107TH CONGRESS
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HOUSE OF REPRESENTATIVES
REPORT
107–37

DEATH TAX ELIMINATION ACT OF 2001

APRIL 3, 2001.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. THOMAS, from the Committee on Ways and Means, submitted the following

R E P O R T

together with

DISSENTING VIEWS

[To accompany H.R. 8]

[Including cost estimate of the Congressional Budget Office]

The Committee on Ways and Means, to whom was referred the bill (H.R. 8) to amend the Internal Revenue Code of 1986 to phase-out the estate and gift taxes over a 10-year period, and for other purposes, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

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The amendment is as follows:
Strike all after the enacting clause and insert the following:

SECTION 1. SHORT TITLE; ETC.

(a) SHORT TITLE.—This Act may be cited as the "Death Tax Elimination Act of 2001".

(b) AMENDMENT OF 1986 CODE.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

(c) TABLE OF CONTENTS.—

TITLE I—REPEAL OF ESTATE, GIFT, AND GENERATION-SKIPPING TAXES

SEC. 101. REPEAL OF ESTATE, GIFT, AND GENERATION-SKIPPING TAXES.

(a) IN GENERAL.—Subtitle B is hereby repealed.

(b) EFFECTIVE DATE.—The repeal made by subsection (a) shall apply to the estates of decedents dying, and gifts and generation-skipping transfers made, after December 31, 2010.

TITLE II—REDUCTIONS OF ESTATE AND GIFT TAX RATES PRIOR TO REPEAL

SEC. 201. ADDITIONAL REDUCTIONS OF ESTATE AND GIFT TAX RATES.

(a) MAXIMUM RATE OF TAX REDUCED TO 50 PERCENT.—

(1) IN GENERAL.—The table contained in section 2001(c)(1) is amended by striking the two highest brackets and inserting the following:

"Over $2,500,000	$1,025,800, plus 50% of the excess over $2,500,000.".

(2) PHASE-IN OF REDUCED RATE.—Subsection (c) of section 2001 is amended by adding at the end the following new paragraph:

"(3) PHASE-IN OF REDUCED RATE.—In the case of decedents dying, and gifts made, during 2002, the last item in the table contained in paragraph (1) shall be applied by substituting '53%' for '50%'.".

(b) REPEAL OF PHASEOUT OF GRADUATED RATES.—Subsection (c) of section 2001 is amended by striking paragraph (2) and redesignating paragraph (3), as added by subsection (a), as paragraph (2).

(c) ADDITIONAL REDUCTIONS OF RATES OF TAX.—Subsection (c) of section 2001, as so amended, is amended by adding at the end the following new paragraph:

"(3) PHASEDOWN OF TAX.—In the case of estates of decedents dying, and gifts made, during any calendar year after 2003 and before 2011—

"(A) IN GENERAL.—Except as provided in subparagraph (C), the tentative tax under this subsection shall be determined by using a table prescribed by the Secretary (in lieu of using the table contained in paragraph (1)) which is the same as such table; except that—

"(i) each of the rates of tax shall be reduced by the number of percentage points determined under subparagraph (B), and

"(ii) the amounts setting forth the tax shall be adjusted to the extent necessary to reflect the adjustments under clause (i).

"(B) PERCENTAGE POINTS OF REDUCTION.—

"For calendar year:	The number of percentage points is:
2004	1.0
2005	2.0
2006	3.0
2007	5.0
2008	7.0
2009	9.0
2010	11.0.

"(C) COORDINATION WITH INCOME TAX RATES.—The reductions under subparagraph (A)—

"(i) shall not reduce any rate under paragraph (1) below the lowest rate in section 1(c) applicable to the taxable year which includes the date of death (or, in the case of a gift, the date of the gift), and

"(ii) shall not reduce the highest rate under paragraph (1) below the highest rate in section 1(c) for such taxable year.

"(D) COORDINATION WITH CREDIT FOR STATE DEATH TAXES.—Rules similar to the rules of subparagraph (A) shall apply to the table contained in section 2011(b) except that the Secretary shall prescribe percentage point reductions which maintain the proportionate relationship (as in effect before any reduction under this paragraph) between the credit under section 2011 and the tax rates under subsection (c).".

(d) EFFECTIVE DATES.—

(1) SUBSECTIONS (a) AND (b).—The amendments made by subsections (a) and (b) shall apply to estates of decedents dying, and gifts made, after December 31, 2001.

(2) SUBSECTION (c).—The amendment made by subsection (c) shall apply to estates of decedents dying, and gifts made, after December 31, 2003.

TITLE III—UNIFIED CREDIT REPLACED WITH UNIFIED EXEMPTION AMOUNT

SEC. 301. UNIFIED CREDIT AGAINST ESTATE AND GIFT TAXES REPLACED WITH UNIFIED EXEMPTION AMOUNT.

(a) IN GENERAL.—

(1) ESTATE TAX.—Subsection (b) of section 2001 (relating to computation of tax) is amended to read as follows:

"(b) COMPUTATION OF TAX.—

"(1) IN GENERAL.—The tax imposed by this section shall be the amount equal to the excess (if any) of—

"(A) the tentative tax determined under paragraph (2), over

"(B) the aggregate amount of tax which would have been payable under chapter 12 with respect to gifts made by the decedent after December 31, 1976, if the provisions of subsection (c) (as in effect at the decedent's death) had been applicable at the time of such gifts.

"(2) TENTATIVE TAX.—For purposes of paragraph (1), the tentative tax determined under this paragraph is a tax computed under subsection (c) on the excess of—

"(A) the sum of—

"(i) the amount of the taxable estate, and

"(ii) the amount of the adjusted taxable gifts, over

"(B) the exemption amount for the calendar year in which the decedent died.

"(3) EXEMPTION AMOUNT.—For purposes of paragraph (2), the term 'exemption amount' means the amount determined in accordance with the following table:

"In the case of calendar year:	The exemption amount is:
2002 and 2003	$700,000
2004	$850,000
2005	$950,000
2006 or thereafter	$1,000,000.

"(4) ADJUSTED TAXABLE GIFTS.—For purposes of paragraph (2), the term 'adjusted taxable gifts' means the total amount of the taxable gifts (within the meaning of section 2503) made by the decedent after December 31, 1976, other than gifts which are includible in the gross estate of the decedent.".

(2) GIFT TAX.—Subsection (a) of section 2502 (relating to computation of tax) is amended to read as follows:

"(a) COMPUTATION OF TAX.—

"(1) IN GENERAL.—The tax imposed by section 2501 for each calendar year shall be the amount equal to the excess (if any) of—

"(A) the tentative tax determined under paragraph (2) for such calendar year, over

"(B) the aggregate amount of tax that would have been payable under this chapter with respect to gifts made by the donor in preceding calendar periods if the tax had been computed under the provisions of section 2001(c) as in effect for such calendar year.

"(2) TENTATIVE TAX.—For purposes of paragraph (1), the tentative tax determined under this paragraph for a calendar year is a tax computed under section 2001(c) on the excess of—

"(A) the aggregate sum of the taxable gifts for such calendar year and for each of the preceding calendar periods, over

"(B) the exemption amount under section 2001(b)(3) for such calendar year.".

(b) REPEAL OF UNIFIED CREDITS.—

(1) Section 2010 (relating to unified credit against estate tax) is hereby repealed.

(2) Section 2505 (relating to unified credit against gift tax) is hereby repealed.

(c) CONFORMING AMENDMENTS.—

(1)(A) Subsection (b) of section 2011 is amended—

(i) by striking "adjusted" in the table; and

(ii) by striking the last sentence.

(B) Subsection (f) of section 2011 is amended by striking ", reduced by the amount of the unified credit provided by section 2010".

(2) Subsection (a) of section 2012 is amended by striking "and the unified credit provided by section 2010".

(3) Subparagraph (A) of section 2013(c)(1) is amended by striking "2010,".

(4) Paragraph (2) of section 2014(b) is amended by striking "2010, 2011," and inserting "2011".

(5) Clause (ii) of section 2056A(b)(12)(C) is amended to read as follows:

"(ii) to treat any reduction in the tax imposed by paragraph (1)(A) by reason of the credit allowable under section 2010 (as in effect on the day before the date of the enactment of the Death Tax Elimination Act of 2001) or the exemption amount allowable under section 2001(b) with respect to the decedent as a credit under section 2505 (as so in effect) or exemption under section 2501 (as the case may be) allowable to such surviving spouse for purposes of determining the amount of the exemption allowable under section 2501 with respect to taxable gifts made by the surviving spouse during the year in which the spouse becomes a citizen or any subsequent year,".

(6) Subsection (a) of section 2057 is amended by striking paragraphs (2) and (3) and inserting the following new paragraph:

"(2) MAXIMUM DEDUCTION.—The deduction allowed by this section shall not exceed the excess of $1,300,000 over the exemption amount (as defined in section 2001(b)(3)).".

(7) Subsection (b) of section 2101 is amended to read as follows:

"(b) COMPUTATION OF TAX.—

"(1) IN GENERAL.—The tax imposed by this section shall be the amount equal to the excess (if any) of—

"(A) the tentative tax determined under paragraph (2), over

"(B) a tentative tax computed under section 2001(c) on the amount of the adjusted taxable gifts.

"(2) TENTATIVE TAX.—For purposes of paragraph (1), the tentative tax determined under this paragraph is a tax computed under section 2001(c) on the excess of—

"(A) the sum of—

"(i) the amount of the taxable estate, and

"(ii) the amount of the adjusted taxable gifts, over

"(B) the exemption amount for the calendar year in which the decedent died.

"(3) EXEMPTION AMOUNT.—

"(A) IN GENERAL.—The term 'exemption amount' means $60,000.

"(B) RESIDENTS OF POSSESSIONS OF THE UNITED STATES.—In the case of a decedent who is considered to be a nonresident not a citizen of the United States under section 2209, the exemption amount under this paragraph shall be the greater of—

"(i) $60,000, or

"(ii) that proportion of $175,000 which the value of that part of the decedent's gross estate which at the time of his death is situated in the United States bears to the value of his entire gross estate wherever situated.

"(C) SPECIAL RULES.—

"(i) COORDINATION WITH TREATIES.—To the extent required under any treaty obligation of the United States, the exemption amount allowed under this paragraph shall be equal to the amount which bears the same ratio to the exemption amount under section 2001(b)(3) (for the calendar year in which the decedent died) as the value of the part of the decedent's gross estate which at the time of his death is situated in the United States bears to the value of his entire gross estate wherever situated. For purposes of the preceding sentence, property shall not be treated as situated in the United States if such property is exempt from the tax imposed by this subchapter under any treaty obligation of the United States.

"(ii) COORDINATION WITH GIFT TAX EXEMPTION AND UNIFIED CREDIT.—If an exemption has been allowed under section 2501 (or a credit has been allowed under section 2505 as in effect on the day before the date of the enactment of the Death Tax Elimination Act of 2001) with respect to any gift made by the decedent, each dollar amount contained in subparagraph (A) or (B) or the exemption amount applicable under clause (i) of this subparagraph (whichever applies) shall be reduced by the exemption so allowed under section 2501 (or, in the case of such a credit, by the amount of the gift for which the credit was so allowed).".

(8) Section 2102 is amended by striking subsection (c).

(9)(A) Paragraph (1) of section 2107(a) is amended by striking "the table contained in".

(B) Paragraph (1) of section 2107(c) is amended to read as follows:

"(1) EXEMPTION AMOUNT.—For purposes of subsection (a), the exemption amount under section 2001 shall be $60,000."

(C) Paragraph (3) of section 2107(c) is amended by striking the second sentence.

(D) The heading of subsection (c) of section 2107 is amended to read as follows:

"(c) EXEMPTION AMOUNT AND CREDITS.—".

(10) Paragraph (1) of section 6018(a) is amended by striking "the applicable exclusion amount in effect under section 2010(c)" and inserting "the exemption amount under section 2001(b)(3)".

(11) Subparagraph (A) of section 6601(j)(2) is amended to read as follows:

"(A) the amount of the tentative tax which would be determined under the rate schedule set forth in section 2001(c) if the amount with respect to which such tentative tax is to be computed were $1,000,000, or".

(12) The table of sections for part II of subchapter A of chapter 11 is amended by striking the item relating to section 2010.

(13) The table of sections for subchapter A of chapter 12 is amended by striking the item relating to section 2505.

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to estates of decedents dying and gifts made after December 31, 2001.

TITLE IV—CARRYOVER BASIS AT DEATH; OTHER CHANGES TAKING EFFECT WITH REPEAL

SEC. 401. TERMINATION OF STEP-UP IN BASIS AT DEATH.

Section 1014 (relating to basis of property acquired from a decedent) is amended by adding at the end the following new subsection:

"(f) TERMINATION.—This section shall not apply with respect to decedents dying after December 31, 2010.".

SEC. 402. TREATMENT OF PROPERTY ACQUIRED FROM A DECEDENT DYING AFTER DECEMBER 31, 2010.

(a) GENERAL RULE.—Part II of subchapter O of chapter 1 (relating to basis rules of general application) is amended by inserting after section 1021 the following new section:

"SEC. 1022. TREATMENT OF PROPERTY ACQUIRED FROM A DECEDENT DYING AFTER DECEMBER 31, 2010.

"(a) IN GENERAL.—Except as otherwise provided in this section—

"(1) property acquired from a decedent dying after December 31, 2010, shall be treated for purposes of this subtitle as transferred by gift, and

"(2) the basis of the person acquiring property from such a decedent shall be the lesser of—

"(A) the adjusted basis of the decedent, or

"(B) the fair market value of the property at the date of the decedent's death.

"(b) BASIS INCREASE FOR CERTAIN PROPERTY.—

"(1) IN GENERAL.—In the case of property to which this subsection applies, the basis of such property under subsection (a) shall be increased by its basis increase under this subsection.

"(2) BASIS INCREASE.—For purposes of this subsection—

"(A) IN GENERAL.—The basis increase under this subsection for any property is the portion of the aggregate basis increase which is allocated to the property pursuant to this section.

"(B) AGGREGATE BASIS INCREASE.—In the case of any estate, the aggregate basis increase under this subsection is $1,300,000.

"(C) LIMIT INCREASED BY UNUSED BUILT-IN LOSSES AND LOSS CARRYOVERS.—The limitation under subparagraph (B) shall be increased by—

"(i) the sum of the amount of any capital loss carryover under section 1212(b), and the amount of any net operating loss carryover under section 172, which would (but for the decedent's death) be carried from the decedent's last taxable year to a later taxable year of the decedent, plus

"(ii) the sum of the amount of any losses that would have been allowable under section 165 if the property acquired from the decedent had been sold at fair market value immediately before the decedent's death.

"(3) DECEDENT NONRESIDENTS WHO ARE NOT CITIZENS OF THE UNITED STATES.—In the case of a decedent nonresident not a citizen of the United States—

"(A) paragraph (2)(B) shall be applied by substituting '$60,000' for '$1,300,000', and

"(B) paragraph (2)(C) shall not apply.

"(c) ADDITIONAL BASIS INCREASE FOR PROPERTY ACQUIRED BY SURVIVING SPOUSE.—

"(1) IN GENERAL.—In the case of property to which this subsection applies and which is qualified spousal property, the basis of such property under subsection (a) (as increased, if any, under subsection (b)) shall be increased by its spousal property basis increase.

"(2) SPOUSAL PROPERTY BASIS INCREASE.—For purposes of this subsection—

"(A) IN GENERAL.—The spousal property basis increase for property referred to in paragraph (1) is the portion of the aggregate spousal property basis increase which is allocated to the property pursuant to this section.

"(B) AGGREGATE SPOUSAL PROPERTY BASIS INCREASE.—In the case of any estate, the aggregate spousal property basis increase is $3,000,000.

"(3) QUALIFIED SPOUSAL PROPERTY.—For purposes of this subsection, the term 'qualified spousal property' means—

"(A) outright transfer property, and

"(B) qualified terminable interest property.

"(4) OUTRIGHT TRANSFER PROPERTY.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'outright transfer property' means any interest in property acquired from the decedent by the decedent's surviving spouse.

"(B) EXCEPTION.—Subparagraph (A) shall not apply where, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, an interest passing to the surviving spouse will terminate or fail—

"(i)(I) if an interest in such property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to any person other than such surviving spouse (or the estate of such spouse), and

"(II) if by reason of such passing such person (or his heirs or assigns) may possess or enjoy any part of such property after such termination or failure of the interest so passing to the surviving spouse, or

"(ii) if such interest is to be acquired for the surviving spouse, pursuant to directions of the decedent, by his executor or by the trustee of a trust.

For purposes of this subparagraph, an interest shall not be considered as an interest which will terminate or fail merely because it is the ownership of a bond, note, or similar contractual obligation, the discharge of which would not have the effect of an annuity for life or for a term.

"(C) INTEREST OF SPOUSE CONDITIONAL ON SURVIVAL FOR LIMITED PERIOD.—For purposes of this paragraph, an interest passing to the surviving spouse shall not be considered as an interest which will terminate or fail on the death of such spouse if—

"(i) such death will cause a termination or failure of such interest only if it occurs within a period not exceeding 6 months after the decedent's death, or only if it occurs as a result of a common disaster resulting in the death of the decedent and the surviving spouse, or only if it occurs in the case of either such event; and

"(ii) such termination or failure does not in fact occur.

"(5) QUALIFIED TERMINABLE INTEREST PROPERTY.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'qualified terminable interest property' means property—

"(i) which passes from the decedent, and

"(ii) in which the surviving spouse has a qualifying income interest for life.

"(B) QUALIFYING INCOME INTEREST FOR LIFE.—The surviving spouse has a qualifying income interest for life if—

"(i) the surviving spouse is entitled to all the income from the property, payable annually or at more frequent intervals, or has a usufruct interest for life in the property, and

"(ii) no person has a power to appoint any part of the property to any person other than the surviving spouse.

Clause (ii) shall not apply to a power exercisable only at or after the death of the surviving spouse. To the extent provided in regulations, an annuity shall be treated in a manner similar to an income interest in property (regardless of whether the property from which the annuity is payable can be separately identified).

"(C) PROPERTY INCLUDES INTEREST THEREIN.—The term 'property' includes an interest in property.

"(D) SPECIFIC PORTION TREATED AS SEPARATE PROPERTY.—A specific portion of property shall be treated as separate property. For purposes of the preceding sentence, the term 'specific portion' only includes a portion determined on a fractional or percentage basis.

"(d) DEFINITIONS AND SPECIAL RULES FOR APPLICATION OF SUBSECTIONS (b) AND (c).—

"(1) PROPERTY TO WHICH SUBSECTIONS (b) AND (c) APPLY.—

"(A) IN GENERAL.—The basis of property acquired from a decedent may be increased under subsection (b) or (c) only if the property was owned by the decedent at the time of death.

"(B) RULES RELATING TO OWNERSHIP.—

"(i) JOINTLY HELD PROPERTY.—In the case of property which was owned by the decedent and another person as joint tenants with right of survivorship or tenants by the entirety—

"(I) if the only such other person is the surviving spouse, the decedent shall be treated as the owner of only 50 percent of the property,

"(II) in any case (to which subclause (I) does not apply) in which the decedent furnished consideration for the acquisition of the property, the decedent shall be treated as the owner to the extent of the portion of the property which is proportionate to such consideration, and

"(III) in any case (to which subclause (I) does not apply) in which the property has been acquired by gift, bequest, devise, or inheritance by the decedent and any other person as joint tenants with right of survivorship and their interests are not otherwise specified or fixed by law, the decedent shall be treated as the owner to the extent of the value of a fractional part to be determined by dividing the value of the property by the number of joint tenants with right of survivorship.

"(ii) REVOCABLE TRUSTS.—The decedent shall be treated as owning property transferred by the decedent during life to a revocable trust to pay all of the income during the decedent's life to the decedent or at the direction of the decedent.

"(iii) POWERS OF APPOINTMENT.—The decedent shall not be treated as owning any property by reason of holding a power of appointment with respect to such property.

"(iv) COMMUNITY PROPERTY.—Property which represents the surviving spouse's one-half share of community property held by the decedent and the surviving spouse under the community property laws of any State or possession of the United States or any foreign country shall be treated for purposes of this section as owned by, and acquired from, the decedent if at least one-half of the whole of the community interest in such property is treated as owned by, and acquired from, the decedent without regard to this clause.

"(C) PROPERTY ACQUIRED BY DECEDENT BY GIFT WITHIN 3 YEARS OF DEATH.—

"(i) IN GENERAL.—Subsections (b) and (c) shall not apply to property acquired by the decedent by gift or by inter vivos transfer for less than adequate and full consideration in money or money's worth during the 3-year period ending on the date of the decedent's death.

"(ii) EXCEPTION FOR CERTAIN GIFTS FROM SPOUSE.—Clause (i) shall not apply to property acquired by the decedent from the decedent's spouse unless, during such 3-year period, such spouse acquired the property in whole or in part by gift or by inter vivos transfer for less than adequate and full consideration in money or money's worth.

"(D) STOCK OF CERTAIN ENTITIES.—Subsections (b) and (c) shall not apply to—

"(i) stock or securities a foreign personal holding company,

"(ii) stock of a DISC or former DISC,

"(iii) stock of a foreign investment company, or

"(iv) stock of a passive foreign investment company unless such company is a qualified electing fund (as defined in section 1295) with respect to the decedent.

"(2) FAIR MARKET VALUE LIMITATION.—The adjustments under subsection (b) and (c) shall not increase the basis of any interest in property acquired from the decedent above its fair market value in the hands of the decedent as of the date of the decedent's death.

"(3) ALLOCATION RULES.—

"(A) IN GENERAL.—The executor shall allocate the adjustments under subsections (b) and (c) on the return required by section 6018.

"(B) CHANGES IN ALLOCATION.—Any allocation made pursuant to subparagraph (A) may be changed only as provided by the Secretary.

"(4) INFLATION ADJUSTMENT OF BASIS ADJUSTMENT AMOUNTS.—

"(A) IN GENERAL.—In the case of decedents dying in a calendar year after 2011, the $1,300,000, $60,000, and $3,000,000 dollar amounts in subsections (b) and (c)(2)(B) shall each be increased by an amount equal to the product of—

"(i) such dollar amount, and

"(ii) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year, determined by substituting '2010' for '1992' in subparagraph (B) thereof.

"(B) ROUNDING.—If any increase determined under subparagraph (A) is not a multiple of—

"(i) $100,000 in the case of the $1,300,000 amount,

"(ii) $5,000 in the case of the $60,000 amount, and

"(iii) $250,000 in the case of the $3,000,000 amount,

such increase shall be rounded to the next lowest multiple thereof.

"(e) PROPERTY ACQUIRED FROM THE DECEDENT.—For purposes of this section, the following property shall be considered to have been acquired from the decedent:

"(1) Property acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent.

"(2) Property transferred by the decedent during his lifetime in trust to pay the income for life to or on the order or direction of the decedent, with the right reserved to the decedent at all times before his death—

"(A) to revoke the trust, or

"(B) to make any change in the enjoyment thereof through the exercise of a power to alter, amend, or terminate the trust.

"(3) Any other property passing from the decedent by reason of death to the extent that such property passed without consideration.

"(f) COORDINATION WITH SECTION 691.—This section shall not apply to property which constitutes a right to receive an item of income in respect of a decedent under section 691.

"(g) CERTAIN LIABILITIES DISREGARDED.—In determining whether gain is recognized on the acquisition of property—

"(1) from a decedent by a decedent's estate or any beneficiary, and

"(2) from the decedent's estate by any beneficiary,

and in determining the adjusted basis of such property, liabilities in excess of basis shall be disregarded.

"(h) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this section.".

(b) INFORMATION RETURNS, ETC.—

(1) IN GENERAL.—Subpart C of part II of subchapter A of chapter 61 is amended to read as follows:

"Subpart C—Returns Relating to Transfers During Life or at Death

"SEC. 6018. RETURNS RELATING TO LARGE TRANSFERS AT DEATH.

"(a) IN GENERAL.—If this section applies to property acquired from a decedent, the executor of the estate of such decedent shall make a return containing the information specified in subsection (c) with respect to such property.

"(b) PROPERTY TO WHICH SECTION APPLIES.—

"(1) LARGE TRANSFERS.—This section shall apply to all property (other than cash) acquired from a decedent if the fair market value of such property acquired from the decedent exceeds the dollar amount applicable under section 1022(b)(2)(B) (without regard to section 1022(b)(2)(C)).

"(2) TRANSFERS OF CERTAIN GIFTS RECEIVED BY DECEDENT WITHIN 3 YEARS OF DEATH.—This section shall apply to any appreciated property acquired from the decedent if—

"(A) subsections (b) and (c) of section 1022 do not apply to such property by reason of section 1022(d)(1)(C), and

"(B) such property was required to be included on a return required to be filed under section 6019.

"(3) NONRESIDENTS NOT CITIZENS OF THE UNITED STATES.—In the case of a decedent who is a nonresident not a citizen of the United States, paragraphs (1) and (2) shall be applied—

"(A) by taking into account only—

"(i) tangible property situated in the United States, and

"(ii) other property acquired from the decedent by a United States person, and

"(B) by substituting the dollar amount applicable under section 1022(b)(3) for the dollar amount referred to in paragraph (1).

"(4) RETURNS BY TRUSTEES OR BENEFICIARIES.—If the executor is unable to make a complete return as to any property acquired from or passing from the decedent, the executor shall include in the return a description of such property and the name of every person holding a legal or beneficial interest therein. Upon notice from the Secretary such person shall in like manner make a return as to such property.

