration of generation-skipping trusts, and providing consistent treatment of grantor trusts along with some other minor changes. Prior provisions would have disallowed minority discounts (for estates left to a family partnership) and addressed other aspects of GRATs. During the recent 2017 tax reform deliberations, the House proposed to increase the higher exemption temporarily, and repeal the estate tax after 2024.

Contents

Introduction 1
Basic Structure 1
Rates and Basic Exemptions 1
Other Exemptions and Deductions 2
Special Provisions for Small Businesses, Farms, and Landowners 2
Step-up in Basis for Appreciated Assets 3
Differences in the Treatment of Bequests and Gifts 3
Brief History of Recent Developments 3
Revenues and Coverage 4
Issues and Options 6
Making the Higher Exemption Levels Permanent 6
Proposal to Repeal the Estate Tax and Reduce the Gift Tax Rate to 35% 6
Proposal to Return to 2009 Rates and Exemptions 7
Narrow Provisions 7
Grantor Retained Annuity Trusts 7
Minority Discounts 7
Consistent Valuation 8
Other Minor Provisions 8
Simplify Gift Tax Exclusion for Annual Gifts 8
Coordinate Grantor Trusts Income and Transfer Tax Rules 8

Contacts

Author Contact Information 9

Introduction

The estate and gift tax is imposed on bequests at death and on inter-vivos (during lifetime) gifts. The rate of the tax and the level of exemption have been under discussion for some time, with temporary provisions in place for a number of years. The American Taxpayer Relief Act of 2012 (P.L. 112-240) established permanent rules for the estate and gift tax for 2013 going forward. Although details of the tax structure are addressed in the following section, the principal rules are as follows:[1]

- In 2011, estates and lifetime gifts had a combined exemption of $5 million in asset value, indexed for inflation. This exemption was made permanent and is $5.49 million for 2017.
- The estate tax rate on the taxable portion of the estate, if any, is 40%.
- The exemption from the estate tax applies to estates and lifetime inter-vivos gifts in the aggregate. The separate annual exemption per donee for inter-vivos gifts is retained; it is also indexed in $1,000 increments and has increased from $13,000 in 2012 to $14,000 in 2017 and $15,000 in 2018.
- Transfers to spouses remain exempt, but spouses can inherit any unused portion of the exemption from each other, so that the combined exemption for a couple was $10 million in 2011. Other estate tax deductions, such as those for charitable contributions, are retained.
- A number of special rules for farms and small businesses are retained.
- A doubling of the exemption level was adopted in the 2017 tax revision (P.L. 115-97), effective from 2018 to 2025; for 2018, the exemption is $11.2 million.

This report describes the basic structure of the estate and gift tax, provides a brief history of recent developments, discusses the revenue effects and distribution of the tax, and briefly discusses issues and options.

Basic Structure

The estate and gift tax is a unified tax, so that assets transferred as gifts during a person's lifetime are combined with those transferred at death (bequests) and subject to a single rate schedule.[2] The tax is imposed on the decedent's estate and the rate structure applies to total bequests and gifts given; heirs are not subject to tax.

Rates and Basic Exemptions

The exemption for 2017 is $5.49 million, and it is indexed for inflation. From 2018 to 2025, the exemption is doubled, and it is $11.2 million for 2018. Although the rates of the tax are graduated, the exemption is applied in the form of a credit and offsets taxes applied at the lower rates. Thus the taxable estate is therefore subject to a flat 40% rate. This rate is higher than the

[1] See Estate Tax, http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Estate-Tax and Frequently Asked Questions on the Gift Tax http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Frequently-Asked-Questions-on-Gift-Taxes#5.

[2] CRS Report 95-416, *The Federal Estate, Gift, and Generation-Skipping Transfer Taxes*, by Emily M. Lanza, provides a detailed description of the estate tax.

35% rate that prevailed in 2011 and 2013, but lower than the 45% rate that applied in 2009.[3] Individuals are also allowed to exempt annual gifts of $14,000 per recipient for 2017, which are not counted as part of the lifetime exemption. The annual gift tax exemption is indexed for inflation in $1,000 increments and will rise to $15,000 in 2018. A generation-skipping tax is also imposed, to address estate tax avoidance through gifts and bequests to a later generation.[4]

Other Exemptions and Deductions

Transfers between spouses are exempt. Estates are allowed to take deductions for charitable contributions and administrative expenses; a deduction for taxes paid on estates and inheritances imposed by states; and to exempt up to $5.49 million for 2017 ($11.2 million in 2018) in remaining assets from the tax.

