

REPORT #669

TAX SECTION

New York State Bar Association

Estate Freeze Legislation

October 10, 1990

Table of Contents

Cover Letteri

TAX SECTION

New York State Bar Association

OFFICERS
AUTHOR A. FEDER
Chairman
1 New York Plaza
New York City 10004
212/820-8275
JAMES M. PEASLEE
First Vice-Chair
1 Liberty Plaza
New York City 10006
212/225-2000
JOHN A. CORRY
Second Vice-Chair
1 Chase Manhattan Plaza
New York City 10005
212/530-4608
PETER C. CANELLOS
Secretary
299 Park Avenue
New York City 10171
212/371-9200

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October 10, 1990

The Honorable Lloyd Bentsen
Chairman, Senate Committee on Finance
205 Dirksen Senate Office Building
Washington, D.C. 20510
Dear Senator Bentsen:

We are writing to express our enthusiastic support for the estate freeze legislation which you introduced on September 26, 1990. However, we believe we should point out that as presently drafted the "control" definition of Section 2512A(c)(2), read together with the attribution rules of Section 2512A(e), leaves certain loopholes which should be corrected.

As indicated in its statement to the House Committee on Ways and Means, the Tax Section of the New York State Bar Association fully endorses the repeal of Section 2036(c) of the Internal Revenue Code. The Section also supports replacing Section 2036(c) with legislation designed to correct the valuation abuses which led to its enactment, provided such legislation does not interfere with legitimate business transactions among family members. In this regard, the Section favors a "closed transaction" approach to the taxation of transfers of closely-held business interests which, by addressing the valuation issues at the time of the initial transfer, would provide certainty to the taxpayer and would eliminate or reduce the enormous administrative burdens created by Section 2036(c) and the replacements proposed thus far.

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The Section applauds the approach taken in the concise legislation sponsored by you as achieving these goals in an uncomplicated, focused manner. The proposed legislation is evidence that the Senate Finance Committee has listened and responded to the concerns of both taxpayers and the government in arriving at a constructive and balanced solution to the problems that motivated Section 2036(c).

In particular, the Section supports the following features, which have the effect of focusing the legislation on those transactions with the greatest potential for abuse under the transfer tax system:

(1) Limiting the application of the legislation to transfers of interests in entities in which the transferor and his family members (including siblings) hold at least 50 percent of the equity and removing from the scope of the legislation those interests for which market quotations are readily available.

(2) Limiting the application of the special valuation rules to transfers to family members where the transferor, his or her spouse, their ancestors and ancestors' spouses retain interests in the entity.

(3) Removing transfers of interests in trust from the scope of the special valuation rules and, instead, modifying the valuation tables under Section 7520 where a term or life interest is held by an individual in a generation higher than that of a remainderman.

We believe, however, that by ignoring the combined interests of the transferor and certain family members and providing a very limited set of attribution rules, the bill as introduced creates loopholes that would enable many transfers to escape the scope of the special valuation rules in those very situations where the incentive and opportunity for valuation manipulation is most significant.

To eliminate such loopholes, the Section believes that the proposed control test under Section 2512A(c)(2), used to determine whether an applicable retained interest exists, should be applied immediately before, rather than after, the transfer and the rules governing the attribution of interests to the transferor should be expanded to include all interests held by lineal descendants of the transferor and transferor's spouse, regardless of whether they have reached majority.

It would also be advisable to clarify that the entity attribution rules under proposed Section 2512A (e)(3)(A) will apply not only to the transferor, but also to any relevant individual, preferably by amending Section 2512A(e).

We would also point out that under the proposed control test, even if so modified, transfers of interests in a closely-held business which is owned by a small group of unrelated families, none of which "controls" the entity, will not be subject to the proposed legislation, even though the owners of the business may have common estate planning goals.

The Section also believes that certain points may require clarification. In particular, the Section assumes that the concepts contained in proposed Sections 2031(c) and (d) are intended to apply not only to deathtime transfers but also lifetime gifts. This point should be clarified in the final legislation by corresponding amendments to Chapter 12.

Once again, subject to these comments, we enthusiastically endorse the proposed legislation.

Very truly yours,

Arthur A. Feder
Chair

cc: The Honorable David L. Boren
453 Russell Senate Office Building
Washington, D.C. 20510

The Honorable Thomas A. Daschle
317 Hart Senate Office Building
Washington, D.C. 20510

The Honorable Dan Rostenkowski
Chairman
House Committee on Ways and Means
1102 Longworth House Office Building
Washington, D.C. 20515

The Honorable Fred T. Goldberg, Jr.
Commissioner of Internal Revenue
Room 3000
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

The Honorable Kenneth W. Gideon
Assistant Secretary of the Treasury
for Tax Policy
3120 Main Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Ronald A. Pearlman, Esq.
Chief of Staff
Joint Committee on Taxation
1015 Longworth House Office Bldg.
Washington, D.C. 20515

Abraham N.M. Shashy, Jr., Esq.
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Michael J. Graetz, Esq.
Deputy Assistant Secretary of the
Treasury for Tax Policy
3108 Main Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Robert Wootton, Esq.
Tax Legislative Counsel
United States Treasury Department
3064 Main Treasury
1500 Pennsylvania Avenue/ N.W.
Washington, D.C. 20220

Gregory Jenner, Esq.
Special Assistant to the Assistant
Secretary of the Treasury for Tax Policy
3120 Main Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Paul S. Kugler, Esq.
Assistant Chief Counsel (Passthroughs
and Special Industries)
Internal Revenue Service
Room 5300
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Robert Weaver, Esq.
Attorney Advisor, Tax Legislative Counsel
Department of the Treasury
1064 Main Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Richard B. Grosgebauer, Esq.
Chief Branch 4, Assistant Chief Counsel
(Passthroughs and Special Industries)
Internal Revenue Service
Room 5427
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Frederick E. Grundeman, Esq.
Attorney, Assistant Chief Counsel
(Passthroughs and Special Industries)
Internal Revenue Service
Room 5412
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Susan B. Hurwitz, Esq.
Attorney, Assistant Chief Counsel
(Passthroughs and Special Industries)
Internal Revenue Service
Room 5315
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Lee A. Dunn, Esq.
Attorney, Assistant Chief Counsel
(Passthroughs and Special Industries)
Internal Revenue Service
Room 5306
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Maurice Foley, Esq.
Tax Counsel
Senate Finance Committee
205 Dirksen Senate Office Building
Washington, D.C. 20510

Vanda McMurty, Esq.
Staff Director, Chief Counsel
Senate Committee on Finance
205 Dirksen Senate Office Building
Washington, D.C. 20510

Samuel Y. Sessions, Esq.
Chief Tax Counsel
Senate Committee on Finance
205 Dirksen Senate Office Building
Washington, D.C. 20510

Robert J. Leonard, Esq.
Chief Counsel, Staff Director
House Committee on Ways and Means
1102 Longworth House Office Building
Washington, D.C. 20515

Ed Mihalski, Esq. (5)
Minority Chief of Staff
Senate Committee on Finance
203 Hart Senate Office Building
Washington, D.C. 20510

Laura Wilcox (5)
Hearing Administrator
Senate Committee on Finance
205 Dirksen Senate Office Building
Washington, D.C. 20510

Lindy Paull, Esq.
Minority Deputy Chief of Staff
Senate Committee on Finance
203 Hart Senate Office Building
Washington, D.C. 20510

Melvin C. Thomas, Esq.
Senior Legislation Counsel
Joint Committee on Taxation
1012 Longworth Office Building
Washington, D.C. 20515