"(c) INFORMATION REQUIRED TO BE FURNISHED.—The information specified in this subsection with respect to any property acquired from the decedent is—

"(1) the name and TIN of the recipient of such property,

"(2) an accurate description of such property,

"(3) the adjusted basis of such property in the hands of the decedent and its fair market value at the time of death,

"(4) the decedent's holding period for such property,

"(5) sufficient information to determine whether any gain on the sale of the property would be treated as ordinary income,

"(6) the amount of basis increase allocated to the property under subsection (b) or (c) of section 1022, and

"(7) such other information as the Secretary may by regulations prescribe.

"(d) PROPERTY ACQUIRED FROM DECEDENT.—For purposes of this section, section 1022 shall apply for purposes of determining the property acquired from a decedent.

"(e) STATEMENTS TO BE FURNISHED TO CERTAIN PERSONS.—Every person required to make a return under subsection (a) shall furnish to each person whose name is required to be set forth in such return (other than the person required to make such return) a written statement showing—

"(1) the name, address, and phone number of the person required to make such return, and

"(2) the information specified in subsection (c) with respect to property acquired from, or passing from, the decedent to the person required to receive such statement.

The written statement required under the preceding sentence shall be furnished not later than 30 days after the date that the return required by subsection (a) is filed.

"SEC. 6019. RETURNS RELATING TO LARGE LIFETIME GIFTS.

"(a) IN GENERAL.—If the value of the aggregate gifts of property made by an individual to any United States person during a calendar year exceeds $25,000, such individual shall make a return for such year setting forth—

"(1) the name and TIN of the donee,

"(2) an accurate description of such property,

"(3) the adjusted basis of such property in the hands of the donor at the time of the gift,

"(4) the donor's holding period for such property,

"(5) sufficient information to determine whether any gain on the sale of the property would be treated as ordinary income, and

"(6) such other information as the Secretary may by regulations prescribe.

"(b) EXCEPTIONS.—Subsection (a) shall not apply to—

"(1) CASH.—Any gift of cash.

"(2) GIFTS TO CHARITY.—Any gift to an organization described in section 501(c) and exempt from tax under section 501(a) but only if no interest in the property is held for the benefit of any person other than such an organization.

"(3) WAIVER OF CERTAIN PENSION RIGHTS individual waives, before the death of a participant, any survivor benefit, or right to such benefit, under section 401(a)(11) or 417, subsection (a) shall not apply to such waiver.

"(4) REPORTING ELSEWHERE.—Any gift required to be reported to the Secretary under any other provision of this title.

"(c) STATEMENTS TO BE FURNISHED TO CERTAIN PERSONS.—Every person required to make a return under subsection (a) shall furnish to each person whose name is required to be set forth in such return a written statement showing—

"(1) the name, address, and phone number of the person required to make such return, and

"(2) the information specified in subsection (a) with respect to property received by the person required to receive such statement.

The written statement required under the preceding sentence shall be furnished on or before January 31 of the year following the calendar year for which the return under subsection (a) was required to be made."

(2) TIME FOR FILING SECTION 6018 RETURNS.—

(A) RETURNS RELATING TO LARGE TRANSFERS AT DEATH.—Subsection (a) of section 6075 is amended to read as follows:

"(a) RETURNS RELATING TO LARGE TRANSFERS AT DEATH.—The return required by section 6018 with respect to a decedent shall be filed with the return of the tax im-

posed by chapter 1 for the decedent's last taxable year or such later date specified in regulations prescribed by the Secretary."

(B) RETURNS RELATING TO LARGE LIFETIME GIFTS.—

(i) The heading for section 6075(b) is amended to read as follows:

"(b) RETURNS RELATING TO LARGE LIFETIME GIFTS.—".

(ii) Paragraph (1) of section 6075(b) is amended by striking "(relating to gift taxes)" and inserting "(relating to returns relating to large lifetime gifts)".

(iii) Paragraph (3) of section 6075(b) is amended—

(I) by striking "ESTATE TAX RETURN" and inserting "SECTION 6018 RETURN", and

(II) by striking "(relating to estate tax returns)" and inserting "(relating to returns relating to large transfers at death)".

(3) PENALTIES.—Part I of subchapter B of chapter 68 (relating to assessable penalties) is amended by adding at the end the following new section:

"SEC. 6716. FAILURE TO FILE INFORMATION WITH RESPECT TO CERTAIN TRANSFERS AT DEATH AND GIFTS.

"(a) INFORMATION REQUIRED TO BE FURNISHED TO THE SECRETARY.—Any person required to furnish any information under section 6018 or 6019 who fails to furnish such information on the date prescribed therefor (determined with regard to any extension of time for filing) shall pay a penalty of $10,000 ($500 in the case of information required to be furnished under section 6018(b)(2) or 6019) for each such failure.

"(b) INFORMATION REQUIRED TO BE FURNISHED TO BENEFICIARIES.—Any person required to furnish in writing to each person described in section 6018(e) or 6019(c) the information required under such section who fails to furnish such information shall pay a penalty of $50 for each such failure.

"(c) REASONABLE CAUSE EXCEPTION.—No penalty shall be imposed under subsection (a) or (b) with respect to any failure if it is shown that such failure is due to reasonable cause.

"(d) INTENTIONAL DISREGARD.—If any failure under subsection (a) or (b) is due to intentional disregard of the requirements under sections 6018 and 6019, the penalty under such subsection shall be 5 percent of the fair market value (as of the date of death or, in the case of section 6019, the date of the gift) of the property with respect to which the information is required.

"(e) DEFICIENCY PROCEDURES NOT TO APPLY.—Subchapter B of chapter 63 (relating to deficiency procedures for income, estate, gift, and certain excise taxes) shall not apply in respect of the assessment or collection of any penalty imposed by this section."

(4) CLERICAL AMENDMENTS.—

(A) The table of sections for part I of subchapter B of chapter 68 is amended by adding at the end the following new item:

"Sec. 6716. Failure to file information with respect to certain transfers at death and gifts."

(B) The item relating to subpart C in the table of subparts for part II of subchapter A of chapter 61 is amended to read as follows:

"Subpart C. Returns relating to transfers during life or at death."

(c) EXCLUSION OF GAIN ON SALE OF PRINCIPAL RESIDENCE MADE AVAILABLE TO HEIR OF DECEDENT IN CERTAIN CASES.—Subsection (d) of section 121 (relating to exclusion of gain from sale of principal residence) is amended by adding at the end the following new paragraph:

"(9) PROPERTY ACQUIRED FROM A DECEDENT.—The exclusion under this section shall apply to property sold by—

"(A) the estate of a decedent, and

"(B) any individual who acquired such property from the decedent (within the meaning of section 1022),

determined by taking into account the ownership and use by the decedent."

(d) TRANSFERS OF APPRECIATED CARRYOVER BASIS PROPERTY TO SATISFY PECUNIARY BEQUEST.—

(1) IN GENERAL.—Section 1040 (relating to transfer of certain farm, etc., real property) is amended to read as follows:

"SEC. 1040. USE OF APPRECIATED CARRYOVER BASIS PROPERTY TO SATISFY PECUNIARY BEQUEST.

"(a) IN GENERAL.—If the executor of the estate of any decedent satisfies the right of any person to receive a pecuniary bequest with appreciated property, then gain on such exchange shall be recognized to the estate only to the extent that, on the

date of such exchange, the fair market value of such property exceeds such value on the date of death.

"(b) SIMILAR RULE FOR CERTAIN TRUSTS.—To the extent provided in regulations prescribed by the Secretary, a rule similar to the rule provided in subsection (a) shall apply where—

"(1) by reason of the death of the decedent, a person has a right to receive from a trust a specific dollar amount which is the equivalent of a pecuniary bequest, and

"(2) the trustee of a trust satisfies such right with property.

"(c) BASIS OF PROPERTY ACQUIRED IN EXCHANGE DESCRIBED IN SUBSECTION (a) OR (b).—The basis of property acquired in an exchange with respect to which gain realized is not recognized by reason of subsection (a) or (b) shall be the basis of such property immediately before the exchange increased by the amount of the gain recognized to the estate or trust on the exchange."

(2) The item relating to section 1040 in the table of sections for part III of subchapter O of chapter 1 is amended to read as follows:

"Sec. 1040. Use of appreciated carryover basis property to satisfy pecuniary bequest."

(e) ANTI-ABUSE RULES.—Section 7701 is amended by redesignating subsection (n) as subsection (o) and by inserting after subsection (m) the following new subsection:

"(n) PURPORTED GIFTS MAY BE DISREGARDED.—For purposes of subtitle A, the Secretary may treat a transfer which purports to be a gift as having never been transferred if, in connection with such transfer—

"(1)(A) the transferor (or any person related to or designated by the transferor or such person) has received anything of value in connection with such transfer from the transferee directly or indirectly, or

"(B) there is an understanding or expectation that the transferor (or such person) will receive anything of value in connection with such transfer from the transferee directly or indirectly, and

"(2) the Secretary determines that such treatment is appropriate to prevent avoidance of tax imposed by subtitle A."

(f) MISCELLANEOUS AMENDMENTS RELATED TO CARRYOVER BASIS.—

(1) RECOGNITION OF GAIN ON TRANSFERS TO NONRESIDENTS.—

(A) Subsection (a) of section 684 is amended by inserting "or to a nonresident not a citizen of the United States" after "or trust".

"(B) Subsection (b) of section 684 is amended by striking "any person" and inserting "any United States person".

(C) The section heading for section 684 is amended by inserting "and nonresident aliens" after "estates".

(D) The item relating to section 684 in the table of sections for subpart F of part I of subchapter J of chapter 1 is amended by inserting "and nonresident aliens" after "estates".

(2) CAPITAL GAIN TREATMENT FOR INHERITED ART WORK OR SIMILAR PROPERTY.—

(A) IN GENERAL.—Subparagraph (C) of section 1221(a)(3) (defining capital asset) is amended by inserting "(other than by reason of section 1022)" after "is determined".

(B) COORDINATION WITH SECTION 170.—Paragraph (1) of section 170(e) (relating to certain contributions of ordinary income and capital gain property) is amended by adding at the end the following: "For purposes of this paragraph, the determination of whether property is a capital asset shall be made without regard to the exception contained in section 1221(a)(3)(C) for basis determined under section 1022.".

(3) DEFINITION OF EXECUTOR.—Section 7701(a) (relating to definitions) is amended by adding at the end the following:

"(47) EXECUTOR.—The term 'executor' means the executor or administrator of the decedent, or, if there is no executor or administrator appointed, qualified, and acting within the United States, then any person in actual or constructive possession of any property of the decedent.".

(4) CERTAIN TRUSTS.—Subparagraph (A) of section 4947(a)(2) is amended by inserting "642(c)," after "170(f)(2)(B),".

(5) OTHER AMENDMENTS.—

(A) Section 1246 is amended by striking subsection (e).

(B) Subsection (e) of section 1291 is amended—

(i) by striking "(e),", and

(ii) by striking "; except that" and all that follows and inserting a period.

(C) Section 1296 is amended by striking subsection (i).

(6) CLERICAL AMENDMENT.—The table of sections for part II of subchapter O of chapter 1 is amended by inserting after the item relating to section 1021 the following new item:

"Sec. 1022. Treatment of property acquired from a decedent dying after December 31, 2010.".

(g) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to estates of decedents dying after December 31, 2010.

(2) PURPORTED GIFTS, ETC.—The amendments made by subsections (e) and (f)(1) shall apply to transfers after December 31, 2010.

(3) SECTION 4947.—The amendment made by subsection (f)(4) shall apply to deductions for taxable years beginning after December 31, 2010.

(h) STUDY.—The Secretary of the Treasury or the Secretary's delegate shall conduct a study of—

(1) opportunities for avoidance of the income tax, if any, and

(2) potential increases in income tax revenues,

by reason of the enactment of this Act. The study shall be submitted to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate not later than December 31, 2002.

TITLE V—CONSERVATION EASEMENTS

SEC. 501. EXPANSION OF ESTATE TAX RULE FOR CONSERVATION EASEMENTS.

(a) WHERE LAND IS LOCATED.—Clause (i) of section 2031(c)(8)(A) (defining land subject to a conservation easement) is amended—

(1) by striking "25 miles" each place it appears and inserting "50 miles"; and

(2) striking "10 miles" and inserting "25 miles".

(b) CLARIFICATION OF DATE FOR DETERMINING VALUE OF LAND AND EASEMENT.—Section 2031(c)(2) (defining applicable percentage) is amended by adding at the end the following new sentence: "The values taken into account under the preceding sentence shall be such values as of the date of the contribution referred to in paragraph (8)(B).".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to estates of decedents dying after December 31, 2000.

TITLE VI—MODIFICATIONS OF GENERATION-SKIPPING TRANSFER TAX

SEC. 601. DEEMED ALLOCATION OF GST EXEMPTION TO LIFETIME TRANSFERS TO TRUSTS; RETROACTIVE ALLOCATIONS.

(a) IN GENERAL.—Section 2632 (relating to special rules for allocation of GST exemption) is amended by redesignating subsection (c) as subsection (e) and by inserting after subsection (b) the following new subsections:

"(c) DEEMED ALLOCATION TO CERTAIN LIFETIME TRANSFERS TO GST TRUSTS.—

"(1) IN GENERAL.—If any individual makes an indirect skip during such individual's lifetime, any unused portion of such individual's GST exemption shall be allocated to the property transferred to the extent necessary to make the inclusion ratio for such property zero. If the amount of the indirect skip exceeds such unused portion, the entire unused portion shall be allocated to the property transferred.

"(2) UNUSED PORTION.—For purposes of paragraph (1), the unused portion of an individual's GST exemption is that portion of such exemption which has not previously been—

"(A) allocated by such individual,

"(B) treated as allocated under subsection (b) with respect to a direct skip occurring during or before the calendar year in which the indirect skip is made, or

"(C) treated as allocated under paragraph (1) with respect to a prior indirect skip.

"(3) DEFINITIONS.—

"(A) INDIRECT SKIP.—For purposes of this subsection, the term 'indirect skip' means any transfer of property (other than a direct skip) subject to the tax imposed by chapter 12 made to a GST trust.

"(B) GST TRUST.—The term 'GST trust' means a trust that could have a generation-skipping transfer with respect to the transferor unless—

"(i) the trust instrument provides that more than 25 percent of the trust corpus must be distributed to or may be withdrawn by one or more individuals who are non-skip persons—

"(I) before the date that the individual attains age 46,

"(II) on or before one or more dates specified in the trust instrument that will occur before the date that such individual attains age 46, or

"(III) upon the occurrence of an event that, in accordance with regulations prescribed by the Secretary, may reasonably be expected to occur before the date that such individual attains age 46;

"(ii) the trust instrument provides that more than 25 percent of the trust corpus must be distributed to or may be withdrawn by one or more individuals who are non-skip persons and who are living on the date of death of another person identified in the instrument (by name or by class) who is more than 10 years older than such individuals;

"(iii) the trust instrument provides that, if one or more individuals who are non-skip persons die on or before a date or event described in clause (i) or (ii), more than 25 percent of the trust corpus either must be distributed to the estate or estates of one or more of such individuals or is subject to a general power of appointment exercisable by one or more of such individuals;

"(iv) the trust is a trust any portion of which would be included in the gross estate of a non-skip person (other than the transferor) if such person died immediately after the transfer;

"(v) the trust is a charitable lead annuity trust (within the meaning of section 2642(e)(3)(A)) or a charitable remainder annuity trust or a charitable remainder unitrust (within the meaning of section 664(d)); or

"(vi) the trust is a trust with respect to which a deduction was allowed under section 2522 for the amount of an interest in the form of the right to receive annual payments of a fixed percentage of the net fair market value of the trust property (determined yearly) and which is required to pay principal to a non-skip person if such person is alive when the yearly payments for which the deduction was allowed terminate.

For purposes of this subparagraph, the value of transferred property shall not be considered to be includible in the gross estate of a non-skip person or subject to a right of withdrawal by reason of such person holding a right to withdraw so much of such property as does not exceed the amount referred to in section 2503(b) with respect to any transferor, and it shall be assumed that powers of appointment held by non-skip persons will not be exercised.

"(4) AUTOMATIC ALLOCATIONS TO CERTAIN GST TRUSTS.—For purposes of this subsection, an indirect skip to which section 2642(f) applies shall be deemed to have been made only at the close of the estate tax inclusion period. The fair market value of such transfer shall be the fair market value of the trust property at the close of the estate tax inclusion period.

"(5) APPLICABILITY AND EFFECT.—

"(A) IN GENERAL.—An individual—

"(i) may elect to have this subsection not apply to—

"(I) an indirect skip, or

"(II) any or all transfers made by such individual to a particular trust, and

"(ii) may elect to treat any trust as a GST trust for purposes of this subsection with respect to any or all transfers made by such individual to such trust.

"(B) ELECTIONS.—

"(i) ELECTIONS WITH RESPECT TO INDIRECT SKIPS.—An election under subparagraph (A)(i)(I) shall be deemed to be timely if filed on a timely filed gift tax return for the calendar year in which the transfer was made or deemed to have been made pursuant to paragraph (4) or on such later date or dates as may be prescribed by the Secretary.

"(ii) OTHER ELECTIONS.—An election under clause (i)(II) or (ii) of subparagraph (A) may be made on a timely filed gift tax return for the calendar year for which the election is to become effective.

"(d) RETROACTIVE ALLOCATIONS.—

"(1) IN GENERAL.—If—

"(A) a non-skip person has an interest or a future interest in a trust to which any transfer has been made,

"(B) such person—

"(i) is a lineal descendant of a grandparent of the transferor or of a grandparent of the transferor's spouse or former spouse, and

"(ii) is assigned to a generation below the generation assignment of the transferor, and

"(C) such person predeceases the transferor,

then the transferor may make an allocation of any of such transferor's unused GST exemption to any previous transfer or transfers to the trust on a chronological basis.

"(2) SPECIAL RULES.—If the allocation under paragraph (1) by the transferor is made on a gift tax return filed on or before the date prescribed by section 6075(b) for gifts made within the calendar year within which the non-skip person's death occurred—

"(A) the value of such transfer or transfers for purposes of section 2642(a) shall be determined as if such allocation had been made on a timely filed gift tax return for each calendar year within which each transfer was made,

"(B) such allocation shall be effective immediately before such death, and

"(C) the amount of the transferor's unused GST exemption available to be allocated shall be determined immediately before such death.

"(3) FUTURE INTEREST.—For purposes of this subsection, a person has a future interest in a trust if the trust may permit income or corpus to be paid to such person on a date or dates in the future.".

(b) CONFORMING AMENDMENT.—Paragraph (2) of section 2632(b) is amended by striking "with respect to a prior direct skip" and inserting "or subsection (c)(1)".

(c) EFFECTIVE DATES.—

(1) DEEMED ALLOCATION.—Section 2632(c) of the Internal Revenue Code of 1986 (as added by subsection (a)), and the amendment made by subsection (b), shall apply to transfers subject to chapter 11 or 12 made after December 31, 2000, and to estate tax inclusion periods ending after December 31, 2000.

(2) RETROACTIVE ALLOCATIONS.—Section 2632(d) of the Internal Revenue Code of 1986 (as added by subsection (a)) shall apply to deaths of non-skip persons occurring after December 31, 2000.

SEC. 602. SEVERING OF TRUSTS.

(a) IN GENERAL.—Subsection (a) of section 2642 (relating to inclusion ratio) is amended by adding at the end the following new paragraph:

"(3) SEVERING OF TRUSTS.—

"(A) IN GENERAL.—If a trust is severed in a qualified severance, the trusts resulting from such severance shall be treated as separate trusts thereafter for purposes of this chapter.

"(B) QUALIFIED SEVERANCE.—For purposes of subparagraph (A)—

"(i) IN GENERAL.—The term 'qualified severance' means the division of a single trust and the creation (by any means available under the governing instrument or under local law) of two or more trusts if—

"(I) the single trust was divided on a fractional basis, and

"(II) the terms of the new trusts, in the aggregate, provide for the same succession of interests of beneficiaries as are provided in the original trust.

"(ii) TRUSTS WITH INCLUSION RATIO GREATER THAN ZERO.—If a trust has an inclusion ratio of greater than zero and less than 1, a severance is a qualified severance only if the single trust is divided into two trusts, one of which receives a fractional share of the total value of all trust assets equal to the applicable fraction of the single trust immediately before the severance. In such case, the trust receiving such fractional share shall have an inclusion ratio of zero and the other trust shall have an inclusion ratio of 1.

"(iii) REGULATIONS.—The term 'qualified severance' includes any other severance permitted under regulations prescribed by the Secretary.

"(C) TIMING AND MANNER OF SEVERANCES.—A severance pursuant to this paragraph may be made at any time. The Secretary shall prescribe by forms or regulations the manner in which the qualified severance shall be reported to the Secretary.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to severances after December 31, 2000.

SEC. 603. MODIFICATION OF CERTAIN VALUATION RULES.

(a) GIFTS FOR WHICH GIFT TAX RETURN FILED OR DEEMED ALLOCATION MADE.—Paragraph (1) of section 2642(b) (relating to valuation rules, etc.) is amended to read as follows:

"(1) GIFTS FOR WHICH GIFT TAX RETURN FILED OR DEEMED ALLOCATION MADE.—If the allocation of the GST exemption to any transfers of property is made on a gift tax return filed on or before the date prescribed by section 6075(b) for such transfer or is deemed to be made under section 2632 (b)(1) or (c)(1)—

"(A) the value of such property for purposes of subsection (a) shall be its value as finally determined for purposes of chapter 12 (within the meaning of section 2001(f)(2)), or, in the case of an allocation deemed to have been made at the close of an estate tax inclusion period, its value at the time of the close of the estate tax inclusion period, and

"(B) such allocation shall be effective on and after the date of such transfer, or, in the case of an allocation deemed to have been made at the close of an estate tax inclusion period, on and after the close of such estate tax inclusion period.".

(b) TRANSFERS AT DEATH.—Subparagraph (A) of section 2642(b)(2) is amended to read as follows:

"(A) TRANSFERS AT DEATH.—If property is transferred as a result of the death of the transferor, the value of such property for purposes of subsection (a) shall be its value as finally determined for purposes of chapter 11; except that, if the requirements prescribed by the Secretary respecting allocation of post-death changes in value are not met, the value of such property shall be determined as of the time of the distribution concerned.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to transfers subject to chapter 11 or 12 of the Internal Revenue Code of 1986 made after December 31, 2000.

SEC. 604. RELIEF PROVISIONS.

(a) IN GENERAL.—Section 2642 is amended by adding at the end the following new subsection:

"(g) RELIEF PROVISIONS.—

"(1) RELIEF FROM LATE ELECTIONS.—

"(A) IN GENERAL.—The Secretary shall by regulation prescribe such circumstances and procedures under which extensions of time will be granted to make—

"(i) an allocation of GST exemption described in paragraph (1) or (2) of subsection (b), and

"(ii) an election under subsection (b)(3) or (c)(5) of section 2632.

Such regulations shall include procedures for requesting comparable relief with respect to transfers made before the date of the enactment of this paragraph.

"(B) BASIS FOR DETERMINATIONS.—In determining whether to grant relief under this paragraph, the Secretary shall take into account all relevant circumstances, including evidence of intent contained in the trust instrument or instrument of transfer and such other factors as the Secretary deems relevant. For purposes of determining whether to grant relief under this paragraph, the time for making the allocation (or election) shall be treated as if not expressly prescribed by statute.

"(2) SUBSTANTIAL COMPLIANCE.—An allocation of GST exemption under section 2632 that demonstrates an intent to have the lowest possible inclusion ratio with respect to a transfer or a trust shall be deemed to be an allocation of so much of the transferor's unused GST exemption as produces the lowest possible inclusion ratio. In determining whether there has been substantial compliance, all relevant circumstances shall be taken into account, including evidence of intent contained in the trust instrument or instrument of transfer and such other factors as the Secretary deems relevant.".

(b) EFFECTIVE DATES.—

(1) RELIEF FROM LATE ELECTIONS.—Section 2642(g)(1) of the Internal Revenue Code of 1986 (as added by subsection (a)) shall apply to requests pending on, or filed after, December 31, 2000.

(2) SUBSTANTIAL COMPLIANCE.—Section 2642(g)(2) of such Code (as so added) shall apply to transfers subject to chapter 11 or 12 of the Internal Revenue Code of 1986 made after December 31, 2000. No implication is intended with respect to the availability of relief from late elections or the application of a rule of substantial compliance on or before such date.

TITLE VII—EXTENSION OF TIME FOR PAYMENT OF ESTATE TAX

SEC. 701. INCREASE IN NUMBER OF ALLOWABLE PARTNERS AND SHAREHOLDERS IN CLOSELY HELD BUSINESSES.

(a) IN GENERAL.—Paragraphs (1)(B)(ii), (1)(C)(ii), and (9)(B)(iii)(I) of section 6166(b) (relating to definitions and special rules) are each amended by striking "15" and inserting "45".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to estates of decedents dying after December 31, 2001.

I. SUMMARY AND BACKGROUND

A. PURPOSE AND SUMMARY

PURPOSE

The bill, H.R. 8, as amended (the "Death Tax Elimination Act of 2001"), repeals the estate, gift, and generation-skipping transfer taxes.