A spouse can inherit any unused exemption. Thus, if a husband died and left an estate of $3 million in 2017, the remainder of his $5.49 million exemption can be used by his wife, whose exemption would be increased by the $2.43 million difference.

Special Provisions for Small Businesses, Farms, and Landowners

A series of provisions benefit small businesses, including farms and landowners. These provisions include the ability of family businesses to pay any estate tax due in installments with only the interest payments during part of the installment period, special use valuations, and conservation easements. Minority discounts, although granted by courts rather than specifically in the law, may also benefit small businesses. Minority discounts are allowed when assets are left to a family partnership in which no individual has a controlling share and are thus deemed to lose value for that reason.

Although the estate tax return is due within nine months of the death, small businesses are allowed to defer payment (except for interest) for the next five years, and pay the remaining installment payments over 10 years. Because the last interest payment and the first installment coincide, the overall delay in full payment is 14 years. The benefit is allowed only for the business portion of assets if 35% of the estate is in a farm or closely held business.

Small businesses are also allowed to value their assets at use as a farm or business. This provision is particularly beneficial to farms and allows a reduction in the estate value of up to $1 million. It means, for example, that the value of the farm will be what it could be sold for if restricted to farm use rather than to be subdivided for development. Heirs are required to continue use of the assets as a farm or business for 10 years.

Farmers and other landowners may also benefit from conservation easements, a perpetual restriction on the use of the land. In addition to the reduction in value due to the easement itself, an exclusion of up to 40% of the restricted value of the land, capped at $500,000, is allowed.

[3] See CRS Report R41203, *Estate Tax Options*, by Jane G. Gravelle, for a discussion of the debate over exemptions and rates as the 2001 tax cut provisions were expiring.

[4] For example, parents may directly skip a generation by leaving some assets to grandchildren, or they may set up a lifetime trust for their children, with the assets subsequently inherited by the grandchildren. The generation-skipping tax is imposed in these circumstances, although it also has an exemption.

Step-up in Basis for Appreciated Assets

Heirs take as their basis (the amount to be deducted from the sales price) for purposes of future capital gains the value of the asset at the date of the decedent's death. This treatment is referred to as step-up in basis and means that no capital gains tax is paid on the appreciation of assets during the decedent's lifetime. For example, if a decedent purchased stock for $100,000 and the value of the stock at the time of death were $200,000, if the heir sells the property for $250,000 a gain of $50,000 ($250,000 minus the stepped-up basis of $200,000) is recognized. The $100,000 of gain that accrued during the decedent's lifetime is never taxed. The step-up rules do not apply to gifts, in which carryover basis is applied. In that case, the original basis of $100,000 would be carried over and the gain would be $150,000 ($250,000 minus $100,000). Both the gain accrued by the donor and the gain accrued by the donee are taxed.

Differences in the Treatment of Bequests and Gifts

Aside from the different exemption levels in some estate tax rules, there are other differences between the taxation of gifts and bequests. As noted above, gifts do not benefit from the step-up in basis. When the donee subsequently sells an asset, the cost (referred to as basis) deducted from the sales price is the original cost to the donor. For example, if a donor purchased stock for $100,000 and the value of the stock at the time of the gift were $200,000, when the donee sells the property for $250,000 a gain of $150,000 ($250,000 minus the original basis of $100,000) is recognized. The basis cannot be less than the fair market value at the time of the gift if a loss is realized.

In addition, the gift tax is tax exclusive (i.e., the tax is imposed on the gift net of the tax), whereas the estate tax is tax inclusive (i.e., the tax is applied to the estate inclusive of the tax). To illustrate, consider a 50% tax rate. Assuming the exemption is already used, to provide a gift of $1 million costs $1.5 million: the tax rate of 50% is applied to the gift of $1 million for a $0.5 million tax. To provide a net amount of $1 million for a bequest, $2 million is required: a tax of $1 million (50% of $2 million) and a net to the heir of $1 million. Another way of stating this is that the gift tax rate, if stated as a tax inclusive rate like the estate tax, would be 33%. Thus for a 40% estate tax rate, the gift tax rate equivalent is 28.6%.[5]

Brief History of Recent Developments

The Economic Growth and Tax Relief Act of 2001 (EGTRRA; P.L. 107-16) provided for a gradual reduction in the estate tax. A unified exemption for both lifetime gifts and the estate of $675,000 applied at that time.