SUMMARY

Phaseout and repeal of estate, gift, and generation-skipping transfer taxes

Phaseout and repeal of estate, gift, and generation-skipping transfer taxes

The estate and gift tax rates above 53 percent and the 5-percent surtax, which phases out the benefit of the graduated rates, are repealed for decedents dying and gifts and generation-skipping transfers made after December 31, 2001. The rates in excess of 50 percent are repealed for decedents dying and gifts and generation-skipping transfers made after December 31, 2002. Each estate and gift tax rate is reduced by one percentage point in each year 2004 through 2006 and by two percentage points in each year 2007 through 2010. The estate, gift, and generation-skipping transfer taxes are repealed, and a carryover basis regime takes effect for decedents dying and gifts and generation-skipping transfers made after December 31, 2010.

Replace unified credit with unified exemption

The bill replaces the unified credit with a unified exemption for decedents dying and gifts made after December 31, 2001.

Basis of property acquired from a decedent

In general.—After repeal, the basis of assets received from a decedent generally will be the basis in the hands of the decedent (i.e., a carryover basis). However, an executor is permitted to increase (i.e., step up) the basis of assets transferred by up to a total of $1.3 million. In addition, the basis of property transferred to a surviving spouse can be increased (i.e., stepped up) by an additional $3 million. For these purposes, an executor will elect which and to what extent assets receive an increase in basis.

Reporting requirements.—A donor is required to report to the Internal Revenue Service ("IRS") and beneficiaries the basis, character, and other information regarding the transfer of non-cash assets with a value in excess of $25,000. In addition, for transfers at

death of non-cash assets in excess of $1.3 million and for appreciated property in excess of $25,000 received by a decedent within three years of death, the executor is required to report to the IRS and beneficiaries the basis, character, and other information regarding the transfer of such property. Penalties will apply for the failure to report to the IRS and beneficiaries the required information.

Modify generation-skipping transfer tax rules

The bill deems there to have been generation-skipping transfer tax exemption allocated to transfers made during life that are "indirect skips," which are transfers to generation-skipping transfer trusts that are not direct skips. The bill also allows the retroactive allocation of generation-skipping transfer tax exemption when there is an unnatural order of death. Moreover, the bill allows a trust holding property with an inclusion ratio greater than zero to be severed at any time in a "qualified severance." In addition, the valuation rules are modified such that, for timely and automatic allocations of generation-skipping transfer tax exemption, the value of the property for purposes of determining the inclusion ratio is its finally determined gift tax value or estate tax value depending on the circumstances of the transfer. The bill also authorizes and directs the Treasury Secretary to grant extensions of time to make the election to allocate generation-skipping transfer tax exemption and to grant exceptions to the time requirement. Finally, the bill provides that substantial compliance with the statutory and regulatory requirements for allocating generation-skipping transfer tax exemption was allocated to a particular transfer or trust. The generation-skipping transfer tax provisions are effective after December 31, 2000.

Expand estate tax rule for conservation easements

The bill expands the availability of qualified conservation easements by modifying the distance requirements. Under the bill, the distance within which the land must be situated from a metropolitan area, national park, or wilderness area is increased from 25 to 50 miles, and the distance from which the land must be situated from an Urban National Forest is increased from 10 to 25 miles. The bill also clarifies that the date for determining easement compliance is the date on which the donation was made. The provisions are effective for estates of decedents dying after December 31, 2000.

Expand availability of installment payment of estate tax for estates of decedents with an interest in a closely-held business

The bill expands availability of installment payment of estate tax for decedents with an interest in a closely-held business by expanding the definition of a closely-held business. The bill increases from 15 to 45 the number of partners in a partnership and shareholders in a corporation that is considered a closely-held business in which a decedent held an interest, and thus will qualify the estate for installment payment of estate tax. The provision is effective for estates of decedent dying after December 31, 2001.

B. Background and Need for Legislation

The provisions approved by the Committee reflect the need for tax relief for all decedents' estates, decedents' heirs, and businesses, including small businesses, family-owned businesses, and farming businesses. This will provide needed tax relief for these taxpayers from the unduly burdensome estate, gift, and generation-skipping transfer taxes. The estimated revenue effects of the provisions comply with the most recent Congressional Budget Office revisions of budget surplus projections.

C. Legislative History

COMMITTEE ACTION

The bill, H.R. 8, was introduced by Ms. Dunn on March 14, 2001. The Committee on Ways and Means marked up the bill on March 29, 2001, and approved the bill with a Chairman's amendment in the nature of a substitute, by a roll call vote of 24 yeas and 14 nays, with a quorum present.

II. EXPLANATION OF THE BILL

A. Phase in Repeal of Estate, Gift, and Generation-Skipping Transfer Taxes (Secs. 101, 201, 301, and 401–402 of the Bill, Secs. 121, 684, 1014, 1040, 1221, 2001–2704, 4947, and 7701 of the Code, and New Secs. 1022, 6018, 6019, and 6716 of the Code)

PRESENT LAW

Estate and gift tax rules

In general

Under present law, a gift tax is imposed on lifetime transfers and an estate tax is imposed on transfers at death. The gift tax and the estate tax are unified so that a single graduated rate schedule applies to cumulative taxable transfers made by a taxpayer during his or her lifetime and at death. The unified estate and gift tax rates begin at 18 percent on the first $10,000 in cumulative taxable transfers and reach 55 percent on cumulative taxable transfers over $3 million. In addition, a 5-percent surtax is imposed on cumulative taxable transfers between $10 million and $17,184,000, which has the effect of phasing out the benefit of the graduated rates. Thus, these estates are subject to a top marginal rate of 60 percent. Estates over $17,184,000 are subject to a flat rate of 55 percent, as the benefit of the graduated rates has been phased out.

GIFT TAX ANNUAL EXCLUSION

Donors of lifetime gifts are provided an annual exclusion of $10,000 (indexed for inflation occurring after 1997) of transfers of present interests in property to any one donee during the taxable year. If the non-donor spouse consents to split the gift with the donor spouse, then the annual exclusion is $20,000. Unlimited transfers between spouses are permitted without imposition of a gift tax.

Unified credit

A unified credit is available with respect to taxable transfers by gift and at death. The unified credit amount effectively exempts from tax transfers totaling $675,000 in 2001, $700,000 in 2002 and 2003, $850,000 in 2004, $950,000 in 2005, and $1 million in 2006 and thereafter. The benefit of the unified credit applies at the lowest estate and gift tax rates. For example, in 2001, the unified credit applies between the 18-percent and 37-percent estate and gift tax rates. Thus, in 2001, taxable transfers, after application of the unified credit, are effectively subject to estate and gift tax rates beginning at 37 percent.

Transfers to a surviving spouse

A 100-percent marital deduction generally is permitted for the value of property transferred between spouses. In addition, transfers of a "qualified terminable interest" also are eligible for the marital deduction. A "qualified terminable interest" is property: (1) which passes from the decedent, (2) in which the surviving spouse has a "qualifying income interest for life," and (3) to which an election under these rules applies. A "qualifying income interest for life" exists if: (1) the surviving spouse is entitled to all the income from the property (payable annually or at more frequent intervals) or the right to use property during the spouse's life, and (2) no person has the power to appoint any part of the property to any person other than the surviving spouse.

EXPENSES, INDEBTEDNESS, AND TAXES

An estate tax deduction is allowed for funeral expenses and administration expenses of an estate. An estate tax deduction also is allowed for claims against the estate and unpaid mortgages on, or any indebtedness in respect of, property for which the value of the decedent's interest therein, undiminished by the debt, is included in the value of the gross estate.

If the total amount of claims and debts against the estate exceeds the value of the property to which the claims relate, an estate tax deduction for the excess is allowed, provided such excess is paid before the due date of the estate tax return. A deduction for claims against the estate generally is permitted only if allowable by the law of the jurisdiction under which the estate is being administered.

A deduction also is allowed for the full unpaid amount of any mortgage upon, or of any other indebtedness in respect of, any property of the gross estate (including interest which has accrued thereon to the date of the decedent's death), provided that the full value of the underlying property is included in the decedent's gross estate.

Basis of property received

In general.—A taxpayer who receives property from a decedent's estate or from a donor of a lifetime gift may want to sell or otherwise dispose of the property. Gain or loss, if any, on the disposition of the property is measured by the taxpayer's amount realized (e.g., gross proceeds received) on the disposition, less the taxpayer's basis in such property.

Basis generally represents a taxpayer's investment in property with certain adjustments required after acquisition. For example, basis is increased by the cost of capital improvements made to the property and decreased by depreciation deductions taken with respect to the property.

Property received from a donor of a lifetime gift takes a carryover basis. "Carryover basis" means that the basis in the hands of the donee is the same as it was in the hands of the donor plus any gift tax paid on any unrealized appreciation. The basis of a lifetime gift, however, generally cannot exceed the property's fair market value on the date of the gift.

Property passing from a decedent's estate generally takes a stepped-up basis. "Stepped-up basis" for estate tax purposes means that the basis of property passing from a decedent's estate generally is the fair market value on the date of the decedent's death (or, if the alternate valuation date is elected, the earlier of six months or the date the property is sold or distributed by the estate). This step up (or step down) in basis eliminates the recognition of any income on the appreciation of the property that occurred prior to the decedent's death, and has the effect of eliminating the tax benefit from any unrealized loss.

In community property states, a surviving spouse's one-half share of community property held by the decedent and the surviving spouse (under the community property laws of any State, U.S. possession, or foreign country) generally is treated as having passed from the decedent, and thus is eligible for stepped-up basis. This rule applies if at least one-half of the whole of the community interest is includible in the decedent's gross estate.

Special rules for interests in certain foreign entities.—Stepped-up basis treatment generally is denied to certain interests in foreign entities. Under present law, stock or securities in a foreign personal holding company takes a carryover basis. Stock in a foreign investment company takes a stepped up basis reduced by the decedent's ratable share of accumulated earnings and profits. In addition, stock in a passive foreign investment company (including those for which a mark-to-market election has been made) generally takes a carryover basis, except that a passive foreign investment company for which a decedent shareholder had made a qualified electing fund election is allowed a stepped up basis. Stock owned by a decedent in a domestic international sales corporation (or former domestic international sales corporation) takes a stepped up basis reduced by the amount (if any) which would have been included in gross income under section 995(c) as a dividend if the decedent had lived and sold the stock at its fair market value on the estate tax valuation date (i.e., generally the date of the decedent's death unless an alternate valuation date is elected).

Provisions affecting small and family-owned businesses and farms

Special-use valuation.—An executor can elect for estate tax purposes to value certain "qualified real property" used in farming or another qualifying closely-held trade or business at its current-use value, rather than its fair market value. The maximum reduction in value for such real property is $750,000 (adjusted for inflation occurring after 1997). Real property generally can qualify for spe-

cial-use valuation if at least 50 percent of the adjusted value of the decedent's gross estate consists of a farm or closely-held business assets in the decedent's estate (including both real and personal property) and at least 25 percent of the adjusted value of the gross estate consists of farm or closely-held business property. In addition, the property must be used in a qualified use (e.g., farming) by the decedent or a member of the decedent's family for five of the eight years before the decedent's death.

If, after a special-use valuation election is made, the heir who acquired the real property ceases to use it in its qualified use within 10 years of the decedent's death, an additional estate tax is imposed in order to recapture the entire estate-tax benefit of the special-use valuation.

Family-owned business deduction.—An estate is permitted to deduct the adjusted value of a qualified-family owned business interest of the decedent, up to $675,000.[1] A qualified family-owned business interest is defined as any interest in a trade or business (regardless of the form in which it is held) with a principal place of business in the United States if the decedent's family owns at least 50 percent of the trade or business, two families own 70 percent, or three families own 90 percent, as long as the decedent's family owns at least 30 percent of the trade or business. An interest in a trade or business does not qualify if any interest in the business (or a related entity) was publicly-traded at any time within three years of the decedent's death. An interest in a trade or business also does not qualify if more than 35 percent of the adjusted ordinary gross income of the business for the year of the decedent's death was personal holding company income. In the case of a trade or business that owns an interest in another trade or business (i.e., "tiered entities"), special look-through rules apply. The value of a trade or business qualifying as a family-owned business interest is reduced to the extent the business holds passive assets or excess cash or marketable securities.

To qualify for the exclusion, the decedent (or a member of the decedent's family) must have owned and materially participated in the trade or business for at least five of the eight years preceding the decedent's date of death. In addition, at least one qualified heir (or member of the qualified heir's family) is required to materially participate in the trade or business for at least 10 years following the decedent's death.

The qualified family-owned business rules provide a graduated recapture based on the number of years after the decedent's death in which the disqualifying event occurred. Under the provision, if the disqualifying event occurred within six years of the decedent's death, then 100 percent of the tax is recaptured. The remaining percentage of recapture based on the year after the decedent's death in which a disqualifying event occurs is as follows: the disqualifying event occurs during the seventh year after the dece-

[1] The qualified family-owned business deduction and the unified credit effective exemption amount are coordinated. If the maximum deduction amount of $675,000 is elected then the unified credit effective exemption amount if $625,000, for a total of $1.3 million. If the qualified family-owned business deduction is less than $675,000 then the unified credit effective exemption amount is equal to $625,000, increased by the difference between $675,000 and the amount of the qualified family-owned business deduction. However, the unified credit effective exemption amount cannot be increased above the generally applicable exemption amount in effect for the taxable year.

dent's death, 80 percent; during the eighth year after the decedent's death, 60 percent; during the ninth year after the decedent's death, 40 percent; and during the tenth year after the decedent's death, 20 percent. For purposes of the qualified family-owned business deduction, the contribution of a qualified conservation easement is not considered a disposition that would trigger recapture of estate tax.

In general, there is no requirement that the qualified heir (or members of his or her family) continue to hold or participate in the trade or business more than 10 years after the decedent's death. However, the 10–year recapture period can be extended for a period of up to two years if the qualified heir does not begin to use the property for a period of up to two years after the decedent's death.

An estate can claim the benefits of both the qualified family-owned business deduction and special-use valuation. For purposes of determining whether the value of the trade or business exceeds 50 percent of the decedent's gross estate, if the estate claimed special-use valuation, then the property's special-use value is used.

State death tax credit

A credit is allowed against the Federal estate tax for any estate, inheritance, legacy, or succession taxes actually paid to any State or the District of Columbia with respect to any property included in the decedent's gross estate. The maximum amount of credit allowable for State death taxes is determined under a graduated rate table, based on the size of the decedent's adjusted taxable estate. Most States impose a "pick-up" or "soak-up" estate tax, which applies when the State death tax liability is less than the maximum Federal death tax credit. This provides States with the maximum amount of death tax for which the State death tax credit provides.

Estate and gift taxation of nonresident noncitizens

Nonresident noncitizens are subject to gift tax with respect to certain transfers by gift of U.S.-situated property. Such property includes real estate and tangible property located within the United States. Nonresident noncitizens generally are not subject to U.S. gift tax on the transfer of intangibles, such as stock or securities, regardless of where such property is situated.

Estates of nonresident noncitizens generally are taxed at the same estate tax rates applicable to U.S. citizens, but the taxable estate includes only property situated within the United States that is owned by the decedent at death. This includes the value at death of all property, real or personal, tangible or intangible, situated in the United States. Special rules apply which treat certain property as being situated within and without the United States for these purposes.

Unless modified by a treaty, a nonresident who is not a U.S. citizen generally is allowed a unified credit of $13,000, which effectively exempts $60,000 in assets from estate tax.

Generation-skipping transfer tax

A generation-skipping transfer tax generally is imposed on transfers, either directly or through a trust or similar arrangement, to a "skip person" (i.e., a beneficiary in a generation more than one

generation below that of the transferor). Transfers subject to the generation-skipping transfer tax include direct skips, taxable terminations, and taxable distributions. The generation-skipping transfer tax is imposed at a flat rate of 55 percent (i.e., the top estate and gift tax rate) on cumulative generation-skipping transfers in excess of $1 million (indexed for inflation occurring after 1997).

Selected income tax provisions

Transfers to certain foreign trusts and estates

Transfers by a U.S. person to a foreign trust or estate generally is treated as a sale or exchange of the property for an amount equal to the fair market value of the transferred property. The amount of gain that must be recognized by the transferor is equal to the excess of the fair market value of the property transferred over the adjusted basis (for purposes of determining gain) of such property in the hands of the transferor.

Net operating loss and capital loss carryovers

Under present law, a capital loss and net operating loss from business operations sustained by a decedent during his last taxable year are deductible only on the final return filed in his or her behalf. Such losses are not deductible by his or her estate.

Transfers of property in satisfaction of a pecuniary bequest

Under present law, gain or loss is recognized on the transfer of property in satisfaction of a pecuniary bequest (i.e., a bequest of a specific dollar amount) to the extent that the fair market value of the property at the time of the transfer exceeds the basis of the property, which generally is the basis stepped up to fair market value on the date of the decedent's death.

Income tax exclusion for the gain on the sale of a principal residence

A taxpayer generally can exclude up to $250,000 ($500,000 if married filing a joint return) of gain realized on the sale or exchange of a principal residence. The exclusion is allowed each time a taxpayer selling or exchanging a principal residence meets the eligibility requirements, but generally no more frequently than once every two years.

To be eligible, a taxpayer must have owned the residence and occupied it as a principal residence for at least two of the five years prior to the sale or exchange. A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or other unforeseen circumstances is able to exclude the fraction of the $250,000 ($500,000 if married filing a joint return) equal to the fraction of two years that these requirements are met.

Excise tax on nonexempt trusts

Under present law, split-interest trusts are subject to certain restrictions that are applicable to private foundations if an income, estate, or gift tax charitable deduction was allowed with respect to the trust. A split-interest trust subject to these rules would be prohibited from engaging in self-dealing, retaining any excess business holdings, and from making certain investments or taxable expendi-

tures. Failure to comply with the restrictions would subject the split-interest trust to certain excise taxes imposed on private foundations, which include excise taxes on self-dealing, excess business holdings, investments which jeopardize charitable purposes, and certain taxable expenditures.

REASONS FOR CHANGE

The Committee finds that the estate, gift, and generation-skipping transfer taxes are unduly burdensome on all taxpayers, and particularly decedents' estates, decedents' heirs, and businesses, such as small business, family-owned businesses, and farming businesses. The Committee further believes it is inappropriate to impose a tax by reason of the death of a taxpayer.

EXPLANATION OF PROVISION

Overview of the bill

Beginning in 2011, the estate, gift, and generation-skipping transfers taxes are repealed. After repeal, the basis of assets received from a decedent generally will equal the basis of the decedent (i.e., carryover basis) at death. However, a decedent's estate is permitted to increase the basis of assets transferred by up to a total of $1.3 million. The basis of property transferred to a surviving spouse can be increased (i.e., stepped up) by an additional $3 million. Thus, the basis of property transferred to a surviving spouse can be increased (i.e., stepped up) by a total of $4.3 million. In no case can the basis of an asset be adjusted above its fair market value. For these purposes, the executor will determine which assets and to what extent each asset receives a basis increase. The $1.3 million and $3 million amounts are adjusted annually for inflation occurring after 2010.

In 2002, the unified credit is replaced with a unified exemption, the 5-percent surtax (which phases out the benefit of the graduated rates) and the rates in excess of 53 percent are repealed. Beginning in 2003, the estate, gift, and generation-skipping transfer tax rates are further reduced each year until the estate, gift, and generation-skipping transfer taxes are repealed in 2011.

Phaseout and repeal of estate, gift, and generation-skipping transfer taxes

In general

In 2002, the top estate and gift tax rates above 53 percent are repealed, as are the 5-percent surtax, which phases out the benefit of the graduated rates. In 2003, all rates in excess of 50 percent are repealed. In each year 2004 through 2006, each of the rates of tax is reduced by one percentage point. In each year 2007 through 2010, each of the rates of tax is reduced by two percentage points. The generation-skipping transfer tax rate in effect for a given year is the highest estate and gift tax rate in effect for that year. The reduction in estate and gift tax rates is coordinated with the income tax rates such that the highest estate and gift tax rate (and, thus, the generation-skipping transfer tax rate) will not be reduced below the top individual rate, and the lower estate and gift tax rates will not be reduced below the lowest individual tax rate. For each year 2002 through 2010, the State death tax credit rates are

reduced in proportion to the reduction in the estate and gift tax rates.

Beginning in 2011, the estate, gift, and generation-skipping transfer taxes are repealed.

Replace unified credit with unified exemption

Beginning in 2002, the unified credit is replaced with a unified exemption amount. The unified exemption amount, which will follow the dollar amounts of the present-law unified credit effective exemption amounts, will be determined as follows: in 2002 and 2003, $700,000; in 2004, $850,000; in 2005, $950,000; and in 2006 and thereafter (until repeal in 2011), $1 million. For decedents who are not residents and not citizens of the United States, the exemption is $60,000.

Basis of property acquired from a decedent

In general

Beginning in 2011, after the estate, gift, and generation-skipping transfer taxes have been repealed, the present-law rules providing for a fair market value basis for property acquired from a decedent are repealed. Instead, a modified carryover basis regime generally takes effect. Recipients of property transferred at the decedent's death will receive a basis equal the lesser of the adjusted basis of the decedent or the fair market value of the property on the date of the decedent's death.

The modified carryover basis rules apply to property acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, property passing from the decedent to the extent such property passed without consideration, and certain other property to which the present law rules apply.[2]

Property acquired from a decedent is treated as if the property had been acquired by gift. Thus, the character of gain on the sale of property received from a decedent's estate is carried over to the heir. For example, real estate that has been depreciated and would be subject to recapture if sold by the decedent will be subject to recapture if sold by the heir.

Property to which the modified carryover basis rules apply

The modified carryover basis rules apply to property acquired from the decedent. Property acquired from the decedent is (1) property acquired by bequest, devise, or inheritance, (2) property acquired by the decedent's estate from the decedent, (3) property transferred by the decedent during his or her lifetime in trust to pay the income for life to or on the order or direction of the decedent, with the right reserved to the decedent at all times before his death to revoke the trust,[3] (4) property transferred by the decedent during his lifetime in trust to pay the income for life to or on the order or direction of the decedent with the right reserved to the decedent at all times before his death to make any change to the enjoyment thereof through the exercise of a power to alter, amend,

[2] Sec. 1014(b)(2) and (3).

[3] This is the same property the basis of which is stepped up to date of death fair market value under present law sec. 1014(b)(2).

or terminate the trust,[4] (5) property passing from the decedent by reason of the decedent's death to the extent such property passed without consideration (e.g., property held as joint tenants with right of survivorship or as tenants by the entireties), and (6) the surviving spouse's one-half share of certain community property held by the decedent and the surviving spouse as community property.

Basis increase for certain property

Amount of basis increase.—The bill allows an executor to increase (i.e., step up) the basis in assets owned by the decedent and acquired by the beneficiaries at death. Under this rule, each decedent's estate generally is permitted to increase (i.e., step up) the basis of assets transferred by up to a total of $1.3 million. The $1.3 million is increased by the amount of unused capital losses, net operating losses, and certain "built-in" losses of the decedent. In addition, the basis of property transferred to a surviving spouse can be increased by an additional $3 million. Thus, the basis of property transferred to surviving spouses can be increased by a total of $4.3 million. Nonresidents who are not U.S. citizens will be allowed to increase the basis of property by up to $60,000. The $60,000, $1.3 million, and $3 million amounts are adjusted annually for inflation occurring after 2010.

Property eligible for basis increase.—In general, the basis of property may be increased above the decedent's adjusted basis in that property only if the property is owned, or is treated as owned, by the decedent at the time of the decedent's death. In the case of property held as joint tenants or tenants by the entireties with the surviving spouse, one-half of the property is treated having been owned by the decedent and is thus eligible for the basis increase. In the case of property held jointly with a person other than the surviving spouse, the portion of the property attributable to the decedent's consideration furnished is treated as having been owned by the decedent and will be eligible for a basis increase. The decedent also is treated as the owner of property (which will be eligible for a basis increase) if the property was transferred by the decedent during his lifetime to a revocable trust that pays all of its income during the decedent's life to the decedent or at the direction of the decedent. The decedent also is treated as having owned the surviving spouse's one-half share of community property (which will be eligible for a basis increase) if at least one-half of the property was owned by, and acquired from, the decedent.[5] The decedent shall not, however, be treated as owning any property solely by reason of holding a power of appointment with respect to such property.

Certain property is not eligible for a basis increase. This includes: (1) property that was acquired by the decedent by gift (other than from his or her spouse) during the three-year period ending on the date of the decedent's death; (2) property that constitutes a right to receive income in respect of a decedent; (3) stock or securities of a foreign personal holding company; (4) stock of a

[4] This is the same property the basis of which is stepped up to date of death fair market value under present law sec. 1014(b)(3).

[5] Thus, similar to the present law rule in sec. 1014(b)(6), both the decedent's and the surviving spouse's share of community property could be eligible for a basis increase.

domestic international sales corporation (or former domestic international sales corporation); (5) stock of a foreign investment company; and (6) stock of a passive foreign investment company (except for which a decedent shareholder had made a qualified electing fund election).

Rules applicable to basis increase.—Basis increase will be allocable on an asset-by-asset basis (e.g., basis increase can be allocated to a share of stock or a block of stock). However, in no case can the basis of an asset be adjusted above its fair market value. If the amount of basis increase is less than the fair market value of assets whose bases are eligible to be increased under these rules, the executor will determine which assets and to what extent each asset receives a basis increase.