Under EGTRRA, the estate tax exemption rose from $675,000 in 2001 to $3.5 million in 2009, and the top tax rate fell from 55% to 45%. Although combined estate and gift tax rates are graduated, the exemption is effectively in the form of a credit that eliminates tax due at lower rates resulting in a flat rate on taxable assets under 2009 law. The gift tax exemption was, however, restricted to $1 million.

For 2010, EGTRRA scheduled the elimination of the estate tax, although it retained the gift tax and its $1 million exemption. EGTRRA also provided for a carryover of basis for assets inherited

[5] To convert the statutory tax inclusive rate into an equivalent rate for a tax exclusive application, the formula is t/(1+t), where t is the tax inclusive rate.

at death, so that, in contrast with prior law, heirs who sold assets would have to pay tax on gains accrued during the decedent's lifetime. This provision has a $1.3 million exemption for gain (plus $3 million for a spouse).

As with other provisions of EGTRRA, the tax revisions were to expire in 2011, returning the tax provisions to their pre-EGTRRA levels. The exemption would have reverted to $1 million (a value that had already been scheduled for pre-EGTRRA law) and the rate to 55% (with some graduated rates). The carryover basis provision effective in 2010 would be eliminated (so that heirs would not be taxed on gain accumulated during the decedent's life when they inherit assets).

During debate on the estate tax, most agreed that the 2010 provisions would not be continued and, indeed, could be repealed retroactively. President Obama proposed a permanent extension of the 2009 rules (a $3.5 million exemption and a 45% tax rate), and the House provided for that permanent extension on December 3, 2009 (H.R. 4154). The Senate Democratic leadership indicated a plan to retroactively reinstate the 2009 rules for 2010 and beyond. Senate Minority Leader McConnell proposed an alternative of a 35% tax rate and a $5 million exemption.[6] A similar proposal for a $5 million exemption and a 35% rate, which also included the ability of the surviving spouse to inherit any unused exemption of the decedent, is often referred to as Lincoln-Kyl (named after the two Senators who supported it). Proposals were also made to begin with the $3.5 million exemption and 45% rate and phase in the $5 million exemption and 55% rate. Others had argued for permanent estate tax repeal.[7] At the end of 2010, a temporary two-year extension, with a $5 million exemption, a 35% rate, and inheritance of unused spousal exemptions was enacted in P.L. 111-312. These provisions provided for estate tax rules through 2012, and absent legislation, the provisions would have reverted to the pre-EGTRRA rules ($1 million exemption, 55% top rate).

The American Taxpayer Relief Act of 2012 (P.L. 112-240) established the permanent exemption ($5.25 million) and rate (40%) described above.

The 2017 tax revision (P.L. 115-97) doubled the exemptions for the years 2018 through 2025. The House had proposed doubling the exemption through 2024 and then repealing the estate tax and lowering the gift tax rates to 35%.

Revenues and Coverage

Compared with pre-existing law (a $1 million exemption and a 55% rate), the ATRA revision was projected to lose $369 billion in revenue from FY2013 to FY2022, rising from $27 billion in FY2015 to $54 billion FY2022.[8] This change reduced total projected revenue from the estate tax by about two-thirds.[9] The 2017 revision was projected to reduce revenues by $83 billion over eight years, for a further reduction in projected revenue of about 40%.

---

[6] See Chuck O'Toole, "Estate Tax Expiration Imminent After Congress Fails to Complete Action," *Tax Notes Today*, December 17, 2009, 2009TNT 240-4. For a discussion indicating that there would not be a legal issue with a retroactive tax, see Jay Starkman, "Can an Estate Tax be Retroactive?" *Tax Notes*, February 22, 2010, pp. 972-974.

[7] In addition to H.R. 4154, numerous bills were introduced in the 111th Congress to address the estate tax. The phase-in proposal was described in Martin Vaughn, U.S. Effort to Reduce Estate Tax Hits Turbulence, Dow Jones Newswire, May 18, 2010, at http://www.nasdaq.com/aspx/stock-market-news-story.aspx?storyid=201005181832dowjonesdjonline000463&title=us-senate-effort-to-reduce-estate-tax-hits-turbulence.