Reporting requirements

Lifetime gifts

A donor is required to report to the Internal Revenue Service ("IRS") the basis and character of any non-cash property transferred by gift with a value in excess of $25,000 (except for gifts to charitable organizations). The donor is required to report to the IRS:

The name and taxpayer identification number of the donee,

An accurate description of the property,

The adjusted basis of the property in the hands of the donor at the time of gift,

The donor's holding period for such property,

Sufficient information to determine whether any gain on the sale of the property would be treated as ordinary income,

And any other information as the Treasury Secretary may prescribe.

Similar information (including the name, address, and phone number of the person making the return) is required to be provided to recipients of such property.

Transfers at death

For transfers at death of non-cash assets in excess of $1.3 million and for appreciated property the value of which exceeds $25,000 received by a decedent within three years of death, the executor of the estate (or the trustee of a revocable trust) would report to the IRS:

The name and taxpayer identification number of the recipient of the property,

An accurate description of the property,

The adjusted basis of the property in the hands of the decedent and its fair market value at the time of death,

The decedent's holding period for the property,

Sufficient information to determine whether any gain on the sale of the property would be treated as ordinary income,

The amount of basis increase allocated to the property, and

Any other information as the Treasury Secretary may prescribe.

Penalties for failure to file required information

Any donor required to report the basis and character of any non-cash property with a value in excess of $25,000 who fails to do so is liable for a penalty of $500 for each failure to report such information to the IRS and $50 for each failure to report such information to a beneficiary.

Any person required to report to the IRS transfers at death of non-cash assets in excess of $1.3 million in value who fails to do so is liable for a penalty of $10,000 for the failure to report such information. Any person required to report to the IRS the receipt by a decedent of appreciated property valued in excess of $25,000 within three years of death who fails to do so is liable for a penalty of $500 for the failure to report such information to the IRS. There also is a penalty of $50 for each failure to report such information to a beneficiary.

No penalty is imposed with respect to any failure that is due to reasonable cause. If any failure to report to the IRS or a beneficiary under the bill is due to intentional disregard of the rules, then the penalty is five percent of the fair market value of the property for which reporting was required, determined at the date of the decedent's death (for property passing at death) or determined at the time of gift (for a lifetime gift).

Certain tax benefits extending past the date for repeal of the estate tax

Prior to repeal of the estate tax, many estates may have claimed certain estate tax benefits which, upon certain events, may trigger a recapture tax. Because repeal of the estate tax is effective for decedents dying after December 31, 2010, these estate tax recapture provisions will continue to apply to estates of decedents dying before January 1, 2011.

Qualified conservation easements

A donor may have retained a development right in the conveyance of a conservation easement that qualified for the estate tax exclusion. Those with an interest in the land may later execute an agreement to extinguish the right. If an agreement to extinguish development rights is not entered into within the earlier of (1) two years after the date of the decedent's death or (2) the date of the sale of such land subject to the conservation easement, then those with an interest in the land are personally liable for an additional tax. This provision is retained after repeal of the estate tax, which will ensure that those persons with an interest in the land who fail to execute the agreement remain liable for any additional tax which may be due after repeal.

Special-use valuation

Property may have qualified for special-use valuation prior to repeal of the estate tax. If such property ceases to qualify for special-use valuation, for example, because an heir ceases to use the property in its qualified use within 10 years of the decedent's death, then the estate tax benefit is required to be recaptured. The recapture provision is retained after repeal of the estate tax, which will ensure that those estates that claimed this benefit prior to repeal

of the estate tax will be subject to recapture if a disqualifying event occurs after repeal.

Qualified family-owned business deduction

Property may have qualified for the family-owned business deduction prior to repeal of the estate tax. If such property ceases to qualify for the family-owned business deduction, for example, because an heir ceases to use the property in its qualified use within 10 years of the decedent's death, then the estate-tax benefit is required to be recaptured. The recapture provision is retained after repeal of the estate tax, which will ensure that those estates that claimed this benefit prior to repeal of the estate tax would be subject to recapture if a disqualifying event occurs after repeal.

Installment payment of estate tax for estates with an interest in a closely-held business

The present-law installment payment rules are retained so that those estates that entered into an installment payment arrangement prior to repeal of the estate tax will continue to make their payments past the date for repeal.

If more than 50 percent of the value of the closely-held business is distributed, sold, exchanged, or otherwise disposed of, the unpaid portion of the tax payable in installments must be paid upon notice and demand from the Treasury Secretary. This rule is retained after repeal of the estate tax, which will ensure that such dispositions that occur after repeal of the estate tax will continue to subject the estate to the unpaid portion of the tax upon notice and demand.

Transfers to foreign trusts, estates, and nonresidents who are not U.S. citizens

The present-law rule providing that transfers by a U.S. person to a foreign trust or estate generally is treated as a sale or exchange is expanded. Under the bill, transfers by a U.S. person to a nonresident who is not a U.S. citizen is treated as a sale or exchange of the property for an amount equal to the fair market value of the transferred property. The amount of gain that must be recognized by the transferor is equal to the excess of the fair market value of the property transferred over the adjusted basis of such property in the hands of the transferor.

Transfers of property in satisfaction of a pecuniary bequest

Under the bill, gain or loss on the transfer of property in satisfaction of a pecuniary bequest is recognized only to the extent that the fair market value of the property at the time of the transfer exceeds the fair market value of the property on the date of the decedent's death (not the property's carryover basis).

Transfer of property subject to a liability

The bill clarifies that gain is not recognized at the time of death when the estate or heir acquires from the decedent property subject to a liability that is greater than the decedent's basis in the property. Similarly, no gain is recognized by the estate on the distribution of such property to a beneficiary of the estate by reason of the liability.

Income tax exclusion for the gain on the sale of a principal residence

The income tax exclusion of up to $250,000 of gain on the sale of a principal residence is extended to estates and heirs. Under the bill, if the decedent's estate or an heir sells the decedent's principal residence, $250,000 of gain can be excluded on the sale of the residence, provided the decedent used the property as a principal residence for two or more years during the five-year period prior to the sale. In addition, if an heir occupies the property as a principal residence, the decedent's period of ownership and occupancy of the property as a principal residence can be added to the heir's subsequent ownership and occupancy in determining whether the property was owned and occupied for two years as a principal residence.

Excise tax on nonexempt trusts

Under the bill, split-interest trusts are subject to certain restrictions that are applicable to private foundations if an income tax charitable deduction, including an income tax charitable deduction by an estate or trust, was allowed with respect to transfers to the trust.

Anti-abuse rules

The Treasury Secretary is given authority to treat a transfer that purports to be a gift as having never been transferred, if, in connection with such transfer, such treatment is appropriate to prevent income tax avoidance and (1) the transferor (or any person related to or designated by the transferor or such person) has received anything of value in connection with the transfer from the transferee directly or indirectly or (2) there is an understanding or expectation that the transferor (or any person related to or designated by the transferor or such person) will receive anything of value in connection with the transfer from the transferee directly or indirectly.

Study mandated by the bill

The bill requires the Treasury Secretary to conduct a study of opportunities for avoidance of the income tax, if any, and potential increases in income tax revenues by reason of enactment of the bill. The results of such study are required to be submitted to the House Committee on Ways and Means and the Senate Committee on Finance no later than December 31, 2002.

Interaction of the bill with death tax treaties

The Committee expects that, where applicable, references in U.S. tax treaties to the unified credit under section 2010 (as in effect prior to January 1, 2002) will be construed as applying, in a similar manner, to the unified exemption amount (as in effect for decedents dying and gifts made after December 31, 2001).[6]

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[6] See, e.g., Article 3, Protocol Amending the Convention Between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation with Respect to Taxes on Estates, Inheritances, and Gifts (Senate Treaty Doc. 106–13, September 21, 1999.) Under the protocol, a pro rata unified credit is provided to the estate of an individual domiciled in Germany (who is not a U.S. citizen) for purposes of computing U.S. estate tax. Such an individual domiciled in Germany is entitled to a credit against U.S. estate tax based on the extent to which the assets of the estate are situated in the United States.

EFFECTIVE DATE

The unified credit is replaced with a unified exemption, the 5–percent surtax is repealed, and the rates in excess of 53 percent are repealed for estates of decedents dying and gifts and generation-skipping transfers made after December 31, 2001. The estate and gift tax rates in excess of 50 percent is repealed for estates of decedents dying and gifts and generation-skipping transfers made after December 31, 2002.

The additional reductions in estate and gift tax rates and of the State death tax credit occur for decedents dying and gifts and generation-skipping transfers made in 2004 through 2010.

The estate, gift, and generation-skipping transfer taxes are repealed and the carryover basis regime takes effect for estates of decedents dying and gifts and generation-skipping transfers made after December 31, 2010.

The provisions relating to purported gifts and recognition of gain on transfers to nonresidents who are not U.S. citizens are effective for transfers made after December 31, 2010.

B. EXPAND ESTATE TAX RULE FOR CONSERVATION EASEMENTS (SEC. 501 OF THE BILL AND SEC. 2031 OF THE CODE)

PRESENT LAW

In general

An executor can elect to exclude from the taxable estate 40 percent of the value of any land subject to a qualified conservation easement, up to a maximum exclusion of $100,000 in 1998, $200,000 in 1999, $300,000 in 2000, $400,000 in 2001, and $500,000 in 2002 and thereafter (sec. 2031(c)). The exclusion percentage is reduced by 2 percentage points for each percentage point (or fraction thereof) by which the value of the qualified conservation easement is less than 30 percent of the value of the land (determined without regard to the value of such easement and reduced by the value of any retained development right).

A qualified conservation easement is one that meets the following requirements: (1) the land is located within 25 miles of a metropolitan area (as defined by the Office of Management and Budget) or a national park or wilderness area, or within 10 miles of an Urban National Forest (as designated by the Forest Service of the U.S. Department of Agriculture); (2) the land has been owned by the decedent or a member of the decedent's family at all times during the three-year period ending on the date of the decedent's death; and (3) a qualified conservation contribution (within the meaning of sec. 170(h)) of a qualified real property interest (as generally defined in sec. 170(h)(2)(C)) was granted by the decedent or a member of his or her family. For purposes of the provision, preservation of a historically important land area or a certified historic structure does not qualify as a conservation purpose.

In order to qualify for the exclusion, a qualifying easement must have been granted by the decedent, a member of the decedent's family, the executor of the decedent's estate, or the trustee of a trust holding the land, no later than the date of the election. To the extent that the value of such land is excluded from the taxable estate, the basis of such land acquired at death is a carryover basis

(i.e., the basis is not stepped-up to its fair market value at death). Property financed with acquisition indebtedness is eligible for this provision only to the extent of the net equity in the property.

Retained development rights

The exclusion for land subject to a conservation easement does not apply to any development right retained by the donor in the conveyance of the conservation easement. An example of such a development right would be the right to extract minerals from the land. If such development rights exist, then the value of the conservation easement must be reduced by the value of any retained development right.

If the donor or holders of the development rights agree in writing to extinguish the development rights in the land, then the value of the easement need not be reduced by the development rights. In such case, those persons with an interest in the land must execute the agreement no later than the earlier of (1) two years after the date of the decedent's death or (2) the date of the sale of such land subject to the conservation easement. If such agreement is not entered into within this time, then those with an interest in the land are personally liable for an additional tax, which is the amount of tax which would have been due on the retained development rights subject to the termination agreement.

REASONS FOR CHANGE

The Committee believes that expanding the availability of qualified conservation easements will further ease existing pressures to develop or sell environmentally significant land in order to raise funds to pay estate taxes and would, thereby, advance the preservation of such land. The Committee also believes it appropriate to clarify the date for determining easement compliance.

EXPLANATION OF PROVISION

The bill expands the availability of qualified conservation easements by modifying the distance requirements. Under the bill, the distance within which the land must be situated from a metropolitan area, national park, or wilderness area is increased from 25 to 50 miles, and the distance from which the land must be situated from an Urban National Forest is increased from 10 to 25 miles. The bill also clarifies that the date for determining easement compliance is the date on which the donation was made.

EFFECTIVE DATE

The provisions are effective for estates of decedents dying after December 31, 2000.

C. MODIFY GENERATION-SKIPPING TRANSFER TAX RULES

1. Deemed allocation of the generation-skipping transfer tax exemption to lifetime transfers to trusts that are not direct skips (sec. 601 of the bill and sec. 2632 of the Code)

PRESENT LAW

A generation-skipping transfer tax generally is imposed on transfers, either directly or through a trust or similar arrangement, to

a "skip person" (i.e., a beneficiary in a generation more than one generation below that of the transferor). Transfers subject to the generation-skipping transfer tax include direct skips, taxable terminations, and taxable distributions. An exemption of $1 million (indexed beginning in 1999) is provided for each person making generation-skipping transfers. The exemption can be allocated by a transferor (or his or her executor) to transferred property.

A direct skip is any transfer subject to estate or gift tax of an interest in property to a skip person. A skip person may be a natural person or certain trusts. All persons assigned to the second or more remote generation below the transferor are skip persons (e.g., grandchildren and great-grandchildren). Trusts are skip persons if (1) all interests in the trust are held by skip persons, or (2) no person holds an interest in the trust and at no time after the transfer may a distribution (including distributions and terminations) be made to a non-skip person.

A taxable termination is a termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in trust unless, immediately after such termination, a non-skip person has an interest in the property, or unless at no time after the termination may a distribution (including a distribution upon termination) be made from the trust to a skip person. A taxable distribution is a distribution from a trust to a skip person (other than a taxable termination or direct skip).

The tax rate on generation-skipping transfers is a flat rate of tax equal to the maximum estate and gift tax rate in effect at the time of the transfer (55 percent under present law) multiplied by the "inclusion ratio." The inclusion ratio with respect to any property transferred in a generation-skipping transfer indicates the amount of "generation-skipping transfer tax exemption" allocated to a trust. The allocation of generation-skipping transfer tax exemption reduces the 55-percent tax rate on a generation-skipping transfer.

If an individual makes a direct skip during his or her lifetime, any unused generation-skipping transfer tax exemption is automatically allocated to a direct skip to the extent necessary to make the inclusion ratio for such property equal to zero. An individual can elect out of the automatic allocation for lifetime direct skips.

For lifetime transfers made to a trust that are not direct skips, the transferor must allocate generation-skipping transfer tax exemption—the allocation is not automatic. If generation-skipping transfer tax exemption is allocated on a timely-filed gift tax return, then the portion of the trust which is exempt from generation-skipping transfer tax is based on the value of the property at the time of the transfer. If, however, the allocation is not made on a timely-filed gift tax return, then the portion of the trust which is exempt from generation-skipping transfer tax is based on the value of the property at the time the allocation of generation-skipping transfer tax exemption was made.

Treas. Reg. sec. 26.2632–1(d) further provides that any unused generation-skipping transfer tax exemption, which has not been allocated to transfers made during an individual's life, is automatically allocated on the due date for filing the decedent's estate tax return. Unused generation-skipping transfer tax exemption is allocated pro rata on the basis of the value of the property as finally determined for estate tax purposes, first to direct skips treated as

occurring at the transferor's death. The balance, if any, of unused generation-skipping transfer tax exemption is allocated pro rata, on the basis of the estate tax value of the nonexempt portion of the trust property (or in the case of trusts that are not included in the gross estate, on the basis of the date of death value of the trust) to trusts with respect to which a taxable termination may occur or from which a taxable distribution may be made.

REASONS FOR CHANGE

The Committee recognizes that there are situations where a taxpayer would desire allocation of generation-skipping transfer tax exemption, yet the taxpayer had missed allocating generation-skipping transfer tax exemption to an indirect skip, e.g., because the taxpayer or the taxpayer's advisor inadvertently omitted making the election on a timely-filed gift tax return or the taxpayer submitted a defective election. Thus, the Committee believes that automatic allocation is appropriate for transfers to a trust from which generation-skipping transfers are likely to occur.

EXPLANATION OF PROVISION

Under the bill, generation-skipping transfer tax exemption will be automatically allocated to transfers made during life that are "indirect skips." An indirect skip is any transfer of property (that is not a direct skip) subject to the gift tax that is made to a generation-skipping transfer trust.

A generation-skipping transfer trust is defined as a trust that could have a generation-skipping transfer with respect to the transferor (e.g., a taxable termination or taxable distribution), unless:

The trust instrument provides that more than 25 percent of the trust corpus must be distributed to or may be withdrawn by 1 or more individuals who are non-skip persons (a) before the date that the individual attains age 46, (b) on or before 1 or more dates specified in the trust instrument that will occur before the date that such individual attains age 46, or (c) upon the occurrence of an event that, in accordance with regulations prescribed by the Treasury Secretary, may reasonably be expected to occur before the date that such individual attains age 46;

The trust instrument provides that more than 25 percent of the trust corpus must be distributed to or may be withdrawn by 1 or more individuals who are non-skip persons and who are living on the date of death of another person identified in the instrument (by name or by class) who is more than 10 years older than such individuals;

The trust instrument provides that, if 1 or more individuals who are non-skip persons die on or before a date or event described in clause (1) or (2), more than 25 percent of the trust corpus either must be distributed to the estate or estates of 1 or more of such individuals or is subject to a general power of appointment exercisable by 1 or more of such individuals;

The trust is a trust any portion of which would be included in the gross estate of a non-skip person (other than the transferor) if such person died immediately after the transfer;

The trust is a charitable lead annuity trust or a charitable remainder annuity trust or a charitable unitrust; or

The trust is a trust with respect to which a deduction was allowed under section 2522 for the amount of an interest in the form of the right to receive annual payments of a fixed percentage of the net fair market value of the trust property (determined yearly) and which is required to pay principal to a non-skip person if such person is alive when the yearly payments for which the deduction was allowed terminate.

If any individual makes an indirect skip during the individual's lifetime, then any unused portion of such individual's generation-skipping transfer tax exemption is allocated to the property transferred to the extent necessary to produce the lowest possible inclusion ratio for such property.

An individual can elect not to have the automatic allocation rules apply to an indirect skip, and such elections will be deemed timely if filed on a timely-filed gift tax return for the calendar year in which the transfer was made or deemed to have been made or on such later date or dates as may be prescribed by the Treasury Secretary. An individual can elect not to have the automatic allocation rules apply to any or all transfers made by such individual to a particular trust and can elect to treat any trust as a generation-skipping transfer trust with respect to any or all transfers made by the individual to such trust, and such election can be made on a timely-filed gift tax return for the calendar year for which the election is to become effective.

EFFECTIVE DATE

The provision applies to transfers subject to estate or gift tax made after December 31, 2000, and to estate tax inclusion periods ending after December 31, 2000.

2. Retroactive allocation of the generation-skipping transfer tax exemption (sec. 601 of the bill and sec. 2632 of the Code)

PRESENT LAW

A taxable termination is a termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in trust unless, immediately after such termination, a non-skip person has an interest in the property, or unless at no time after the termination may a distribution (including a distribution upon termination) be made from the trust to a skip person. A taxable distribution is a distribution from a trust to a skip person (other than a taxable termination or direct skip). If a transferor allocates generation-skipping transfer tax exemption to a trust prior to the taxable termination or taxable distribution, generation-skipping transfer tax may be avoided.

A transferor likely will not allocate generation-skipping transfer tax exemption to a trust that the transferor expects will benefit only non-skip persons. However, if a taxable termination occurs because, for example, the transferor's child unexpectedly dies such that the trust terminates in favor of the transferor's grandchild, and generation-skipping transfer tax exemption had not been allocated to the trust, then generation-skipping transfer tax would be due even if the transferor had unused generation-skipping transfer tax exemption.

REASONS FOR CHANGE

The Committee recognizes that when a transferor does not expect the second generation (e.g., the transferor's child) to die before the termination of a trust, the transferor likely will not allocate generation-skipping transfer tax exemption to the transfer to the trust. If a transferor knew, however, that the transferor's child might predecease the transferor and that there could be a taxable termination as a result thereof, the transferor likely would have allocated generation-skipping transfer tax exemption at the time of the transfer to the trust. The Committee believes it is appropriate to provide that when there is an unnatural order of death (e.g., when the second generation dies before the first generation transferor), the transferor can allocate generation-skipping transfer tax exemption retroactively to the date of the respective transfer to trust.

EXPLANATION OF PROVISION

Under the bill, generation-skipping transfer tax exemption can be allocated retroactively when there is an unnatural order of death. If a lineal descendant of the transferor predeceases the transferor, then the transferor can allocate any unused generation-skipping transfer exemption to any previous transfer or transfers to the trust on a chronological basis. The provision allows a transferor to retroactively allocate generation-skipping transfer exemption to a trust where a beneficiary (a) is a non-skip person, (b) is a lineal descendant of the transferor's grandparent or a grandparent of the transferor's spouse, (c) is a generation younger than the generation of the transferor, and (d) dies before the transferor. Exemption is allocated under this rule retroactively, and the applicable fraction and inclusion ratio would be determined based on the value of the property on the date that the property was transferred to trust.

EFFECTIVE DATE

The provision applies to deaths of non-skip persons occurring after December 31, 2000.

3. Severing of trusts holding property having an inclusion ratio of greater than zero (sec. 602 of the bill and sec. 2642 of the Code)

PRESENT LAW

A generation-skipping transfer tax generally is imposed on transfers, either directly or through a trust or similar arrangement, to a "skip person" (i.e., a beneficiary in a generation more than one generation below that of the transferor). Transfers subject to the generation-skipping transfer tax include direct skips, taxable terminations, and taxable distributions. An exemption of $1 million (indexed beginning in 1999) is provided for each person making generation-skipping transfers. The exemption can be allocated by a transferor (or his or her executor) to transferred property.

If the value of transferred property exceeds the amount of the generation-skipping transfer tax exemption allocated to that property, then the generation-skipping transfer tax generally is determined by multiplying a flat tax rate equal to the highest estate tax

rate (which is currently 55 percent) by the "inclusion ratio" and the value of the taxable property at the time of the taxable event. The "inclusion ratio" is the number one minus the "applicable fraction." The applicable fraction is a fraction calculated by dividing the amount of the generation-skipping transfer tax exemption allocated to the property by the value of the property.

Under Treas. Reg. 26.2654–1(b), a trust may be severed into two or more trusts (e.g., one with an inclusion ratio of zero and one with an inclusion ratio of one) only if (1) the trust is severed according to a direction in the governing instrument or (2) the trust is severed pursuant to the trustee's discretionary powers, but only if certain other conditions are satisfied (e.g., the severance occurs or a reformation proceeding begins before the estate tax return is due). Under current Treasury regulations, however, a trustee cannot establish inclusion ratios of zero and one by severing a trust that is subject to the generation-skipping transfer tax after the trust has been created.

REASONS FOR CHANGE

Complexity can be reduced if a generation-skipping transfer trust is treated as two separate trusts for generation-skipping transfer tax purposes—one with an inclusion ratio of zero and one with an inclusion ratio of one. This result can be achieved by drafting complex documents in order to meet the specific requirements of severance. The Committee believes it is appropriate to make the rules regarding severance less burdensome and less complex.

EXPLANATION OF PROVISION

Under the bill, a trust can be severed in a "qualified severance." A qualified severance is defined as the division of a single trust and the creation of two or more trusts if (1) the single trust was divided on a fractional basis, and (2) the terms of the new trusts, in the aggregate, provide for the same succession of interests of beneficiaries as are provided in the original trust. If a trust has an inclusion ratio of greater than zero and less than one, a severance is a qualified severance only if the single trust is divided into two trusts, one of which receives a fractional share of the total value of all trust assets equal to the applicable fraction of the single trust immediately before the severance. In such case, the trust receiving such fractional share shall have an inclusion ratio of zero and the other trust shall have an inclusion ratio of one. Under the provision, a trustee may elect to sever a trust in a qualified severance at any time.

EFFECTIVE DATE

The provision is effective for severances of trusts occurring after December 31, 2000.

4. Modification of certain valuation rules (sec. 603 of the bill and sec. 2642 of the Code)

PRESENT LAW

Under present law, the inclusion ratio is determined using gift tax values for allocations of generation-skipping transfer tax ex-

emption made on timely filed gift tax returns. The inclusion ratio generally is determined using estate tax values for allocations of generation-skipping transfer tax exemption made to transfers at death. Treas. Reg. 26.2642–5(b) provides that, with respect to taxable terminations and taxable distributions, the inclusion ratio becomes final on the later of the period of assessment with respect to the first transfer using the inclusion ratio or the period for assessing the estate tax with respect to the transferor's estate.

REASONS FOR CHANGE

The Committee believes it is appropriate to clarify the valuation rules relating to timely and automatic allocations of generation-skipping transfer tax exemption.

EXPLANATION OF PROVISION

Under the bill, in connection with timely and automatic allocations of generation-skipping transfer tax exemption, the value of the property for purposes of determining the inclusion ratio shall be its finally determined gift tax value or estate tax value depending on the circumstances of the transfer. In the case of a generation-skipping transfer tax exemption allocation deemed to be made at the conclusion of an estate tax inclusion period, the value for purposes of determining the inclusion ratio shall be its value at that time.

EFFECTIVE DATE

The provision is effective for transfers subject to estate or gift tax made after December 31, 2000.

5. Relief from late elections (sec. 604 of the bill and sec. 2642 of the Code)

PRESENT LAW

Under present law, an election to allocate generation-skipping transfer tax exemption to a specific transfer may be made at any time up to the time for filing the transferor's estate tax return. If an allocation is made on a gift tax return filed timely with respect to the transfer to trust, then the value on the date of transfer to the trust is used for determining generation-skipping transfer tax exemption allocation. However, if the allocation relating to a specific transfer is not made on a timely-filed gift tax return, then the value on the date of allocation must be used. There is no statutory provision allowing relief for an inadvertent failure to make an election on a timely-filed gift tax return to allocate generation-skipping transfer tax exemption.

REASONS FOR CHANGE

The Committee believes it is appropriate for the Treasury Secretary to grant extensions of time to make an election to allocate generation-skipping transfer tax exemption and to grant exceptions to the statutory time requirement in appropriate circumstances, e.g., when the taxpayer intended to allocate generation-skipping transfer tax exemption and the failure to timely allocate generation-skipping transfer tax exemption was inadvertent.

EXPLANATION OF PROVISION

Under the bill, the Treasury Secretary is authorized and directed to grant extensions of time to make the election to allocate generation-skipping transfer tax exemption and to grant exceptions to the time requirement. If such relief is granted, then the value on the date of transfer to trust would be used for determining generation-skipping transfer tax exemption allocation.

In determining whether to grant relief for late elections, the Treasury Secretary is directed to consider all relevant circumstances, including evidence of intent contained in the trust instrument or instrument of transfer and such other factors as the Treasury Secretary deems relevant. For purposes of determining whether to grant relief, the time for making the allocation (or election) is treated as if not expressly prescribed by statute.

EFFECTIVE DATE

The provision applies to requests pending on, or filed after, December 31, 2000. No inference is intended with respect to the availability of relief from late elections prior to the effective date of the provision.

6. Substantial compliance (sec. 604 of the bill and sec. 2642 of the Code)

PRESENT LAW

Under present law, there is no statutory rule which provides that substantial compliance with the statutory and regulatory requirements for allocating generation-skipping transfer tax exemption will suffice to establish that generation-skipping transfer tax exemption was allocated to a particular transfer or trust.

REASONS FOR CHANGE

The Committee recognizes that the rules and regulations regarding the allocation of generation-skipping transfer tax exemption are complex. Thus, it is often difficult for taxpayers to comply with the technical requirements for making a proper election to allocate generation-skipping transfer tax exemption. The Committee therefore believes it is appropriate to provide that generation-skipping transfer tax exemption will be allocated when a taxpayer substantially complies with the rules and regulations for allocating generation-skipping transfer tax exemption.

EXPLANATION OF PROVISION

Under the bill, substantial compliance with the statutory and regulatory requirements for allocating generation-skipping transfer tax exemption will suffice to establish that generation-skipping transfer tax exemption was allocated to a particular transfer or a particular trust. If a taxpayer demonstrates substantial compliance, then so much of the transferor's unused generation-skipping transfer tax exemption will be allocated to the extent it produces the lowest possible inclusion ratio. In determining whether there has been substantial compliance, all relevant circumstances will be considered, including evidence of intent contained in the trust in-

strument or instrument of transfer and such other factors as the Treasury Secretary deems appropriate.

EFFECTIVE DATE

The provision applies to transfers subject to estate or gift tax made after December 31, 2000. No inference is intended with respect to the availability of a rule of substantial compliance prior to the effective date of the provision.

D. EXPAND AVAILABILITY OF INSTALLMENT PAYMENT OF ESTATE TAX FOR CLOSELY-HELD BUSINESSES (SEC. 701 OF THE BILL AND SEC. 6166 OF THE CODE)

PRESENT LAW

Under present law, the estate tax generally is due within nine months of a decedent's death. However, an executor generally may elect to pay estate tax attributable to an interest in a closely-held business in two or more installments (but no more than 10). If the election is made, the estate pays only interest for the first five years, followed by up to 10 annual installments of principal and interest. This provision effectively extends the time for paying estate tax by 14 years from the original due date of the estate tax.[7] A special two-percent interest rate applies to the amount of deferred estate tax attributable to the first $1 million (adjusted annually for inflation occurring after 1998) in taxable value of a closely-held business. The interest rate applicable to the amount of estate tax attributable to the taxable value of the closely-held business in excess of $1 million is equal to 45 percent of the rate applicable to underpayments of tax under section 6621 (i.e., 45 percent of the Federal short-term rate plus 3 percentage points). Interest paid on deferred estate taxes is not deductible for estate or income tax purposes.

For purposes of these rules, an interest in a closely-held business is: (1) an interest as a proprietor in a sole proprietorship, (2) an interest as a partner in a partnership carrying on a trade or business if 20 percent or more of the total capital interest of such partnership is included in the decedent's gross estate or the partnership had 15 or fewer partners, and (3) stock in a corporation carrying on a trade or business if 20 percent or more of the value of the voting stock of the corporation is included in the decedent's gross estate or such corporation had 15 or fewer shareholders.

If more than 50 percent of the value of the closely-held business is distributed, sold, exchanged, or otherwise disposed of, then, in general, the extension of time for the payment of tax no longer applies, and the unpaid portion of the tax payable in installments must be paid upon notice and demand from the Treasury Secretary. An exception to this rule is provided for transfers of property to a person entitled to receive the decedent's property under the decedent's will, the applicable State law, or a trust created by the decedent. Moreover, a similar exception applies in the case of a series of subsequent transfers of the property by reason of death

[7] For example, assume estate tax is due in 2001. If interest only is paid each year for the first five years (2001 through 2005), and if 10 installments of both principal and interest are paid for the 10 years thereafter (2006 through 2015), then payment of estate tax would be extended by 14 years from the original due date of 2001.

so long as each transfer is to a member of the decedent's family, which includes the decedent's brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants.

REASONS FOR CHANGE

The Committee finds that the present-law 15 partner limitation on partnerships and 15 shareholder limitation on corporations is restrictive and keeps estates of decedents who otherwise held an interest in a closely-held business at death from claiming the benefits of installment payment of estate tax. Thus, the Committee wishes to expand the definition of partnerships and corporations to enable more estates of decedents with an interest in a closely-held business to claim the benefits of installment payment of estate tax.

EXPLANATION OF PROVISION

Under the bill, the definition of a closely-held business is expanded. The bill increases from 15 to 45 the number of partners in a partnership and shareholders in a corporation that is considered a closely-held business in which a decedent held an interest, and thus will qualify the estate for installment payment of estate tax.

EFFECTIVE DATE

The provision is effective for decedents dying after December 31, 2001.

III. VOTES OF THE COMMITTEE

In compliance with clause 3(b) of rule XIII of the Rules of the House of Representatives, the following statements are made concerning the votes of the Committee on Ways and Means in its consideration of the bill, H.R. 8.

MOTION TO REPORT THE BILL

The bill, H.R. 8, as amended, was ordered favorably reported by a roll call vote of 24 yeas to 14 nays (with a quorum being present). The vote was as follows:

Representatives	Yea	Nay	Representatives	Yea	Nay
Mr. Thomas	X		Mr. Rangel		X
Mr. Crane	X		Mr. Stark		X
Mr. Shaw	X		Mr. Matsui		X
Mrs. Johnson	X		Mr. Coyne		X
Mr. Houghton		X	Mr. Levin		X
Mr. Herger	X		Mr. Cardin		X
Mr. McCrery	X		Mr. McDermott		X
Mr. Camp	X		Mr. Kleczka		X
Mr. Ramstad	X		Mr. Lewis (GA)		
Mr. Nussle	X		Mr. Neal		X
Mr. Johnson	X		Mr. McNulty		
Ms. Dunn	X		Mr. Jefferson		X
Mr. Collins	X		Mr. Tanner	X	
Mr. Portman	X		Mr. Becerra		
Mr. English	X		Mrs. Thurman		X
Mr. Watkins	X		Mr. Doggett		X
Mr. Hayworth	X		Mr. Pomeroy		X
Mr. Weller	X				
Mr. Hulshof	X				
Mr. McInnis	X				

Representatives	Yea	Nay	Representatives	Yea	Nay
Mr. Lewis (KY)	X				
Mr. Foley	X				
Mr. Brady	X				
Mr. Ryan	X				

VOTES ON AMENDMENTS

A roll call vote was conducted on the following amendment to the Chairman's amendment in the nature of a substitute.

An amendment by Mr. Matsui, to change the effective date and title of the bill, was defeated by a roll call vote of 7 yeas to 31 nays. The vote was as follows:

Representatives	Yea	Nay	Representatives	Yea	Nay
Mr. Thomas		X	Mr. Rangel		X
Mr. Crane		X	Mr. Stark	X	
Mr. Shaw		X	Mr. Matsui	X	
Mrs. Johnson		X	Mr. Coyne	X	
Mr. Houghton		X	Mr. Levin		X
Mr. Herger		X	Mr. Cardin	X	
Mr. McCrery		X	Mr. McDermott		X
Mr. Camp		X	Mr. Kleczka		X
Mr. Ramstad		X	Mr. Lewis (GA)		
Mr. Nussle		X	Mr. Neal	X	
Mr. Johnson		X	Mr. McNulty		
Ms. Dunn		X	Mr. Jefferson	X	
Mr. Collins		X	Mr. Tanner		X
Mr. Portman		X	Mr. Becerra		
Mr. English		X	Mrs. Thurman		X
Mr. Watkins		X	Mr. Doggett		X
Mr. Hayworth		X	Mr. Pomeroy	X	
Mr. Weller		X			
Mr. Hulshof		X			
Mr. McInnis		X			
Mr. Lewis (KY)		X			
Mr. Foley		X			
Mr. Brady		X			
Mr. Ryan		X			

A roll call vote was conducted on the following amendment to the Chairman's amendment in the nature of a substitute.

A substitute amendment by Mr. Rangel was defeated by a roll call vote of 14 yeas to 24 nays. The vote was as follows:

Representatives	Yea	Nay	Representatives	Yea	Nay
Mr. Thomas		X	Mr. Rangel	X	
Mr. Crane		X	Mr. Stark	X	
Mr. Shaw		X	Mr. Matsui	X	
Mrs. Johnson		X	Mr. Coyne	X	
Mr. Houghton		X	Mr. Levin	X	
Mr. Herger		X	Mr. Cardin	X	
Mr. McCrery		X	Mr. McDermott	X	
Mr. Camp		X	Mr. Kleczka	X	
Mr. Ramstad		X	Mr. Lewis (GA)		
Mr. Nussle		X	Mr. Neal	X	
Mr. Johnson		X	Mr. McNulty		
Ms. Dunn		X	Mr. Jefferson	X	
Mr. Collins		X	Mr. Tanner	X	
Mr. Portman		X	Mr. Becerra		
Mr. English		X	Mrs. Thurman	X	
Mr. Watkins		X	Mr. Doggett	X	
Mr. Hayworth		X	Mr. Pomeroy	X	
Mr. Weller		X			

Representatives	Yea	Nay	Representatives	Yea	Nay
Mr. Hulshof		X			
Mr. McInnis		X			
Mr. Lewis (KY)		X			
Mr. Foley		X			
Mr. Brady		X			
Mr. Ryan		X			

IV. BUDGET EFFECTS OF THE BILL

A. Committee Estimate of Budgetary Effects

In compliance with clause 3(d)(2) of the rule XIII of the Rules of the House of Representatives, the following statement is made concerning the effects on the budget of the revenue provisions of the bill, H.R. 8 as reported.

The bill is estimated to have the following effects on budget receipts for fiscal years 2001–2006:

ESTIMATED REVENUE EFFECTS OF H.R. 8, THE ''DEATH TAX ELIMINATION ACT OF 2001'' AS REPORTED BY THE COMMITTEE ON WAYS AND MEANS; FISCAL YEARS 2002–2006

[In millions of dollars]

Provision	Effective	2002	2003	2004	2005	2006	2002–06
1. Phase In Repeal of Estate, Gift, and Generation-Skipping Transfer Taxes—beginning in 2002, convert the unified credit into a true exemption, repeal the 5% ''bubble'' (which phases out the lower rates); repeal rates in excess of 53%; in 2003, repeal rates in excess of 50%; in 2004 through 2006, reduce all rates by 1 percentage point a year; in 2007 through 2010 reduce all rates by 2 percentage points a year; proportionately reduce State tax credit rates; beginning in 2011, repeal all of these taxes, carryover basis applies to transfers at death after 12/31/10 of assets fully owned by decedents except: (1) $1.3 million of additional basis and certain loss carryforwards of the decedent are allowed to be added to carryover basis, and (2) an additional $3 million of basis is allowed to be added to carryover basis of assets going to surviving spouse; certain reporting requirements on large gifts and bequests..	dda & gma 12/31/01	.....	−6,724	−8,774	−10,964	−12,720	−39,183
2. Expand Availability of Estate Tax Exclusion for Conservation Easements—increase the 25-mile limit to 50 miles; increase 10-mile limit to 25 miles, and clarify the date for determining easement compliance.	dda 12/31/00	−2	−13	−19	−20	−20	−74
3. Modifications to Generation-Skipping Transfer Tax Rules:							
a. Deemed allocation of the generation-skipping transfer tax exemption to lifetime transfers to trusts that are not direct skips.	ta 12/31/00	−1	−3	−4	−4	−4	−16
b. Retroactive allocation of the generation-skipping tax exemption	generally 12/31/00	−1	−4	−6	−6	−6	−23
c. Serving of trusts holding property having an inclusion ratio of greater than zero	.....			Included in Item 3.b.			
d. Modification of certain valuation rules	.....			Included in Item 3.b.			
e. Relief from late elections	.....			Included in Item 3.b.			
f. Substantial compliance	.....			Included in Item 3.b.			
4. Modifications to Section 6166—increase from 15 to 45 the number of partners of a partnership or shareholders in a corporation eligible for installment payments of estate tax under section 6166.	dda 12/31/01	.....	−285	−297	−330	−364	−1,276
Net total	.....	−4	7,029	−9,100	−11,324	−13,114	−40,572

Note. Details may not add to totals due to rounding.

Legend for ''Effective column: dda = decedents dying after; gma = gifts made after; ta = transfers after.

B. Statement Regarding New Budget Authority and Tax Expenditures Budget Authority

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee states that the bill involves no new or increased budget authority (as detailed in the statement by the Congressional Budget Office ("CBO"); see Part IV.C., below). The Committee further states that the revenue reducing tax provisions of the bill do not involve increased tax expenditures. (See amounts in table in Part IV.A., above.)

C. Cost Estimate Prepared by the Congressional Budget Office

In compliance with clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, requiring a cost estimate prepared by the CBO, the following statement by CBO is provided.

U.S. Congress,
Congressional Budget Office,
Washington, DC, April 2, 2001.

Hon. Bill Thomas,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, DC.

Dear Mr. Chairman: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 8, the Death Tax Elimination Act of 2001.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Erin Whitaker.

Sincerely,

Barry B. Anderson
(For Dan L. Crippen, Director).

Enclosure.

CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

H.R. 8—Death Tax Elimination Act of 2001

Summary: H.R. 8 would phase out estate, gift, and generation-skipping taxes over a nine-year period beginning in fiscal year 2002. The bill would modify the provisions of current law that allow property passed from a decedent's estate to take a stepped-up basis. The bill also would modify the rules governing generation-skipping transfer taxes and expand the estate tax rule for conservation easements. H.R. 8 would expand the availability of the installment method of payment of the estate tax for the estates of decedents with an interest in a closely-held business. In addition, the bill would require the executor of the estate to furnish additional information to the Internal Revenue Service (IRS) with respect to certain transfers at death and gifts. The Congressional Budget Office and the Joint Committee on Taxation (JCT) estimate that the bill would reduce revenues by $4 million in fiscal year 2002, by about $41 billion over the 2002–2006 period, and by about $186 billion over the 2002–2011 period. Because the bill would affect receipts, pay-as-you-go procedures would apply.

H.R. 8 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would not affect the budgets of state, local, or tribal governments.

Estimated cost to the Federal Government: The estimated budgetary impact of H.R. 8 is shown in the following table.

	By fiscal year in millions of dollars—				
	2002	2003	2004	2005	006
	Changes in revenues				
Estimated revenues	−4	−7,029	−9,100	−11,324	−13,114

Basis of estimate: With the exception of the following, all estimates of the revenue effects of H.R. 8 were provided by JCT.

H.R. 8 would require the executor of an estate, or the trustee of a revocable trust, to report certain information to the IRS and to the recipients of property from the estate or trust. An individual who fails to provide the information would be subject to certain penalties. Based on information from the IRS, CBO estimates that such penalties would be negligible.

Pay-as-you-go considerations: The Balanced Budget and Emergency Deficit Control Act sets up pay-as-you-go procedures for legislation affecting direct spending or receipts. The net changes in outlays and governmental receipts that are subject to pay-as-you-go procedures are shown in the following tables. For the purposes of enforcing pay-as-you-go procedures, only the effects in the current year, the budget year, and the succeeding four years are counted.

By fiscal year, in millions of dollars—	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Changes in outlays	Not applicable										
Changes in receipts	0	−4	−7,029	−9,100	−11,324	−13,114	−14,869	−19,823	−27,383	−33,690	−49,228

Intergovernmental and private-sector impact: H.R. 8 contains no intergovernmental or private-sector mandates as defined in UMRA and would not affect the budgets of state, local, or tribal governments.

Estimate prepared by: Federal costs: Erin Whitaker; intergovernmental mandates: Leo Lex; private-sector mandates: Paige Piper/Bach.

Estimate approved by: G. Thomas Woodward, Assistant Director for Tax Analysis.

V. OTHER MATTERS TO BE DISCUSSED UNDER THE RULES OF THE HOUSE

A. Committee Oversight Findings and Recommendations

With respect to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives (relating to oversight findings), the Committee advises that it was a result of the Committee's oversight review concerning the tax burden on individual taxpayers that the Committee concluded that it is appropriate and timely to enact the revenue provisions included in the bill as reported.

B. Statement of General Performance Goals and Objectives

With respect to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee advises that the bill contains no measure that authorizes funding, so no statement of general performance goals and objectives for which any measure authorizes funding is required.

C. Constitutional Authority Statement

With respect to clause 3(d)(1) of the rule XIII of the Rules of the House of Representatives (relating to Constitutional Authority), the Committee states that the Committee's action in reporting this bill is derived from Article I of the Constitution, Section 8 ("The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises . . . "), and from the 16th Amendment to the Constitution.

D. Information Relating to Unfunded Mandates

This information is provided in accordance with section 423 of the Unfunded Mandates Act of 1995 (P.L. 104–4).

The Committee has determined that the bill does not contain Federal mandates on the private sector. The Committee has determined that the bill does not impose a Federal intergovernmental mandate on State, local, or tribal governments.

E. Applicability of House Rule XXI 5(b)

Rule XXI 5(b) of the Rules of the House of Representatives provides, in part, that "A bill or joint resolution, amendment, or conference report carrying a Federal income tax rate increase may not be considered as passed or agreed to unless so determined by a vote of not less than three-fifths of the Members voting, a quorum being present." The Committee has carefully reviewed the provisions of the bill, and states that the provisions of the bill do not involve any Federal income tax rate increases within the meaning of the rule.

F. Tax Complexity Analysis

Section 4022(b) of the Internal Revenue Service Reform and Restructuring Act of 1998 (the "IRS Reform Act") requires the Joint Committee on Taxation (in consultation with the Internal Revenue Service and the Department of the Treasury) to provide a tax complexity analysis. The complexity analysis is required for all legislation reported by the House Committee on Ways and Means, the Senate Committee on Finance, or any committee of conference if the legislation includes a provision that directly or indirectly amends the Internal Revenue Code and has widespread applicability to individuals or small businesses.

The staff of the Joint Committee on Taxation has determined that a complexity analysis is not required under section 4022(b) of the IRS Reform Act because the bill contains no provisions that amend the Internal Revenue Code and that have "widespread applicability" to individuals or small businesses.

VI. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1986

* * * * * * *

Subtitle A—Income Taxes

* * * * * * *

CHAPTER 1—NORMAL TAXES AND SURTAXES

* * * * * * *

Subchapter O—Gain or Loss on Disposition of Property

* * * * * * *

PART II—BASIS RULES OF GENERAL APPLICATION

* * * * * * *

SEC. 1014. BASIS OF PROPERTY ACQUIRED FROM A DECEDENT.

(a) * * *

* * * * * * *

(f) TERMINATION.—This section shall not apply with respect to decedents dying after December 31, 2010.

* * * * * * *

THE FOLLOWING AMENDMENTS TO SUBTITLE B ARE EFFECTIVE DECEMBER 31, 2001.

Subtitle B—Estate and Gift Taxes

* * * * * * *

CHAPTER 11—ESTATE TAX

* * * * * * *

Subchapter A—Estates of Citizens or Residents

* * * * * * *

PART I—TAX IMPOSED

* * * * * * *

SEC. 2001. IMPOSITION AND RATE OF TAX.

(a) IMPOSITION.—A tax is hereby imposed on the transfer of the taxable estate of every decedent who is a citizen orresident of the United States.

[(b) COMPUTATION OF TAX.—The tax imposed by this section shall be the amount equal to the excess (if any) of—

[(1) a tentative tax computed under subsection (c) on the sum of—

[(A) the amount of the taxable estate, and

[(B) the amount of the adjusted taxable gifts, over

[(2) the aggregate amount of tax which would have been payable under chapter 12 with respect to gifts made by the decedent after December 31, 1976, if the provisions of subsection (c) (as in effect at the decedent's death) had been applicable at the time of such gifts.

For purposes of paragraph (1)(B), the term "adjusted taxable gifts" means the total amount of the taxable gifts (within the meaning of section 2503) made by the decedent after December 31, 1976, other than gifts which are includible in the gross estate of the decedent.]

(b) COMPUTATION OF TAX.—

(1) IN GENERAL.—The tax imposed by this section shall be the amount equal to the excess (if any) of—

(A) the tentative tax determined under paragraph (2), over

(B) the aggregate amount of tax which would have been payable under chapter 12 with respect to gifts made by the decedent after December 31, 1976, if the provisions of subsection (c) (as in effect at the decedent's death) had been applicable at the time of such gifts.

(2) TENTATIVE TAX.—For purposes of paragraph (1), the tentative tax determined under this paragraph is a tax computed under subsection (c) on the excess of—

(A) the sum of—

(i) the amount of the taxable estate, and

(ii) the amount of the adjusted taxable gifts, over

(B) the exemption amount for the calendar year in which the decedent died.

(3) EXEMPTION AMOUNT.—For purposes of paragraph (2), the term "exemption amount" means the amount determined in accordance with the following table:

In the case of calendar year:	***The exemption amount is:***
2002 and 2003	*$700,000*
2004	*$850,000*
2005	*$950,000*
2006 or thereafter	*$1,000,000.*

(4) ADJUSTED TAXABLE GIFTS.—For purposes of paragraph (2), the term "adjusted taxable gifts" means the total amount of the taxable gifts (within the meaning of section 2503) made by the decedent after December 31, 1976, other than gifts which are includible in the gross estate of the decedent.

(c) RATE SCHEDULE.—

(1) IN GENERAL.—

If the amount with respect to which the tentative tax to be computed is:	The tentative tax is:
Not over $10,000	18 percent of such amount.
Over $10,000 but not over $20,000	$1,800, plus 20 percent of the excess of such amount over $10,000.
* * * *	* * *
[Over $2,500,000 but not over $3,000,000	$1,025,800, plus 53% of the excess over $2,500,000.
[Over $3,000,000	$1,290,800, plus 55% of the excessover $3,000,000.]
Over $2,500,000	*$1,025,800, plus 50% of the excess over $2,500,000.*

[(2) PHASEOUT OF GRADUATED RATES AND UNIFIED CREDIT.—The tentative tax determined under paragraph (1) shall be increased by an amount equal to 5 percent of so much of the amount (with respect to which the tentative tax is to be computed) asexceeds $10,000,000 but does not exceed the amount at which the average tax rate under this section is 55 percent.]

(2) PHASE-IN OF REDUCED RATE.—In the case of decedents dying, and gifts made, during 2002, the last item in the table contained in paragraph (1) shall be applied by substituting "53%" for "50%".

(3) PHASEDOWN OF TAX.—In the case of estates of decedents dying, and gifts made, during any calendar year after 2003 and before 2011—

(A) IN GENERAL.—Except as provided in subparagraph (C), the tentative tax under this subsection shall be determined by using a table prescribed by the Secretary (in lieu of using the table contained in paragraph (1)) which is the same as such table; except that—

(i) each of the rates of tax shall be reduced by the number of percentage points determined under subparagraph (B), and

(ii) the amounts setting forth the tax shall be adjusted to the extent necessary to reflect the adjustments under clause (i).

(B) PERCENTAGE POINTS OF REDUCTION.—

For calendar year:	*The number of percentage points is:*
2004	*1.0*
2005	*2.0*
2006	*3.0*
2007	*5.0*
2008	*7.0*
2009	*9.0*
2010	*11.0.*

(C) COORDINATION WITH INCOME TAX RATES.—The reductions under subparagraph (A)—

(i) shall not reduce any rate under paragraph (1) below the lowest rate in section 1(c) applicable to the taxable year which includes the date of death (or, in the case of a gift, the date of the gift), and

(ii) shall not reduce the highest rate under paragraph (1) below the highest rate in section 1(c) for such taxable year.

(D) COORDINATION WITH CREDIT FOR STATE DEATH TAXES.—Rules similar to the rules of subparagraph (A) shall apply to the table contained in section 2011(b) except that the Secretary shall prescribe percentage point reductions which maintain the proportionate relationship (as in effect before any reduction under this paragraph) between the credit under section 2011 and the tax rates under subsection (c).

* * * * * * *

PART II—CREDIT AGAINST TAX

[Sec. 2010. Unified credit against estate tax.]