[8] Estimates of the Joint Committee on Taxation, JCX-1-13, January 1, 2013, at https://www.jct.gov/publications.html?func=startdown&id=4497.

[9] Based on data reported in CRS Report R41203, *Estate Tax Options*, by Jane G. Gravelle, using data from the Urban (continued...)

Only a small portion of high-income decedents would be affected by the tax under a $5 million exemption.

- The estate tax would have affected less than 0.2% of decedents over the next decade under the permanent rules. The doubling of the exemption would reduce that share to 0.05%.[10]
- The estate tax is concentrated among high-income taxpayers: 91% is paid by the top quintile, 60.4% by the top 1%, and 26% by the top 0.1%. The concentration in upper income categories would be increased with the higher exemption levels.
- About 0.2% of estates with half or more of their assets in businesses will be subject to the estate tax under the permanent rules, and less with the higher exemption levels.
- About 100 farm estates (or approximately two per state) are projected to be subject to the estate tax, and constitute 1.8% of taxable estates according to a projection from a CBO study. If the number of farm estates fall in proportion to the number of estates in general, around 25 farm estates (one estate every two years per state) would be taxable with the higher exemption level enacted in 2017. Less than a quarter of taxable farm estates (0.4% of all farm estates) are projected to have inadequate liquidity to pay estate taxes. The Department of Agriculture, using a somewhat different measure of what constitutes a farm, projects less than 1% (0.4%) of farm operator estates is projected to pay the tax, totaling 153 estates. These shares would also be expected to decline significantly with the higher exemptions.
- About 94 estates (about two per state) with half their assets in small business and that expect their heirs to continue in the business are projected to be subject to the estate tax; they constitute 2.5% of total estates.[11] Less than a half (1.1%) is

(...continued)

Brookings Tax Policy Center, Table T09-0431, at http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=2506&topic2ID=60&topic3ID=66&DocTypeID=.

[10] The 0.2% share is based on 2.7 million deaths in 2017 and estimates that 5,460 estates are projected to pay the estate tax in 2017 according to estimates by the Tax Policy Center, Table T17-0230, at http://www.taxpolicycenter.org/model-estimates/baseline-estate-tax-tables-2017/t17-0230-current-law-distribution-gross-estate-and. The Tax Policy Center estimates that 1,700 estates would be subject to tax under the Senate proposal that doubled the exemption. See Table T17-0308, http://www.taxpolicycenter.org/model-estimates/estate-tax-and-tax-cuts-and-jobs-act-dec-2017/t17-0308-estate-tax-returns-and. The distribution by income class is based on the Tax Policy Center, Table T17-0056, at http://www.taxpolicycenter.org/model-estimates/baseline-share-federal-taxes-march-2017/t17-0056-share-federal-taxes-all-tax-units. Some of these estimates are reported in CRS Report R41203, *Estate Tax Options*, by Jane G. Gravelle. Sources include data from Urban Brookings Tax Policy Center, Tables T10-0073 and T09-0402, http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=2664&topic2ID=60&topic3ID=66&DocTypeID=; Table T10-0269, http://www.taxpolicycenter.org/numbers/displayatab.cfm?Docid=2868&DocTypeID=7; Tables T09-0196, T09-0198, and T09-0199, http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=2270&topic2ID=60&topic3ID=66&DocTypeID=; Table T09-0431, http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=2506&topic2ID=60&topic3ID=66&DocTypeID=. Table T09-0426, http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=2501&topic2ID=60&topic3ID=73&DocTypeID= Congressional Budget Office, *Effects of the Federal Estate Tax on Farms and Small Businesses*, July 2005, http://www.cbo.gov/ftpdocs/65xx/doc6512/07-06-EstateTax.pdf. The number of farms is based on 1.8% applied to the taxable estates projected for 2016 reflecting data from the CBO study.

[11] These estates were identified by their use of the qualified family owned business income (QFOBI). In prior law, this provision allowed estates with at least half of their assets in a family business to take a deduction for these business assets. This provision originally allowed up to $675,000 of business deductions at a time when the basic estate tax exemption was $625,000, and imposed an overall cap of $1.3 million on the total of both deductions. To qualify for the (continued...)

projected to have inadequate liquidity to pay estate taxes.[12] These amounts would also decline significantly with the higher exemption level.