* * * * * * *

[SEC. 2010. UNIFIED CREDIT AGAINST ESTATE TAX.

[(a) GENERAL RULE.—A credit of the applicable credit amout shall be allowed to the estate of every decedent against the tax imposed by section 2001.

[(b) ADJUSTMENT TO CREDIT FOR CERTAIN GIFTS MADE BEFORE 1977.—The amount of the credit allowable under subsection (a) shall be reduced by an amount equal to 20 percent of the aggregate amount allowed as a specific exemption under section 2521 (as in effect before its repeal by the Tax Reform Act of 1976) with respect to gifts made by the decedent after September 8, 1976.

[(c) APPLICABLE CREDIT AMOUNT.—For purposes of this section, the applicable credit amount is the amount of the tentative tax which would be determined under the rate schedule set forth in section 2001(c) if the amount with respect to which such tentative tax is to be computed were the applicable exclusion amount determined in accordance with the following table:

[In the case of estates of decedents dying, and gifts made, during:	The applicable exclusion amount is:
1998	$625,000
1999	$650,000
2000 and 2001	$675,000
2002 and 2003	$700,000
2004	$850,000
2005	$950,000
2006 or thereafter	$1,000,000

[(d) LIMITATION BASED ON AMOUNT OF TAX.—The amount of the credit allowed by subsection (a) shall not exceed the amount of the tax imposed by section 2001.]

SEC. 2011. CREDIT FOR STATE DEATH TAXES.

(a) * * *

(b) AMOUNT OF CREDIT.—The credit allowed by this section shall not exceed the appropriate amount stated in the following table:

If the [adjusted] taxable estate is:	The maximum tax credit shall be:
Not over $90,000	8/10ths of 1% of the amountby which the adjusted taxable estate exceeds $40,000.
Over $90,000 but not over $140,000	$400 plus 1.6% of the excess over $90,000.

* * * * * * *

[For purposes of this section, the term "adjusted taxable estate" means the taxable estate reduced by $60,000.]

(f) LIMITATION BASED ON AMOUNT OF TAX.—The credit provided by this section shall not exceed the amount of the tax imposed by section 2001[, reduced by the amount of the unified credit provided by section 2010].

SEC. 2012. CREDIT FOR GIFT TAX.

(a) IN GENERAL.—If a tax on a gift has been paid under chapter 12 (sec. 2501 and following), or under corresponding provisions of prior laws, and thereafter on the death of the donor any amount in respect of such gift is required to be included in the value of the gross estate of the decedent for purposes of this chapter, then there shall be credited against the tax imposed by section 2001 the amount of the tax paid on a gift under chapter 12, or under corresponding provisions of prior laws, with respect to so much of the property which constituted the gift as is included in the gross estate, except that the amount of such credit shall not exceed an amount which bears the same ratio to the tax imposed by section 2001 (after deducting from such tax the credit for State death taxes provided by section 2011 [and the unified credit provided by section 2010]) as the value (at the time of the gift or at the time of the death, whichever is lower) of so much of the property which constituted the gift as is included in the gross estate bears to the value of the entire gross estate reduced by the aggregate amount of the charitable and marital deductions allowed under sections 2055, 2056, and 2106(a)(2).

* * * * * * *

SEC. 2013. CREDIT FOR TAX ON PRIOR TRANSFERS.

(a) * * *

* * * * * * *

(c) LIMITATION ON CREDIT.—

(1) IN GENERAL.—The credit provided in this section shall not exceed the amount by which—

(A) the estate tax imposed by section 2001 or section 2101 (after deducting the credits provided for in sections [2010,] 2011, 2012, and 2014) computed without regard to this section, exceeds

* * * * * * *

SEC. 2014. CREDIT FOR FOREIGN DEATH TAXES.

(a) * * *

(b) LIMITATIONS ON CREDIT.—The credit provided in this section with respect to such taxes paid to any foreign country—

(1) * * *

(2) shall not, with respect to all such taxes, exceed an amount which bears the same ratio to the tax imposed by section 2001 (after deducting from such tax the credits provided by sections[2010, 2011,] *2011* and 2012) as the value of property which is—

(A) * * *

* * * * * * *

PART III—GROSS ESTATE

* * * * * * *

SEC. 2031. DEFINITION OF GROSS ESTATE.

(a) * * *

* * * * * * *

(c) ESTATE TAX WITH RESPECT TO LAND SUBJECT TO A QUALIFIED CONSERVATION EASEMENT.—

(1) * * *

(2) APPLICABLE PERCENTAGE.—For purposes of paragraph (1), the term "applicable percentage" means 40 percent reduced (butnot below zero) by 2 percentage points for each percentage point (or fraction thereof) by which the value of the qualified conservation easement is less than 30 percent of the value of the land (determined without regard to the value of such easement and reduced by the value of any retained development right (as defined in paragraph (5)). *The values taken into account under the preceding sentence shall be such values as of the date of the contribution referred to in paragraph (8)(B).*

* * * * * * *

(8) DEFINITIONS.—For purposes of this subsection—

(A) LAND SUBJECT TO A QUALIFIED CONSERVATION EASEMENT.—The term "land subject to a qualified conservation easement" means land—

(i) which is located—

(I) in or within **[**25 miles**]** *50 miles* of an area which, on the date of the decedent's death, is a metropolitan area (as defined by the Office of Management and Budget),

(II) in or within **[**25 miles**]** *50 miles* of an area which, on the date of the decedent's death, is a national park or wilderness area designated as part of the National Wilderness Preservation System (unless it is determined by the Secretary that land in or within **[**25 miles**]** *50 miles* of such a park or wilderness area is not under significant development pressure), or

(III) in or within **[**10 miles**]** *25 miles* of an area which, on the date of the decedent's death, is an Urban National Forest (as designated by the Forest Service),

* * * * * * *

PART IV—TAXABLE ESTATE

* * * * * * *

SEC. 2056A. QUALIFIED DOMESTIC TRUST.

(a) * * *

(b) TAX TREATMENT OF TRUST.—

(1) * * *

* * * * * * *

(12) SPECIAL RULE WHERE SPOUSE BECOMES CITIZEN.—If the surviving spouse of the decedent becomes a citizen of the United States and if—

(A) * * *

* * * * * * *

(C) such spouse elects—

(i) * * *

[(ii) to treat any reduction in the tax imposed by paragraph (1)(A) by reason of the credit allowable under section 2010 with respect to the decedent as a credit allowable to such surviving spouse under section 2505 for purposes of determining the amount of the credit allowable under section 2505 with respect to taxable gifts made by the surviving spouse during the year in which the spouse becomes a citizen or any subsequent year, paragraph (1)(A) shall not apply to any distributions after such spouse becomes such a citizen (and paragraph (1)(B) shall not apply),]

(ii) to treat any reduction in the tax imposed by paragraph (1)(A) by reason of the credit allowable under section 2010 (as in effect on the day before the date of the enactment of the Death Tax Elimination Act of 2001) or the exemption amount allowable under section 2001(b) with respect to the decedent as a credit under section 2505 (as so in effect) or exemption under section 2501 (as the case may be) allowable to such surviving spouse for purposes of determining the amount of the exemption allowable under section 2501 with respect to taxable gifts made by the surviving spouse during the year in which the spouse becomes a citizen or any subsequent year,

* * * * * * *

SEC. 2057. FAMILY-OWNED BUSINESS INTERESTS.

(a) GENERAL RULE.—

(1) * * *

[(2) MAXIMUM DEDUCTION.—The deduction allowed by this section shall not exceed $675,000.

[(3) COORDINATION WITH UNIFIED CREDIT.—

[(A) IN GENERAL.—Except as provided in subparagraph (B), if this section applies to an estate, the applicable exclusion amount under section 2010 shall be $625,000.

[(B) INCREASE IN UNIFIED CREDIT IF DEDUCTION IS LESS THAN $675,000.—If the deduction allowed by this section is less than $675,000, the amount of the applicable exclusion amount under section 2010 shall be increased (but not above the amount which would apply to the estate without regard to this section) by the excess of $675,000 over the amount of the deduction allowed.]

(2) MAXIMUM DEDUCTION.—The deduction allowed by this section shall not exceed the excess of $1,300,000 over the exemption amount (as defined in section 2001(b)(3)).

* * * * * * *

Subchapter B—Estates of Nonresidents Not Citizens

* * * * * * *

SEC. 2101. TAX IMPOSED.

(a) * * *

[(b) COMPUTATION OF TAX.—The tax imposed by this section shall be the amount equal to the excess (if any) of—

[(1) a tentative tax computed under section 2001(c) on the sum of—

[(A) the amount of the taxable estate, and

[(B) the amount of the adjusted taxable gifts, over

[(2) a tentative tax computed under section 2001(c) on the amount of the adjusted taxable gifts.

For purposes of the preceding sentence, there shall be appropriate adjustments in the application of section 2001(c)(2) to reflect the difference between the amount of the credit provided under section 2102(c) and the amount of the credit provided under section 2010.]

(b) COMPUTATION OF TAX.—

(1) IN GENERAL.—The tax imposed by this section shall be the amount equal to the excess (if any) of—

(A) the tentative tax determined under paragraph (2), over

(B) a tentative tax computed under section 2001(c) on the amount of the adjusted taxable gifts.

(2) TENTATIVE TAX.—For purposes of paragraph (1), the tentative tax determined under this paragraph is a tax computed under section 2001(c) on the excess of—

(A) the sum of—

(i) the amount of the taxable estate, and

(ii) the amount of the adjusted taxable gifts, over

(B) the exemption amount for the calendar year in which the decedent died.

(3) EXEMPTION AMOUNT.—

(A) IN GENERAL.—The term "exemption amount" means $60,000.

(B) RESIDENTS OF POSSESSIONS OF THE UNITED STATES.—In the case of a decedent who is considered to be a nonresident not a citizen of the United States under section 2209, the exemption amount under this paragraph shall be the greater of—

(i) $60,000, or

(ii) that proportion of $175,000 which the value of that part of the decedent's gross estate which at the time of his death is situated in the United States bears to the value of his entire gross estate wherever situated.

(C) SPECIAL RULES.—

(i) COORDINATION WITH TREATIES.—To the extent required under any treaty obligation of the United States, the exemption amount allowed under this paragraph shall be equal to the amount which bears the same ratio to the exemption amount under section 2001(b)(3) (for the calendar year in which the decedent died) as the value of the part of the decedent's gross es-

tate which at the time of his death is situated in the United States bears to the value of his entire gross estate wherever situated. For purposes of the preceding sentence, property shall not be treated as situated in the United States if such property is exempt from the tax imposed by this subchapter under any treaty obligation of the United States.

(ii) COORDINATION WITH GIFT TAX EXEMPTION AND UNIFIED CREDIT.—If an exemption has been allowed under section 2501 (or a credit has been allowed under section 2505 as in effect on the day before the date of the enactment of the Death Tax Elimination Act of 2001) with respect to any gift made by the decedent, each dollar amount contained in subparagraph (A) or (B) or the exemption amount applicable under clause (i) of this subparagraph (whichever applies) shall be reduced by the exemption so allowed under section 2501 (or, in the case of such a credit, by the amount of the gift for which the credit was so allowed).

SEC. 2102. CREDITS AGAINST TAX.

(a) * * *

* * * * * * *

[(c) UNIFIED CREDIT.—

[(1) IN GENERAL.—A credit of $13,000 shall be allowed against the tax imposed by section 2101.

[(2) RESIDENTS OF POSSESSIONS OF THE UNITED STATES.—In the case of a decedent who is considered to be a "nonresident not a citizen of the United States" under section 2209, the credit under this subsection shall be the greater of—

[(A) $13,000, or

[(B) that proportion of $46,800 which the value of that part of the decedent's gross estate which at the time of his death is situated in the United States bears to the value of his entire gross estate wherever situated.

[(3) SPECIAL RULES.—

[(A) COORDINATION WITH TREATIES.—To the extent required under any treaty obligation of the United States, the credit allowed under this subsection shall be equal to the amount which bears the same ratio to the applicable credit amount in effect under section 2010(c) for the calendar year which includes the date of death as the value of the part of the decedent's gross estate which at the time of his death is situated in the United States bears to the value of his entire gross estate wherever situated. For purposes of the preceding sentence, property shall not be treated as situated in the United States if such property is exempt from the tax imposed by this subchapter under any treaty obligation of the United States.

[(B) COORDINATION WITH GIFT TAX UNIFIED CREDIT.—If a credit has been allowed under section 2505 with respect to any gift made by the decedent, each dollar amount contained in paragraph (1) or (2) or subparagraph (A) of this paragraph (whichever applies) shall be reduced by the amount so allowed.

[(4) LIMITATION BASED ON AMOUNT OF TAX.—The credit allowed under this subsection shall not exceed the amount of the tax imposed by section 2101.

[(5) APPLICATION OF OTHER CREDITS.—For purposes of subsection (a), sections 2011 to 2013, inclusive, shall be applied as if the credit allowed under this subsection were allowed under section 2010.]

SEC. 2107. EXPATRIATION TO AVOID TAX.

(a) TREATMENT OF EXPATRIATES.—

(1) RATE OF TAX.—A tax computed in accordance with [the table contained in] section 2001 is hereby imposed on the transfer of the taxable estate, determined as provided in section 2106, of every decedent nonresident not a citizen of the United States if, within the 10-year period ending with the date of death, such decedent lost United States citizenship, unless such loss did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle A—

* * * * * * *

[(c) CREDITS.—

[(1) UNIFIED CREDIT.—

[(A) IN GENERAL.—A credit of $13,000 shall be allowed against the tax imposed by subsection (a).

[(B) LIMITATION BASED ON AMOUNT OF TAX.—The credit allowed under this paragraph shall not exceed the amount of the tax imposed by subsection (a).]

(c) EXEMPTION AMOUNT AND CREDITS.—

(1) EXEMPTION AMOUNT.—For purposes of subsection (a), the exemption amount under section 2001 shall be $60,000.

* * * * * * *

(3) OTHER CREDITS.—The tax imposed by subsection (a) shall be credited with the amounts determined in accordance with subsections (a) and (b) of section 2102. [For purposes of subsection (a) of section 2102, sections 2011 to 2013, inclusive, shall be applied as if the credit allowed under paragraph (1) were allowed under section 2010.]

* * * * * * *

CHAPTER 12—GIFT TAX

* * * * * * *

Subchapter A—Determination of Tax Liability

* * * * * * *

SEC. 2502. RATE OF TAX.

[(a) COMPUTATION OF TAX.—The tax imposed by section 2501 for each calendar year shall be an amount equal to the excess of—

[(1) a tentative tax, computed under section 2001(c), on the aggregate sum of the taxable gifts for such calendar year and for each of the preceding calendar periods, over

[(2) a tentative tax, computed under such section, on the aggregate sum of the taxable gifts for each of the preceding calendar periods.]

(a) COMPUTATION OF TAX.—

(1) IN GENERAL.—The tax imposed by section 2501 for each calendar year shall be the amount equal to the excess (if any) of—

(A) the tentative tax determined under paragraph (2) for such calendar year, over

(B) the aggregate amount of tax that would have been payable under this chapter with respect to gifts made by the donor in preceding calendar periods if the tax had been computed under the provisions of section 2001(c) as in effect for such calendar year.

(2) TENTATIVE TAX.—For purposes of paragraph (1), the tentative tax determined under this paragraph for a calendar year is a tax computed under section 2001(c) on the excess of—

(A) the aggregate sum of the taxable gifts for such calendar year and for each of the preceding calendar periods, over

(B) the exemption amount under section 2001(b)(3) for such calendar year.

* * * * * * *

[SEC. 2505. UNIFIED CREDIT AGAINST GIFT TAX.

[(a) GENERAL RULE.—In the case of a citizen or resident of the United States, there shall be allowed as a credit against the tax imposed by section 2501 for each calendar year an amount equal to—

[(1) The applicable credit amount in effect under section 2010(c) for such calendar year, reduced by

[(2) the sum of the amounts allowable as a credit to the individual under this section for allpreceding calendar periods.

[(b) ADJUSTMENT TO CREDIT FOR CERTAIN GIFTS MADE BEFORE 1977.—The amount allowable under subsection (a) shall be reduced by an amount equal to 20 percent of the aggregate amount allowed as a specific exemption under section 2521 (as in effect before its repeal by the Tax Reform Act of 1976) with respect to gifts made by the individual after September 8, 1976.

[(c) LIMITATION BASED ON AMOUNT OF TAX.—The amount of the credit allowed under subsection (a) for any calendar year shall not exceed the amount of the tax imposed by section 2501 for such calendar year.]

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CHAPTER 13—TAX ON CERTAIN GENERATION-SKIPPING TRANSFERS

* * * * * * *

Subchapter D—GST Exemption

* * * * * * *

SEC. 2632. SPECIAL RULES FOR ALLOCATION OF GST EXEMPTION.

(a) * * *

(b) DEEMED ALLOCATION TO CERTAIN LIFETIME DIRECT SKIPS.—

(1) * * *

(2) UNUSED PORTION.—For purposes of paragraph (1), the unused portion of an individual's GST exemption is that portion of such exemption which has not previously been allocated by such individual (or treated as allocated under paragraph (1) [with respect to a prior direct skip] *or subsection (c)(1)*).

(3) SUBSECTION NOT TO APPLY IN CERTAIN CASES.—An individual may elect to have this subsection not apply to a transfer.

(c) DEEMED ALLOCATION TO CERTAIN LIFETIME TRANSFERS TO GST TRUSTS.—

(1) IN GENERAL.—If any individual makes an indirect skip during such individual's lifetime, any unused portion of such individual's GST exemption shall be allocated to the property transferred to the extent necessary to make the inclusion ratio for such property zero. If the amount of the indirect skip exceeds such unused portion, the entire unused portion shall be allocated to the property transferred.

(2) UNUSED PORTION.—For purposes of paragraph (1), the unused portion of an individual's GST exemption is that portion of such exemption which has not previously been—

(A) allocated by such individual,

(B) treated as allocated under subsection (b) with respect to a direct skip occurring during or before the calendar year in which the indirect skip is made, or

(C) treated as allocated under paragraph (1) with respect to a prior indirect skip.

(3) DEFINITIONS.—

(A) INDIRECT SKIP.—For purposes of this subsection, the term "indirect skip" means any transfer of property (other than a direct skip) subject to the tax imposed by chapter 12 made to a GST trust.

(B) GST TRUST.—The term "GST trust" means a trust that could have a generation-skipping transfer with respect to the transferor unless—

(i) the trust instrument provides that more than 25 percent of the trust corpus must be distributed to or may be withdrawn by one or more individuals who are non-skip persons—

(I) before the date that the individual attains age 46,

(II) on or before one or more dates specified in the trust instrument that will occur before the date that such individual attains age 46, or

(III) upon the occurrence of an event that, in accordance with regulations prescribed by the Secretary, may reasonably be expected to occur before the date that such individual attains age 46;

(ii) the trust instrument provides that more than 25 percent of the trust corpus must be distributed to or may be withdrawn by one or more individuals who are non-skip persons and who are living on the date of death of another person identified in the instrument (by name or by class) who is more than 10 years older than such individuals;

(iii) the trust instrument provides that, if one or more individuals who are non-skip persons die on or before a date or event described in clause (i) or (ii), more than 25 percent of the trust corpus either must be distributed to the estate or estates of one or more of such individuals or is subject to a general power of appointment exercisable by one or more of such individuals;

(iv) the trust is a trust any portion of which would be included in the gross estate of a non-skip person (other than the transferor) if such person died immediately after the transfer;

(v) the trust is a charitable lead annuity trust (within the meaning of section 2642(e)(3)(A)) or a charitable remainder annuity trust or a charitable remainder unitrust (within the meaning of section 664(d)); or

(vi) the trust is a trust with respect to which a deduction was allowed under section 2522 for the amount of an interest in the form of the right to receive annual payments of a fixed percentage of the net fair market value of the trust property (determined yearly) and which is required to pay principal to a non-skip person if such person is alive when the yearly payments for which the deduction was allowed terminate.

For purposes of this subparagraph, the value of transferred property shall not be considered to be includible in the gross estate of a non-skip person or subject to a right of withdrawal by reason of such person holding a right to withdraw so much of such property as does not exceed the amount referred to in section 2503(b) with respect to any transferor, and it shall be assumed that powers of appointment held by non-skip persons will not be exercised.

(4) AUTOMATIC ALLOCATIONS TO CERTAIN GST TRUSTS.—For purposes of this subsection, an indirect skip to which section 2642(f) applies shall be deemed to have been made only at the close of the estate tax inclusion period. The fair market value of such transfer shall be the fair market value of the trust property at the close of the estate tax inclusion period.

(5) APPLICABILITY AND EFFECT.—

(A) IN GENERAL.—An individual—

(i) may elect to have this subsection not apply to—

(I) an indirect skip, or

(II) any or all transfers made by such individual to a particular trust, and

(ii) may elect to treat any trust as a GST trust for purposes of this subsection with respect to any or all transfers made by such individual to such trust.

(B) ELECTIONS.—

(i) ELECTIONS WITH RESPECT TO INDIRECT SKIPS.—An election under subparagraph (A)(i)(I) shall be deemed to be timely if filed on a timely filed gift tax return for the calendar year in which the transfer was made or deemed to have been made pursuant to paragraph (4) or on such later date or dates as may be prescribed by the Secretary.

(ii) OTHER ELECTIONS.—An election under clause (i)(II) or (ii) of subparagraph (A) may be made on a timely filed gift tax return for the calendar year for which the election is to become effective.

(d) RETROACTIVE ALLOCATIONS.—

(1) IN GENERAL.—If—

(A) a non-skip person has an interest or a future interest in a trust to which any transfer has been made,

(B) such person—

(i) is a lineal descendant of a grandparent of the transferor or of a grandparent of the transferor's spouse or former spouse, and

(ii) is assigned to a generation below the generation assignment of the transferor, and

(C) such person predeceases the transferor,

then the transferor may make an allocation of any of such transferor's unused GST exemption to any previous transfer or transfers to the trust on a chronological basis.

(2) SPECIAL RULES.—If the allocation under paragraph (1) by the transferor is made on a gift tax return filed on or before the date prescribed by section 6075(b) for gifts made within the calendar year within which the non-skip person's death occurred—

(A) the value of such transfer or transfers for purposes of section 2642(a) shall be determined as if such allocation had been made on a timely filed gift tax return for each calendar year within which each transfer was made,

(B) such allocation shall be effective immediately before such death, and

(C) the amount of the transferor's unused GST exemption available to be allocated shall be determined immediately before such death.

(3) FUTURE INTEREST.—For purposes of this subsection, a person has a future interest in a trust if the trust may permit income or corpus to be paid to such person on a date or dates in the future.

[(c)**]** *(e)* ALLOCATION OF UNUSED GST EXEMPTION.—

(1) * * *

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Subchapter E—Applicable Rate; Inclusion Ratio

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SEC. 2642. INCLUSION RATIO.

(a) INCLUSION RATIO DEFINED.—For purposes of this chapter—

(1) * * *

* * * * * * *

(3) SEVERING OF TRUSTS.—

(A) IN GENERAL.—If a trust is severed in a qualified severance, the trusts resulting from such severance shall be treated as separate trusts thereafter for purposes of this chapter.

(B) QUALIFIED SEVERANCE.—For purposes of subparagraph (A)—

(i) IN GENERAL.—The term "qualified severance" means the division of a single trust and the creation (by any means available under the governing instrument or under local law) of two or more trusts if—

(I) the single trust was divided on a fractional basis, and

(II) the terms of the new trusts, in the aggregate, provide for the same succession of interests of beneficiaries as are provided in the original trust.

(ii) TRUSTS WITH INCLUSION RATIO GREATER THAN ZERO.—If a trust has an inclusion ratio of greater than zero and less than 1, a severance is a qualified severance only if the single trust is divided into two trusts, one of which receives a fractional share of the total value of all trust assets equal to the applicable fraction of the single trust immediately before the severance. In such case, the trust receiving such fractional share shall have an inclusion ratio of zero and the other trust shall have an inclusion ratio of 1.

(iii) REGULATIONS.—The term "qualified severance" includes any other severance permitted under regulations prescribed by the Secretary.

(C) TIMING AND MANNER OF SEVERANCES.—A severance pursuant to this paragraph may be made at any time. The Secretary shall prescribe by forms or regulations the manner in which the qualified severance shall be reported to the Secretary.

(b) VALUATION RULES, ETC.—Except as provided in subsection (f)—

[(1) GIFTS FOR WHICH GIFT TAX RETURN FILED OR DEEMED ALLOCATION MADE.—If the allocation of the GST exemption to any property is made on a gift tax return filed on or before the date prescribed by section 6075(b) or is deemed to be made under section 2632(b)(1)—

[(A) the value of such property for purposes of subsection (a) shall be its value for purposes of chapter 12, and

[(B) such allocation shall be effective on and after the date of such transfer.**]**

(1) GIFTS FOR WHICH GIFT TAX RETURN FILED OR DEEMED ALLOCATION MADE.—If the allocation of the GST exemption to any transfers of property is made on a gift tax return filed on or before the date prescribed by section 6075(b) for such transfer or is deemed to be made under section 2632 (b)(1) or (c)(1)—

(A) the value of such property for purposes of subsection (a) shall be its value as finally determined for purposes of chapter 12 (within the meaning of section 2001(f)(2)), or, in the case of an allocation deemed to have been made at the

close of an estate tax inclusion period, its value at the time of the close of the estate tax inclusion period, and

(B) such allocation shall be effective on and after the date of such transfer, or, in the case of an allocation deemed to have been made at the close of an estate tax inclusion period, on and after the close of such estate tax inclusion period.

(2) TRANSFERS AND ALLOCATIONS AT OR AFTER DEATH.—

[(A) TRANSFERS AT DEATH.—If property is transferred as a result of the death of the transferor, the value of such property for purposes of subsection (a) shall be its value for purposes of chapter 11; except that, if the requirements prescribed by the Secretary respecting allocation of post-death changes in value are not met, the value of such property shall be determined as of the time of the distribution concerned.]

(A) TRANSFERS AT DEATH.—If property is transferred as a result of the death of the transferor, the value of such property for purposes of subsection (a) shall be its value as finally determined for purposes of chapter 11; except that, if the requirements prescribed by the Secretary respecting allocation of post-death changes in value are not met, the value of such property shall be determined as of the time of the distribution concerned.

* * * * * * *

(g) RELIEF PROVISIONS.—

(1) RELIEF FROM LATE ELECTIONS.—

(A) IN GENERAL.—The Secretary shall by regulation prescribe such circumstances and procedures under which extensions of time will be granted to make—

(i) an allocation of GST exemption described in paragraph (1) or (2) of subsection (b), and

(ii) an election under subsection (b)(3) or (c)(5) of section 2632.

Such regulations shall include procedures for requesting comparable relief with respect to transfers made before the date of the enactment of this paragraph.

(B) BASIS FOR DETERMINATIONS.—In determining whether to grant relief under this paragraph, the Secretary shall take into account all relevant circumstances, including evidence of intent contained in the trust instrument or instrument of transfer and such other factors as the Secretary deems relevant. For purposes of determining whether to grant relief under this paragraph, the time for making the allocation (or election) shall be treated as if not expressly prescribed by statute.

(2) SUBSTANTIAL COMPLIANCE.—An allocation of GST exemption under section 2632 that demonstrates an intent to have the lowest possible inclusion ratio with respect to a transfer or a trust shall be deemed to be an allocation of so much of the transferor's unused GST exemption as produces the lowest possible inclusion ratio. In determining whether there has been substantial compliance, all relevant circumstances shall be taken into account, including evidence of intent contained in the

trust instrument or instrument of transfer and such other factors as the Secretary deems relevant.

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Subtitle F—Procedure and Administration

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CHAPTER 61—INFORMATION AND RETURNS

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Subchapter A—Returns and Records

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PART II—TAX RETURNS OR STATEMENTS

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Subpart C—Estate and Gift Tax Returns

* * * * * * *

SEC. 6018. ESTATE TAX RETURNS.

(a) RETURNS BY EXECUTOR.—

(1) CITIZENS OR RESIDENTS.—In all cases where the gross estate at the death of a citizen or resident exceeds **[**the applicable exclusion amount in effect under section 2010(c)**]** *the exemption amount under section 2001(b)(3)* for the calendar year which includes the date of death, the executor shall make a return with respect to the estate tax imposed by subtitle B.

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CHAPTER 62—TIME AND PLACE FOR PAYING TAX

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Subchapter B—Extension of Time for Payment

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SEC. 6166. EXTENSION OF TIME FOR PAYMENT OF ESTATE TAX WHERE ESTATE CONSISTS LARGELY OF INTEREST IN CLOSELY HELD BUSINESS.

(a) * * *

(b) DEFINITIONS AND SPECIAL RULES.—

(1) INTEREST IN CLOSELY HELD BUSINESS.—For purposes of this section, the term "interest in a closely held business" means—

(A) * * *

(B) an interest as a partner in a partnership carrying on a trade or business, if—

(i) * * *

(ii) such partnership had [15] *45* or fewer partners; or

(C) stock in a corporation carrying on a trade or business if—

(i) * * *

(ii) such corporation had [15] *45* or fewer shareholders.

* * * * * * *

(9) DEFERRAL NOT AVAILABLE FOR PASSIVE ASSETS.—

(A) * * *

(B) PASSIVE ASSET DEFINED.—For purposes of this paragraph—

(i) * * *

* * * * * * *

(iii) EXCEPTION FOR ACTIVE CORPORATIONS.—If—

(I) a corporation owns 20 percent or more in value of the voting stock of another corporation, or such other corporation has [15] *45* or fewer shareholders, and

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CHAPTER 67—INTEREST

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Subchapter A—Interest on Underpayments

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SEC. 6601. INTEREST ON UNDERPAYMENT, NONPAYMENT, OR EXTENSIONS OF TIME FOR PAYMENT, OF TAX.

(a) * * *

* * * * * * *

(j) 2-PERCENT RATE ON CERTAIN PORTION OF ESTATE TAX EXTENDED UNDER SECTION 6166.—

(1) * * *

(2) 2-PERCENT PORTION.—For purposes of this subsection, the term "2-percent portion" means the lesser of—

[(A)(i) the amount of the tentative tax which would be determined under the rate schedule set forth in section 2001(c) if the amount with respect to which such tentative tax is to be computed were the sum of $1,000,000 and the applicable exclusion amount in effect under section 2010(c), reduced by

[(ii) the applicable credit amount in effect under section 2010(c), or]

(A) the amount of the tentative tax which would be determined under the rate schedule set forth in section 2001(c) if the amount with respect to which such tentative tax is to be computed were $1,000,000, or

* * * * * * *

THE FOLLOWING AMENDMENTS ARE EFFECTIVE AFTER DECEMBER 31, 2010

Subtitle A—Income Taxes

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CHAPTER 1—NORMAL TAXES AND SURTAXES

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Subchapter B—Computation of Taxable Income

* * * * * * *

PART III—ITEMS SPECIFICALLY EXCLUDED FROM GROSS INCOME

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SEC. 121. EXCLUSION OF GAIN FROM SALE OF PRINCIPAL RESIDENCE.

(a) * * *

* * * * * * *

(d) SPECIAL RULES.—

(1) * * *

* * * * * * *

(9) PROPERTY ACQUIRED FROM A DECEDENT.—The exclusion under this section shall apply to property sold by—

(A) the estate of a decedent, and

(B) any individual who acquired such property from the decedent (within the meaning of section 1022),

determined by taking into account the ownership and use by the decedent.

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PART VI—ITEMIZED DEDUCTIONS FOR INDIVIDUALS AND CORPORATIONS

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SEC. 170. CHARITABLE, ETC., CONTRIBUTIONS AND GIFTS.

(a) * * *

* * * * * * *

(e) CERTAIN CONTRIBUTIONS OF ORDINARY INCOME AND CAPITAL GAIN PROPERTY.—

(1) GENERAL RULE.—The amount of any charitable contribution of property otherwise taken into account under this section shall be reduced by the sum of—

(A) * * *

* * * * * * *

For purposes of applying this paragraph in the case of a charitable contribution of stock in an S corporation, rules similar to the rules of section 751 shall apply in determining whether gain on such stock would have been long-term capital gain if such stock were

sold by the taxpayer. *For purposes of this paragraph, the determination of whether property is a capital asset shall be made without regard to the exception contained in section 1221(a)(3)(C) for basis determined under section 1022.*

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Subchapter J—Estates, Trusts, Beneficiaries, and Decedents

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PART I—ESTATES, TRUSTS, AND BENEFICIARIES

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Subpart F—Miscellaneous

Sec. 681. Limitation on charitable deduction.

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Sec. 684. Recognition of gain on certain transfers to certain foreign trusts and estates *and nonresident aliens*.

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SEC. 684. RECOGNITION OF GAIN ON CERTAIN TRANSFERS TO CERTAIN FOREIGN TRUSTS AND ESTATES *AND NONRESIDENT ALIENS*.

(a) IN GENERAL.—Except as provided in regulations, in the case of any transfer of property by a United States person to a foreign estate or trust *or to a nonresident not a citizen of the United States*, for purposes of this subtitle, such transfer shall be treated as a sale or exchange for an amount equal to the fair market value of the property transferred, and thetransferor shall recognize as gain the excess of—

(1) * * *

* * * * * * *

(b) EXCEPTION.—Subsection (a) shall not apply to a transfer to a trust by a United States person to the extent that any *United States* person is treated as the owner of such trust under section 671.

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Subchapter O—Gain or Loss on Disposition of Property

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PART II—BASIS RULES OF GENERAL APPLICATION

Sec. 1011. Adjusted basis for determining gain or loss.

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Sec. 1022. Treatment of property acquired from a decedent dying after December 31, 2010.

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SEC. 1022. TREATMENT OF PROPERTY ACQUIRED FROM A DECEDENT DYING AFTER DECEMBER 31, 2010.

(a) IN GENERAL.—Except as otherwise provided in this section—

(1) property acquired from a decedent dying after December 31, 2010, shall be treated for purposes of this subtitle as transferred by gift, and

(2) the basis of the person acquiring property from such a decedent shall be the lesser of—

(A) the adjusted basis of the decedent, or

(B) the fair market value of the property at the date of the decedent's death.

(b) BASIS INCREASE FOR CERTAIN PROPERTY.—

(1) IN GENERAL.—In the case of property to which this subsection applies, the basis of such property under subsection (a) shall be increased by its basis increase under this subsection.

(2) BASIS INCREASE.—For purposes of this subsection—

(A) IN GENERAL.—The basis increase under this subsection for any property is the portion of the aggregate basis increase which is allocated to the property pursuant to this section.

(B) AGGREGATE BASIS INCREASE.—In the case of any estate, the aggregate basis increase under this subsection is $1,300,000.

(C) LIMIT INCREASED BY UNUSED BUILT-IN LOSSES AND LOSS CARRYOVERS.—The limitation under subparagraph (B) shall be increased by—

(i) the sum of the amount of any capital loss carryover under section 1212(b), and the amount of any net operating loss carryover under section 172, which would (but for the decedent's death) be carried from the decedent's last taxable year to a later taxable year of the decedent, plus

(ii) the sum of the amount of any losses that would have been allowable under section 165 if the property acquired from the decedent had been sold at fair market value immediately before the decedent's death.

(3) DECEDENT NONRESIDENTS WHO ARE NOT CITIZENS OF THE UNITED STATES.—In the case of a decedent nonresident not a citizen of the United States—

(A) paragraph (2)(B) shall be applied by substituting "$60,000" for "$1,300,000", and

(B) paragraph (2)(C) shall not apply.

(c) ADDITIONAL BASIS INCREASE FOR PROPERTY ACQUIRED BY SURVIVING SPOUSE.—

(1) IN GENERAL.—In the case of property to which this subsection applies and which is qualified spousal property, the basis of such property under subsection (a) (as increased, if any, under subsection (b)) shall be increased by its spousal property basis increase.

(2) SPOUSAL PROPERTY BASIS INCREASE.—For purposes of this subsection—

(A) IN GENERAL.—The spousal property basis increase for property referred to in paragraph (1) is the portion of the aggregate spousal property basis increase which is allocated to the property pursuant to this section.

(B) AGGREGATE SPOUSAL PROPERTY BASIS INCREASE.—In the case of any estate, the aggregate spousal property basis increase is $3,000,000.

(3) QUALIFIED SPOUSAL PROPERTY.—For purposes of this subsection, the term "qualified spousal property" means—

(A) outright transfer property, and

(B) qualified terminable interest property.

(4) OUTRIGHT TRANSFER PROPERTY.—For purposes of this subsection—

(A) IN GENERAL.—The term "outright transfer property" means any interest in property acquired from the decedent by the decedent's surviving spouse.

(B) EXCEPTION.—Subparagraph (A) shall not apply where, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, an interest passing to the surviving spouse will terminate or fail—

(i)(I) if an interest in such property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to any person other than such surviving spouse (or the estate of such spouse), and

(II) if by reason of such passing such person (or his heirs or assigns) may possess or enjoy any part of such property after such termination or failure of the interest so passing to the surviving spouse, or

(ii) if such interest is to be acquired for the surviving spouse, pursuant to directions of the decedent, by his executor or by the trustee of a trust.

For purposes of this subparagraph, an interest shall not be considered as an interest which will terminate or fail merely because it is the ownership of a bond, note, or similar contractual obligation, the discharge of which would not have the effect of an annuity for life or for a term.

(C) INTEREST OF SPOUSE CONDITIONAL ON SURVIVAL FOR LIMITED PERIOD.—For purposes of this paragraph, an interest passing to the surviving spouse shall not be considered as an interest which will terminate or fail on the death of such spouse if—

(i) such death will cause a termination or failure of such interest only if it occurs within a period not exceeding 6 months after the decedent's death, or only if it occurs as a result of a common disaster resulting in the death of the decedent and the surviving spouse, or only if it occurs in the case of either such event; and

(ii) such termination or failure does not in fact occur.

(5) QUALIFIED TERMINABLE INTEREST PROPERTY.—For purposes of this subsection—

(A) IN GENERAL.—The term "qualified terminable interest property" means property—

(i) which passes from the decedent, and

(ii) in which the surviving spouse has a qualifying income interest for life.

(B) QUALIFYING INCOME INTEREST FOR LIFE.—The surviving spouse has a qualifying income interest for life if—

(i) the surviving spouse is entitled to all the income from the property, payable annually or at more frequent intervals, or has a usufruct interest for life in the property, and

(ii) no person has a power to appoint any part of the property to any person other than the surviving spouse.

Clause (ii) shall not apply to a power exercisable only at or after the death of the surviving spouse. To the extent provided in regulations, an annuity shall be treated in a manner similar to an income interest in property (regardless of whether the property from which the annuity is payable can be separately identified).

(C) PROPERTY INCLUDES INTEREST THEREIN.—The term "property" includes an interest in property.

(D) SPECIFIC PORTION TREATED AS SEPARATE PROPERTY.—A specific portion of property shall be treated as separate property. For purposes of the preceding sentence, the term "specific portion" only includes a portion determined on a fractional or percentage basis.

(d) DEFINITIONS AND SPECIAL RULES FOR APPLICATION OF SUBSECTIONS (b) AND (c).—

(1) PROPERTY TO WHICH SUBSECTIONS (b) AND (c) APPLY.—

(A) IN GENERAL.—The basis of property acquired from a decedent may be increased under subsection (b) or (c) only if the property was owned by the decedent at the time of death.

(B) RULES RELATING TO OWNERSHIP.—

(i) JOINTLY HELD PROPERTY.—In the case of property which was owned by the decedent and another person as joint tenants with right of survivorship or tenants by the entirety—

(I) if the only such other person is the surviving spouse, the decedent shall be treated as the owner of only 50 percent of the property,

(II) in any case (to which subclause (I) does not apply) in which the decedent furnished consideration for the acquisition of the property, the decedent shall be treated as the owner to the extent of the portion of the property which is proportionate to such consideration, and

(III) in any case (to which subclause (I) does not apply) in which the property has been acquired by gift, bequest, devise, or inheritance by the decedent and any other person as joint tenants with right of survivorship and their interests are not otherwise specified or fixed by law, the decedent shall be treated as the owner to the extent of the value of a fractional part to be determined by dividing the value of the property by the number of joint tenants with right of survivorship.

(ii) REVOCABLE TRUSTS.—The decedent shall be treated as owning property transferred by the dece-

dent during life to a revocable trust to pay all of the income during the decedent's life to the decedent or at the direction of the decedent.

(iii) POWERS OF APPOINTMENT.—The decedent shall not be treated as owning any property by reason of holding a power of appointment with respect to such property.

(iv) COMMUNITY PROPERTY.—Property which represents the surviving spouse's one-half share of community property held by the decedent and the surviving spouse under the community property laws of any State or possession of the United States or any foreign country shall be treated for purposes of this section as owned by, and acquired from, the decedent if at least one-half of the whole of the community interest in such property is treated as owned by, and acquired from, the decedent without regard to this clause.

(C) PROPERTY ACQUIRED BY DECEDENT BY GIFT WITHIN 3 YEARS OF DEATH.—

(i) IN GENERAL.—Subsections (b) and (c) shall not apply to property acquired by the decedent by gift or by inter vivos transfer for less than adequate and full consideration in money or money's worth during the 3-year period ending on the date of the decedent's death.

(ii) EXCEPTION FOR CERTAIN GIFTS FROM SPOUSE.—Clause (i) shall not apply to property acquired by the decedent from the decedent's spouse unless, during such 3-year period, such spouse acquired the property in whole or in part by gift or by inter vivos transfer for less than adequate and full consideration in money or money's worth.

(D) STOCK OF CERTAIN ENTITIES.—Subsections (b) and (c) shall not apply to—

(i) stock or securities a foreign personal holding company,

(ii) stock of a DISC or former DISC,

(iii) stock of a foreign investment company, or

(iv) stock of a passive foreign investment company unless such company is a qualified electing fund (as defined in section 1295) with respect to the decedent.

(2) FAIR MARKET VALUE LIMITATION.—The adjustments under subsection (b) and (c) shall not increase the basis of any interest in property acquired from the decedent above its fair market value in the hands of the decedent as of the date of the decedent's death.

(3) ALLOCATION RULES.—

(A) IN GENERAL.—The executor shall allocate the adjustments under subsections (b) and (c) on the return required by section 6018.

(B) CHANGES IN ALLOCATION.—Any allocation made pursuant to subparagraph (A) may be changed only as provided by the Secretary.

(4) INFLATION ADJUSTMENT OF BASIS ADJUSTMENT AMOUNTS.—

(A) IN GENERAL.—In the case of decedents dying in a calendar year after 2011, the $1,300,000, $60,000, and $3,000,000 dollar amounts in subsections (b) and (c)(2)(B) shall each be increased by an amount equal to the product of—

(i) such dollar amount, and

(ii) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year, determined by substituting "2010" for "1992" in subparagraph (B) thereof.

(B) ROUNDING.—If any increase determined under subparagraph (A) is not a multiple of—

(i) $100,000 in the case of the $1,300,000 amount,

(ii) $5,000 in the case of the $60,000 amount, and

(iii) $250,000 in the case of the $3,000,000 amount,

such increase shall be rounded to the next lowest multiple thereof.

(e) PROPERTY ACQUIRED FROM THE DECEDENT.—For purposes of this section, the following property shall be considered to have been acquired from the decedent:

(1) Property acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent.

(2) Property transferred by the decedent during his lifetime in trust to pay the income for life to or on the order or direction of the decedent, with the right reserved to the decedent at all times before his death—

(A) to revoke the trust, or

(B) to make any change in the enjoyment thereof through the exercise of a power to alter, amend, or terminate the trust.

(3) Any other property passing from the decedent by reason of death to the extent that such property passed without consideration.

(f) COORDINATION WITH SECTION 691.—This section shall not apply to property which constitutes a right to receive an item of income in respect of a decedent under section 691.

(g) CERTAIN LIABILITIES DISREGARDED.—In determining whether gain is recognized on the acquisition of property—

(1) from a decedent by a decedent's estate or any beneficiary, and

(2) from the decedent's estate by any beneficiary,

and in determining the adjusted basis of such property, liabilities in excess of basis shall be disregarded.

(h) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this section.

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PART III—COMMON NONTAXABLE EXCHANGES

Sec. 1031. Exchange of property held for productive use or investment.

* * * * * * *

[Sec. 1040. Transfer of certain farm, etc., real property.]

Sec. 1040. Use of appreciated carryover basis property to satisfy pecuniary bequest.

* * * * * * *

[SEC. 1040. TRANSFER OF CERTAIN FARM, ETC., REAL PROPERTY.

[(a) GENERAL RULE.—If the executor of the estate of any decedent transfers to a qualified heir (within the meaning ofsection 2032A(e)(1)) any property with respect to which an election was made under section 2032A, then gain on such transfer shall be recognized to the estate only to the extent that, on the date of such transfer, the fair market value of such property exceeds the value of such property for purposes of chapter 11 (determined without regard to section 2032A).

[(b) SIMILAR RULE FOR CERTAIN TRUSTS.—To the extent provided in regulations prescribed by the Secretary, a rule similar to the rule provided in subsection (a) shall apply where the trustee of a trust (any portion of which is included in the gross estate of the decedent) transfers property with respect to which an electionwas made under section 2032A.

[(c) BASIS OF PROPERTY ACQUIRED IN TRANSFER DESCRIBED IN SUBSECTION (A) OR (B).—The basis of property acquired in a transfer with respect to which gain realized is not recognizedby reason of subsection (a) or (b) shall be the basis of such property immediately before the transfer increased by the amount of the gain recognized to the estate or trust on the transfer.]

SEC. 1040. USE OF APPRECIATED CARRYOVER BASIS PROPERTY TO SATISFY PECUNIARY BEQUEST.

(a) IN GENERAL.—If the executor of the estate of any decedent satisfies the right of any person to receive a pecuniary bequest with appreciated property, then gain on such exchange shall be recognized to the estate only to the extent that, on the date of such exchange, the fair market value of such property exceeds such value on the date of death.

(b) SIMILAR RULE FOR CERTAIN TRUSTS.—To the extent provided in regulations prescribed by the Secretary, a rule similar to the rule provided in subsection (a) shall apply where—

(1) by reason of the death of the decedent, a person has a right to receive from a trust a specific dollar amount which is the equivalent of a pecuniary bequest, and

(2) the trustee of a trust satisfies such right with property.

(c) BASIS OF PROPERTY ACQUIRED IN EXCHANGE DESCRIBED IN SUBSECTION (a) OR (b).—The basis of property acquired in an exchange with respect to which gain realized is not recognized by reason of subsection (a) or (b) shall be the basis of such property immediately before the exchange increased by the amount of the gain recognized to the estate or trust on the exchange.

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Subchapter P—Capital Gains and Losses

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PART III—GENERAL RULES FOR DETERMINING CAPITAL GAINS AND LOSSES

* * * * * * *

SEC. 1221. CAPITAL ASSET DEFINED.

(a) IN GENERAL.—For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

(1) * * *

* * * * * * *

(3) a copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property, held by—

(A) * * *

* * * * * * *

(C) a taxpayer in whose hands the basis of such property is determined *(other than by reason of section 1022)*, for purposes of determining gain from a sale or exchange, in whole or part by reference to the basis of such property in the hands of a taxpayer described in subparagraph (A) or (B);

* * * * * * *

PART IV—SPECIAL RULES FOR DETERMINING CAPITAL GAINS AND LOSSES

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SEC. 1246. GAIN ON FOREIGN INVESTMENT COMPANY STOCK.

(a) * * *

* * * * * * *

[(e) RULES RELATING TO STOCK ACQUIRED FROM A DECEDENT.—

[(1) BASIS.—In the case of stock of a foreign investment company acquired by bequest, devise, or inheritance (or by the decedent's estate) from a decedent dying after December 31, 1962, the basis determined under section 1014 shall be reduced (but not below the adjusted basis of such stock in the hands of the decedent immediately before his death) by the amount of the decedent's ratable share of the earnings and profits of such company accumulated after December 31, 1962. Any stock so acquired shall be treated as stock described in subsection (c).

[(2) DEDUCTION FOR ESTATE TAX.—If stock to which subsection (a) applies is acquired from a decedent, the taxpayer shall, under regulations prescribed by the Secretary, be allowed (for the taxable year of the sale or exchange) a deduction from gross income equal to that portion of the decedent's estate tax deemed paid which is attributable to the excess of (A) the value at which such stock was taken into account for purposes of determining the value of the decedent's gross estate, over (B) the value at which it would have been so taken into account if such value had been reduced by the amount described in paragraph (1).]

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PART VI—TREATMENT OF CERTAIN PASSIVE FOREIGN INVESTMENT COMPANIES

* * * * * * *

Subpart A—Interest on Tax Deferral

* * * * * * *

SEC. 1291. INTEREST ON TAX DEFERRAL.

(a) * * *

* * * * * * *

(e) CERTAIN BASIS, ETC., RULES MADE APPLICABLE.—Except to the extent inconsistent with the regulations prescribed under subsection (f), rules similar to the rules of subsections (c), (d), [(e),] and (f) of section 1246 shall apply for purposes of this section[; except that—

[(1) the reduction under subsection (e) of such section shall be the excess of the basis determined under section 1014 over the adjusted basis of the stock immediately before the decedent's death, and

[(2) such a reduction shall not apply in the case of a decedent who was a nonresident alien at all times during his holding period in the stock.].

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Subpart C—Election of Mark to Market for Marketable Stock

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SEC. 1296. ELECTION OF MARK TO MARKET FOR MARKETABLE STOCK.

(a) * * *

* * * * * * *

[(i) STOCK ACQUIRED FROM A DECEDENT.—In the case of stock of a passive foreign investment company which is acquired by bequest, devise, or inheritance (or by the decedent's estate) and with respect to which an election under this section was in effect as of the date of the decedent's death, notwithstanding section 1014, the basis of such stock in the hands of the person so acquiring it shall be the adjusted basis of such stock in the hands of the decedent immediately before his death (or, if lesser, the basis which would have been determined under section 1014 without regard to this subsection).]

* * * * * * *

[Subtitle B—Estate and Gift Taxes

[CHAPTER 11—ESTATE TAX

[Subchapter A—Estates of citizens or residents

[PART I—TAX IMPOSED

[SEC. 2001. IMPOSITION AND RATE OF TAX.

[(a) IMPOSITION.—A tax is hereby imposed on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

[(b) COMPUTATION OF TAX.—The tax imposed by this section shall be the amount equal to the excess (if any) of—

[(1) a tentative tax computed under subsection (c) on the sum of—

[(A) the amount of the taxable estate, and

[(B) the amount of the adjusted taxable gifts, over

[(2) the aggregate amount of tax which would have been payable under chapter 12 with respect to gifts made by the decedent after December 31, 1976, if the provisions of subsection (c) (as in effect at the decedent's death) had been applicable at the time of such gifts.