Issues and Options

A number of general issues have been raised about the estate tax. For example, some have expressed concern that the estate tax discourages savings. Others have noted that the tax encourages charitable bequests because they are deductible and reducing rates and increasing the exemption will reduce charitable contributions. A broader estate tax is also criticized as causing complex planning and tax administration problems.[13]

Although the current size of the exemption and the rate of tax had been set in permanent tax law, the House and Senate tax reform proposals differed in their approaches. Although both proposed an immediate doubling of the exemption level, the House would have repealed the estate tax (and reduced the gift tax rate to 35%) after 2024. The final bill doubled the exemption level but, as with other individual provisions, the increase is set to expire after 2025. As a result, the exemption level will return to its permanent level in 2026, absent further legislative change to extend the increase or make the increase permanent. The Obama Administration had previously proposed to return to the 2009 rates and levels. The President Obama's current and past budgets have also contained some more narrow proposals aimed at perceived abuses of the estate tax. All of the estimates of revenue gain unless otherwise noted are for FY2016-FY2025 and are obtained from the FY2016 budget proposals.[14] Note that these estimates of narrow provisions are based on the assumption of lower exemptions and higher rates in the 2016 budget.

Making the Higher Exemption Levels Permanent

The 2017 increase in exemption level was estimated to lose $83 billion in revenue.[15] Making it permanent would appear to have increased the cost by about $12 billion; it would also eventually be larger, not just due to growth in wealth, but to lags in filing estate tax returns.

Proposal to Repeal the Estate Tax and Reduce the Gift Tax Rate to 35%

The House version of H.R. 1 would have first increased the exemption levels and repealed the estate tax after 2023. The revenue estimate indicates a cost of $150 billion from FY2018 to

(...continued)

QFOBI deduction, heirs had to continue the business for 10 years or the tax savings must be repaid. Once the regular exemption passed the $1.3 million level, the provision was no longer relevant. Although QFOBI is obsolete, it was used in prior statistical studies to identify small business estates whose continuance might be made more difficult due to an estate tax.

[12] Data on the 0.8% of farms that pay the tax are from the U.S. Department of Agriculture, https://www.ers.usda.gov/topics/farm-economy/federal-tax-issues/federal-estate-taxes.aspx.

[13] These issues are discussed in more detail in CRS Report R41203, *Estate Tax Options*, by Jane G. Gravelle.

[14] Department of the Treasury, *General Explanations of the Administrations Fiscal Year 2016 Revenue Proposals*, February 2015, at http://www.treasury.gov/resource-center/tax-policy/Pages/general_explanation.aspx. Past budget proposals can be found there as well.

[15] Joint Committee on Taxation, "Estimated Budget Effects Of The Conference Agreement For H.R.1, The 'Tax Cuts And Jobs Act'," JCX-67-17, December 18, 2027, https://www.jct.gov/publications.html?func=startdown&id=5053.

2027,[16] but this estimate understates the permanent cost of this proposal because repeal was delayed (and there is a delay in filing estate tax returns as well). In the 114th Congress, H.R. 1105 and S. 860 would have immediately repealed the estate tax and reduced the rate of the gift tax rate. H.R. 1105 was reported by the House Ways and Means Committee (H.Rept. 114-52). The bills would have provided a transition rule for assets placed in a qualified domestic trust by a decedent who died before the effective date. The estate tax would not apply after 10 years or after the death of the surviving spouse. The proposal was estimated to cost $269 billion for FY2015-FY2025.[17]

Proposal to Return to 2009 Rates and Exemptions

The Obama Administration's FY2016 budget proposals to restore the 2009 higher rates and lower exemptions were estimated to raise $189 billion over 10 years.

Narrow Provisions

Grantor Retained Annuity Trusts

A Grantor Retained Annuity Trust (GRAT) is a trust that allows the grantor to receive an annuity, with any remaining assets transferred to the trust recipient. The value of the gift is reduced by the value of the assets used to fund the annuity. If the assets in the trust appreciate substantially, then virtually all of the gift can be reduced by the value of the annuity, while still providing a substantial ultimate gift to the recipient. If the grantor dies during the annuity period, the remaining value of the annuity is included in the estate. This trust approach could be a method of transferring assets roughly tax free if the assets appreciate at a rate faster than the discount rate used to value the annuity. The grantor needs to survive over the period of the annuity. To assure the latter will be likely to occur, many of these trusts have very short annuity periods, as short as two years.

Although successive short-term GRATs reduce the risk of losing control of capital by the grantor, there is also an advantage of a long-term GRAT. If the interest rate is expected to rise, the trust can lock in a low discount rate for the entire term. This low interest rate will increase the value of the annuity deduction compared with successive short-term GRATs that will have to use the current interest rate at the time the GRAT is established.

The GRAT proposal in President Obama's 2016 budget proposal would have imposed a minimum annuity term of 10 years, disallowed any decline in the annuity, and required a non-zero remainder interest. It would have imposed a maximum term of the annuitant's life plus 10 years. The provision was estimated to raise $18.4 billion over 10 years.

Minority Discounts

There are existing restrictions to keep estates from engaging in artificial actions designed to reduce the value of estates (such as freezes on assets). As discussed above, courts sometimes

[16] Joint Committee on Taxation, "Estimated Revenue Effects Of H.R. 1, The 'Tax Cuts and Jobs Act', As Ordered Reported By The Committee On Ways And Means On November 9, 2017," JCX-54-17, November 11, 2017, https://www.jct.gov/publications.html?func=startdown&id=5034.

[17] Joint Committee on Taxation, "Description of an Amendment in the Nature of a Substitute to the Provisions of H.R. 1105, The 'Death Tax Repeal Act Of 2015'," JCX-68-15, March 24, 2015, https://www.jct.gov/publications.html?func=startdown&id=4761.

allow estates to reduce the fair-market value when assets are left in family partnerships in which no one has a majority control. These discounts have even been allowed when assets are in cash and readily marketable securities, and the setting up of these family partnerships has become an estate tax avoidance tool. This provision is not in the current budget proposal, but it was estimated in the past to raise $18.1 billion from FY2013 to FY2022.

Consistent Valuation

Currently, there is no explicit rule preventing a low valuation of fair-market value for an estate and a high valuation of the asset for purposes of stepped-up basis in the hands of the heir. A low value of an asset reduces the estate tax, but a high value (because it reduces the amount of gain) reduces the capital gains tax. Requiring the same value for both purposes was projected to raise $3.2 billion over 10 years.

Other Minor Provisions

When generation-skipping transfers are made to a trust, the estate tax exemption applicable to them also exempts the associated earnings during the trust lifetime. In the past, a trust life has been limited because most states had a Rule Against Perpetuities that generally limited trusts to a 21-year life. Most of those laws have been eliminated. The Obama Administration's proposal would have limited the life of a generation-skipping trust to 90 years. The revenue effect would have been negligible over the next 10 years.

Currently, the Internal Revenue Service (IRS) has a lien on estate tax deferrals for closely held business, but these liens are for 10 years, shorter than the deferral period. This provision would have extended the liens through the deferral period and was projected to raise $0.3 billion over 10 years.

Currently, payments for medical care or education made directly to the provider for another are exempt from the generation-skipping tax and the gift tax. Taxpayers have been using trusts to eventually pay for these expenses and avoid tax on the accumulations. The Obama Administration indicated that the original purpose of this provision was to exempt payments between living persons and would have disallowed exemptions for payments to trusts. This provision would have lost revenue in the budget horizon, $0.2 billion.

The executor of an estate is responsible for estate tax issues, but there is no clear federal rule about authority to address income tax issues of the decedent form prior years. This provision would have extended authority for addressing federal income tax issues to the executor. It would have involved a negligible revenue loss.

Simplify Gift Tax Exclusion for Annual Gifts

This provision would have disallowed the unlimited use of trusts (called Crummey trusts) to expand the number of annual gift exclusions, by imposing an additional overall limit of $50,000 on gifts made via trusts. This provision was projected to raise $3.4 billion over 10 years.

Coordinate Grantor Trusts Income and Transfer Tax Rules

In a grantor trust, an individual is treated as owner for income tax purposes. However, the trust and the individual are treated as separate persons for purposes of the estate and gift tax. This proposal from the Obama Administration included the assets of the trust in the grantors estate and subjected distributions to the gift tax if the grantor is the owner for income tax purposes. If the grantor ceases to be the owner, the assets would have been subject to a gift tax. This provision is not in the current budget proposal, but was included in prior budgets and was projected to raise $3.3 billion over 10 years at that time.

Author Contact Information

Jane G. Gravelle
Senior Specialist in Economic Policy
jgravelle@crs.loc.gov, 7-7829