[For purposes of paragraph (1)(B), the term "adjusted taxable gifts" means the total amount of the taxable gifts (within the meaning of section 2503) made by the decedent after December 31, 1976, other than gifts which are includible in the gross estate of the decedent.

[(c) RATE SCHEDULE.—

[(1) IN GENERAL.—

[If the amount with respect to which the tentative tax to be computed is:	The tentative tax is:
Not over $10,000	18 percent of such amount.
Over $10,000 but not over $20,000	$1,800, plus 20 percent of the excess of such amount over $10,000.
Over $20,000 but not over $40,000	$3,800, plus 22 percent of the excess of such amount over $20,000.
Over $40,000 but not over $60,000	$8,200 plus 24 percent of the excess of such amount over $40,000.
Over $60,000 but not over $80,000	$13,000, plus 26 percent of the excess of such amount over $60,000.
Over $80,000 but not over $100,000	$18,200, plus 28 percent of the excess of such amount over $80,000.
Over $100,000 but not over $150,000	$23,800, plus 30 percent of the excess of such amount over $100,000.
Over $150,000 but not over $250,000	$38,800, plus 32 percent of the excess of such amount over $150,000.

[If the amount with respect to which the tentative tax to be computed is:	The tentative tax is:
Over $250,000 but not over $500,000	$70,800, plus 34 percent of the excess of such amount over $250,000.
Over $500,000 but not over $750,000	$155,800, plus 37 percent of the excess of such amount over $500,000.
Over $750,000 but not over $1,000,000	$248,300, plus 39 percent of the excess of such amount over $750,000.
Over $1,000,000 but not over $1,250,000	$345,800, plus 41 percent of the excess of such amount over $1,000,000.
Over $1,250,000 but not over $1,500,000	$448,300, plus 43 percent of the excess of such amount over $1,250,000.
Over $1,500,000 but not over $2,000,000	$555,800, plus 45 percent of the excess of such amount over $1,500,000.
Over $2,000,000 but not over $2,500,000	$780,800, plus 49 percent of the excess of such amount over $2,000,000.
Over $2,500,000 but not over $3,000,000	$1,025,800, plus 53% of the excess over $2,500,000.
Over $3,000,000	$1,290,800, plus 55% of the excessover $3,000,000.

[(2) PHASEOUT OF GRADUATED RATES AND UNIFIED CREDIT.—The tentative tax determined under paragraph (1) shall be increased by an amount equal to 5 percent of so much of the amount (with respect to which the tentative tax is to be computed) as exceeds $10,000,000 but does not exceed the amount at which the average tax rate under this section is 55 percent.

[(d) ADJUSTMENT FOR GIFT TAX PAID BY SPOUSE.—For purposes of subsection (b)(2), if—

[(1) the decedent was the donor of any gift one-half of which was considered under section 2513 as made by the decedent's spouse, and

[(2) the amount of such gift is includible in the gross estate of the decedent, any tax payable by the spouse under chapter 12 on such gift (as determined under section 2012(d)) shall be treated as a tax payable with respect to a gift made by the decedent.

[(e) COORDINATION OF SECTIONS 2513 AND 2035.—If—

[(1) the decedent's spouse was the donor of any gift one-half of which was considered under section 2513 as made by the decedent, and

[(2) the amount of such gift is includible in the gross estate of the decedent's spouse by reason of section 2035, such gift shall not be included in the adjusted taxable gifts of the decedent for purposes of subsection (b)(1)(B), and the aggregate amount determined under subsection (b)(2) shall be reduced by the amount (if any) determined under subsection (d) which was

treated as a taxpayable by the decedent's spouse with respect to such gift.

[(f) VALUATION OF GIFTS.—

[(1) IN GENERAL.—If the time has expired under section 6501 within which a tax may be assessed under chapter 12 (or under corresponding provisions of prior laws) on—

[(A) the transfer of property by gift made during a preceding calendar period (as defined in section 2502(b)); or

[(B) an increase in taxable gifts required under section 2701(d), the value thereof shall, for purposes of computing the tax under this chapter, be the value as finally determined for purposes of chapter 12.

[(2) FINAL DETERMINATION.—For purposes of paragraph (1), a value shall be treated as finally determined for purposes of chapter 12 if—

[(A) the value is shown on a return under such chapter and such value is not contested by the Secretary before the expiration of the time referred to in paragraph (1) with respect to such return;

[(B) in a case not described in subparagraph (A), the value is specified by the Secretary and such value is not timely contested by the taxpayer; or

[(C) the value is determined by a court or pursuant to a settlement agreement with the Secretary.

For purposes of subparagraph (A), the value of an item shall be treated as shown on a return if the item is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary of the nature of such item.

[SEC. 2002. LIABILITY FOR PAYMENT.

[The tax imposed by this chapter shall be paid by the executor.

[PART II—CREDITS AGAINST TAX

[SEC. 2010. UNIFIED CREDIT AGAINST ESTATE TAX.

[(a) GENERAL RULE.—A credit of the applicable credit amout shall be allowed to the estate of every decedent against the tax imposed by section 2001.

[(b) ADJUSTMENT TO CREDIT FOR CERTAIN GIFTS MADE BEFORE 1977—The amount of the credit allowable under subsection (a) shall be reduced by an amount equal to 20 percent of the aggregate amount allowed as a specific exemption under section 2521 (as in effect before its repeal by the Tax Reform Act of 1976) with respect to gifts made by the decedent after September 8, 1976.

[(c) APPLICABLE CREDIT AMOUNT.—For purposes of this section, the applicable credit amount is the amount of the tentative tax which would be determined under the rate schedule set forth in section 2001(c) if the amount with respect to which such tentative tax is to be computed were the applicable exclusion amount determined in accordance with the following table:

[In the case of estates of decedents [dying, and gifts made, during:	The applicable exclusion amount is:
1998	$625,000
1999	$650,000
2000 and 2001	$675,000
2002 and 2003	$700,000
2004	$850,000
2005	$950,000
2006 or thereafter	$1,000,000

[(d) LIMITATION BASED ON AMOUNT OF TAX.—The amount of the credit allowed by subsection (a) shall not exceed the amount of the tax imposed by section 2001.

[SEC. 2011. CREDIT FOR STATE DEATH TAXES.

[(a) IN GENERAL.—The tax imposed by section 2001 shall be credited with the amount of any estate, inheritance, legacy, or succession taxes actually paid to any State or the District of Columbia, in respect of any property included in the gross estate (not including any such taxes paid with respect to the estate of a person other than the decedent).

[(b) AMOUNT OF CREDIT.—The credit allowed by this section shall not exceed the appropriate amount stated in the following table:

[If the adjusted taxable estate is:	The maximum tax credit shall be:
Not over $90,000	8/10ths of 1% of the amountby which the adjusted taxable estate exceeds $40,000.
Over $90,000 but not over $140,000	$400 plus 1.6% of the excess over $90,000.
Over $140,000 but not over $240,000	$1,200 plus 2.4% of the excess over $140,000.
Over $240,000 but not over $440,000	$3,600 plus 3.2% of the excess over $240,000.
Over $440,000 but not over $640,000	$10,000 plus 4% of the excess over $440,000.
Over $640,000 but not over $840,000	$18,000 plus 4.8% of the excess over $640,000.
Over $840,000 but not over $1,040,000	$27,600 plus 5.6% of the excess over $840,000.
Over $1,040,000 but not over $1,540,000	$38,800 plus 6.4% of the excess over $1,040,000.
Over $1,540,000 but not over $2,040,000	$70,800 plus 7.2% of the excess over $1,540,000.
Over $2,040,000 but not over $2,540,000	$106,800 plus 8% of the excess over $2,040,000.
Over $2,540,000 but not over $3,040,000	$146,800 plus 8.8% of the excess over $2,540,000
Over $3,040,000 but not over $3,540,000	$190,800 plus 9.6% of the excess over $3,040,000.
Over $3,540,000 but not over $4,040,000	$238,800 plus 10.4% of the excess over $3,540,000.
Over $4,040,000 but not over $5,040,000	$290,800 plus 11.2% of the excess over $4,040,000.
Over $5,040,000 but not over $6,040,000	$402,800 plus 12% of the excess over $5,040,000.

[If the adjusted taxable estate is:	The maximum tax credit shall be:
Over $6,040,000 but not over $7,040,000	$522,800 plus 12.8% of the excess over $6,040,000.
Over $7,040,000 but not over $8,040,000	$650,800 plus 13.6% of the excess over $7,040,000.
Over $8,040,000 but not over $9,040,000	$786,800 plus 14.4% of the excess over $8,040,000.
Over $9,040,000 but not over $10,040,000	$930,800 plus 15.2% of the excess over $9,040,000.
Over $10,040,000	$1,082,800 plus 16% of the excess over $10,040,000.

For purposes of this section, the term "adjusted taxable estate" means the taxable estate reduced by $60,000.

[(c) PERIOD OF LIMITATIONS ON CREDIT.—The credit allowed by this section shall include only such taxes as were actually paid and credit therefor claimed within 4 years after the filing of the return required by section 6018, except that—

[(1) If a petition for redetermination of a deficiency has been filed with the Tax Court within the time prescribed in section 6213(a), then within such 4-year period or before the expiration of 60 days after the decision of the Tax Court becomes final.

[(2) If, under section 6161 or 6166, an extension of time has been granted for payment of the tax shown on the return, or of a deficiency, then within such 4-year period or before the date of the expiration of the period of the extension.

[(3) If a claim for refund or credit of an overpayment of tax imposed by this chapter has been filed within the time prescribed in section 6511, then within such 4-year period or before the expiration of 60 days from the date of mailing by certified mail or registered mail by the Secretary to the taxpayer of a notice of the disallowance of any part of such claim, or before the expiration of 60 days after a decision by any court of competent jurisdiction becomes final with respect to a timely suit instituted upon such claim, whichever is later.

Refund based on the credit may (despite the provisions of sections 6511 and 6512) be made if claim therefor is filed within the period above provided. Any such refund shall be made without interest.

[(d) BASIC ESTATE TAX.—The basic estate tax and the estate tax imposed by the Revenue Act of 1926 shall be 125 percent of the amount determined to be the maximum credit provided by subsection (b). The additional estate tax shall be the difference between the tax imposed by section 2001 or 2101 and the basic estate tax.

[(e) LIMITATION IN CASES INVOLVING DEDUCTION UNDER SECTION 2053(d)—In any case where a deduction is allowed under section 2053(d) for an estate, succession, legacy, or inheritance tax imposed by a State or the District of Columbia upon a transfer for public, charitable, or religious uses described in section 2055 or 2106(a)(2), the allowance of the credit under this section shall be subject to the following conditions and limitations:

[(1) The taxes described in subsection (a) shall not include any estate, succession, legacy, or inheritance tax for which such deduction is allowed under section 2053(d).

[(2) The credit shall not exceed the lesser of—

[(A) the amount stated in subsection (b) on an adjusted taxable estate determined by allowing such deduction authorized by section 2053(d), or

[(B) that proportion of the amount stated in subsection (b) on an adjusted taxable estate determined without regard to such deduction authorized by section 2053(d) as (i) the amount of the taxes described in subsection (a), as limited by the provisions of paragraph (1) of this subsection, bears to (ii) the amount of the taxes described in subsection (a) before applying the limitation contained in paragraph (1) of this subsection.

[(3) If the amount determined under subparagraph (B) of paragraph (2) is less than the amount determined under subparagraph (A) of that paragraph, then for purposes of subsection (d) such lesser amount shall be the maximum credit provided by subsection (b).

[(f) LIMITATION BASED ON AMOUNT OF TAX.—The credit provided by this section shall not exceed the amount of the tax imposed by section 2001, reduced by the amount of the unified credit provided by section 2010.

[SEC. 2012. CREDIT FOR GIFT TAX.

[(a) IN GENERAL.—If a tax on a gift has been paid under chapter 12 (sec. 2501 and following), or under corresponding provisions of prior laws, and thereafter on the death of the donor any amount in respect of such gift is required to be included in the value of the gross estate of the decedent for purposes of this chapter, then there shall be credited against the tax imposed by section 2001 the amount of the tax paid on a gift under chapter 12, or under corresponding provisions of prior laws, with respect to so much of the property which constituted the gift as is included in the gross estate, except that the amount of such credit shall not exceed an amount which bears the same ratio to the tax imposed by section 2001 (after deducting from such tax the credit for State death taxes provided by section 2011 and the unified credit provided by section 2010) as the value (at the time of the gift or at the time of the death, whichever is lower) of so much of the property which constituted the gift as is included in the gross estate bears to the value of the entire gross estate reduced by the aggregate amount of the charitable and marital deductions allowed under sections 2055, 2056, and 2106(a)(2).

[(b) VALUATION REDUCTIONS.—In applying, with respect to any gift, the ratio stated in subsection (a), the value at the time of the gift or at the time of the death, referred to in such ratio, shall be reduced—

[(1) by such amount as will properly reflect the amount of such gift which was excluded in determining (for purposes of section 2503(a)), or of corresponding provisions of prior laws, the total amount of gifts made during the calendar quarter (or calendar year if the gift was made before January 1, 1971) in which the gift was made;

[(2) if a deduction with respect to such gift is allowed under section 2056(a) (relating to marital deduction), then by the amount of such value, reduced as provided in paragraph (1); and

[(3) if a deduction with respect to such gift is allowed under sections 2055 or 2106(a)(2) (relating to charitable deduction), then by the amount of such value, reduced as provided in paragraph (1) of this subsection.

[(c) WHERE GIFT CONSIDERED MADE ONE-HALF BY SPOUSE.—Where the decedent was the donor of the gift but, under the provisions of section 2513, or corresponding provisions of prior laws, the gift was considered as made one-half by his spouse—

[(1) the term "the amount of the tax paid on a gift under chapter 12", as used in subsection (a), includes the amounts paid with respect to each half of such gift, the amount paid with respect to each being computed in the manner provided in subsection (d); and

[(2) in applying, with respect to such gift, the ratio stated in subsection (a), the value at the time of the gift or at the time of the death, referred to in such ratio, includes such value with respect to each half of such gift, each such value being reduced as provided in paragraph (1) of subsection (b).

[(d) COMPUTATION OF AMOUNT OF GIFT TAX PAID.—

[(1) AMOUNT OF TAX.—For purposes of subsection (a), the amount of tax paid on a gift under chapter 12, or under corresponding provisions of prior laws, with respect to any gift shall be an amount which bears the same ratio to the total tax paid for the calendar quarter (or calendar year if the gift was made before January 1, 1971) in which the gift was made as the amount of such gift bears to the total amount of taxable gifts (computed without deduction of the specific exemption) for such quarter or year.

[(2) AMOUNT OF GIFT.—For purposes of paragraph (1), the "amount of such gift" shall be the amount included with respect to such gift in determining (for the purposes of section 2503(a), or of corresponding provisions of prior laws) the total amount of gifts made during such quarter or year, reduced by the amount of any deduction allowed with respect to such gift under section 2522, or under corresponding provisions of prior laws (relating to charitable deduction), or under section 2523 (relating to marital deduction).

[(e) SECTION INAPPLICABLE TO GIFTS MADE AFTER DECEMBER 31, 1976.—No credit shall be allowed under this section with respect to the amount of any tax paid under chapter 12 on any gift made after December 31, 1976.

[SEC. 2013. CREDIT FOR TAX ON PRIOR TRANSFERS.

[(a) GENERAL RULE.—The tax imposed by section 2001 shall be credited with all or a part of the amount of the Federal estate tax paid with respect to the transfer of property (including property passing as a result of the exercise or non-exercise of a power of appointment) to the decedent by or from a person (herein designated as a "transferor") who died within 10 years before, or within 2 years after, the decedent's death. If the transferor died within 2 years of the death of the decedent, the credit shall be the amount determined under subsections (b) and (c). If the transferor predeceased the decedent by more than 2 years, the credit shall be the following percentage of the amount so determined—

[(1) 80 percent, if within the third or fourth years preceding the decedent's death;

[(2) 60 percent, if within the fifth or sixth years preceding the decedent's death;

[(3) 40 percent, if within the seventh or eighth years preceding the decedent's death; and

[(4) 20 percent, if within the ninth or tenth years preceding the decedent's death.

[(b) COMPUTATION OF CREDIT.—Subject to the limitation prescribed in subsection (c), the credit provided by this section shall be an amount which bears the same ratio to the estate tax paid (adjusted as indicated hereinafter) with respect to the estate of the transferor as the value of the property transferred bears to the taxable estate of the transferor (determined for purposes of the estate tax) decreased by any death taxes paid with respect to such estate. For purposes of the preceding sentence, the estate tax paid shall be the Federal estate tax paid increased by any credits allowed against such estate tax under section 2012, or corresponding provisions of prior laws, on account of gift tax, and for any credits allowed against such estate tax under this section on account of prior transfers where the transferor acquired property from a person who died within 10 years before the death of the decedent.

[(c) LIMITATION ON CREDIT.—

[(1) IN GENERAL.—The credit provided in this section shall not exceed the amount by which—

[(A) the estate tax imposed by section 2001 or section 2101 (after deducting the credits provided for in sections 2010, 2011, 2012, and 2014) computed without regard to this section, exceeds

[(B) such tax computed by excluding from the decedent's gross estate the value of such property transferred and, if applicable, by making the adjustment hereinafter indicated.

If any deduction is otherwise allowable under section 2055 or section 2106(a)(2) (relating to charitable deduction) then, for the purpose of the computation indicated in subparagraph (B), the amount of such deduction shall be reduced by that part of such deduction which the value of such property transferred bears to the decedent's entire gross estate reduced by the deductions allowed under sections 2053 and 2054, or section 2106(a)(1) (relating to deduction for expenses, losses, etc.). For purposes of this section, the value of such property transferred shall be the value as provided for in subsection (d) of this section.

[(2) TWO OR MORE TRANSFERORS.—If the credit provided in this section relates to property received from 2 or more transferors, the limitation provided in paragraph (1) of this subsection shall be computed by aggregating the value of the property so transferred to the decedent. The aggregate limitation so determined shall be apportioned in accordance with the value of the property transferred to the decedent by each transferor.

[(d) VALUATION OF PROPERTY TRANSFERRED.—The value of property transferred to the decedent shall be the value used for the purpose of determining the Federal estate tax liability of the estate of the transferor but—

[(1) there shall be taken into account the effect of the tax imposed by section 2001 or 2101, or any estate, succession, leg-

acy, or inheritance tax, on the net value to the decedent of such property;

[(2) where such property is encumbered in any manner, or where the decedent incurs any obligation imposed by the transferor with respect to such property, such encumbrance or obligation shall be taken into account in the same manner as if the amount of a gift to the decedent of such property was being determined; and

[(3) if the decedent was the spouse of the transferor at the time of the transferor's death, the net value of the property transferred to the decedent shall be reduced by the amount allowed under section 2056 (relating to marital deductions), as a deduction from the gross estate of the transferor.

[(e) PROPERTY DEFINED.—For purposes of this section, the term "property" includes any beneficial interest in property,including a general power of appointment (as defined in section 2041).

[(f) TREATMENT OF ADDITIONAL TAX IMPOSED UNDER SECTION 2032A.—If section 2032A applies to any property included in the gross estate of the transferor and an additional tax is imposed with respect to such property under section 2032A(c) before the date which is 2 years after the date of the decedent's death, for purposes of this section—

[(1) the additional tax imposed by section 2032A(c) shall be treated as a Federal estate tax payable with respect to the estate of the transferor; and

[(2) the value of such property and the amount of the taxable estate of the transferor shall be determined as if section 2032A did not apply with respect to such property.

[SEC. 2014. CREDIT FOR FOREIGN DEATH TAXES.

[(a) IN GENERAL.—The tax imposed by section 2001 shall be credited with the amount of any estate, inheritance, legacy, or succession taxes actually paid to any foreign country in respect of any property situated within such foreign country and included in the gross estate (not including any such taxes paid with respect to the estate of a person other than the decedent). The determination of the country within which property is situated shall be made in accordance with the rules applicable under subchapter B (sec. 2101 and following) in determining whether property is situated within or without the United States.

[(b) LIMITATIONS ON CREDIT.—The credit provided in this section with respect to such taxes paid to any foreign country—

[(1) shall not, with respect to any such tax, exceed an amount which bears the same ratio to the amount of such tax actually paid to such foreign country as the value of property which is—

[(A) situated within such foreign country,

[(B) subjected to such tax, and

[(C) included in the gross estate bears to the value of all property subjected to such tax; and

[(2) shall not, with respect to all such taxes, exceed an amount which bears the same ratio to the tax imposed by section 2001 (after deducting from such tax the credits provided by sections 2010, 2011, and 2012) as the value of property which is—

[(A) situated within such foreign country,

[(B) subjected to the taxes of such foreign country, and

[(C) included in the gross estate bears to the value of the entire gross estate reduced by the aggregate amount of the deductions allowed under sections 2055 and 2056.

[(c) VALUATION OF PROPERTY.—

[(1) The values referred to in the ratio stated in subsection (b)(1) are the values determined for purposes of the tax imposed by such foreign country.

[(2) The values referred to in the ratio stated in subsection (b)(2) are the values determined under this chapter; but, in applying such ratio, the value of any property described in subparagraphs (A), (B), and (C) thereof shall be reduced by such amount as will properly reflect, in accordance with regulations prescribed by the Secretary, the deductions allowed in respect of such property under sections 2055 and 2056 (relating to charitable and marital deductions).

[(d) PROOF OF CREDIT.—The credit provided in this section shall be allowed only if the taxpayer establishes to the satisfaction of the Secretary—

[(1) the amount of taxes actually paid to the foreign country,

[(2) the amount and date of each payment thereof,

[(3) the description and value of the property in respect of which such taxes are imposed, and

[(4) all other information necessary for the verification and computation of the credit.

[(e) PERIOD OF LIMITATION.—The credit provided in this section shall be allowed only for such taxes as were actually paid and credit therefor claimed within 4 years after the filing of the return required by section 6018, except that—

[(1) If a petition for redetermination of a deficiency has been filed with the Tax Court within the time prescribed in section 6213(a), then within such 4-year period or before the expiration of 60 days after the decision of the Tax Court becomes final.

[(2) If, under section 6161, an extension of time has been granted for payment of the tax shown on the return, or of a deficiency, then within such 4-year period or before the date of the expiration of the period of the extension.

Refund based on such credit may (despite the provisions of sections 6511 and 6512) be made if claim therefor is filed within the period above provided. Any such refund shall be made without interest.

[(f) ADDITIONAL LIMITATION IN CASES INVOLVING A DEDUCTION UNDER SECTION 2053(d).—In any case where a deduction is allowed under section 2053(d) for an estate, succession, legacy, or inheritance tax imposed by and actually paid to any foreign country upon a transfer by the decedent for public, charitable, or religious uses described in section 2055, the property described in subparagraphs (A), (B), and (C) of paragraphs (1) and (2) of subsection (b) of this section shall not include any property in respect of which such deduction is allowed under section 2053(d).

[(g) POSSESSION OF UNITED STATES DEEMED A FOREIGN COUNTRY.—For purposes of the credits authorized by this section, each possession of the United States shall be deemed to be a foreign country.

[(h) SIMILAR CREDIT REQUIRED FOR CERTAIN ALIEN RESIDENTS.—Whenever the President finds that—

[(1) a foreign country, in imposing estate, inheritance, legacy, or succession taxes, does not allow to citizens of the United States resident in such foreign country at the time of death a credit similar to the credit allowed under subsection (a),

[(2) such foreign country, when requested by the United States to do so has not acted to provide such a similar credit in the case of citizens of the United States resident in such foreign country at the time of death, and

[(3) it is in the public interest to allow the credit under subsection (a) in the case of citizens or subjects of such foreign country only if it allows such a similar credit in the case of citizens of the United States resident in such foreign country at the time of death, the President shall proclaim that, in the case of citizens or subjects of such foreign country dying while the proclamation remains in effect, the credit under subsection (a) shall be allowed only if such foreign country allows such a similar credit in the case of citizens of the United States resident in such foreign country at the time of death.

[SEC. 2015. CREDIT FOR DEATH TAXES ON REMAINDERS.

[Where an election is made under section 6163(a) to postpone payment of the tax imposed by section 2001, or 2101, such part of any estate, inheritance, legacy, or succession taxes allowable as a credit under section 2011 or 2014, as is attributable to a reversionary or remainder interest may be allowed as a credit against the tax attributable to such interest, subject to the limitations on the amount of the credit contained in such sections, if such part is paid, and credit therefor claimed, at any time before the expiration of the time for payment of the tax imposed by section 2001 or 2101 as postponed and extended under section 6163.

[SEC. 2016. RECOVERY OF TAXES CLAIMED AS CREDIT.

[If any tax claimed as a credit under section 2011 or 2014 is recovered from any foreign country, any State, any possession of the United States, or the District of Columbia, the executor, or any other person or persons recovering such amount, shall give notice of such recovery to the Secretary at such time and in such manner as may be required by regulations prescribed by him, and the Secretary shall (despite the provisions of section 6501) redetermine the amount of the tax under this chapter and the amount, if any, of the tax due on such redetermination, shall be paid by the executor or such person or persons, as the case may be, on notice and demand. No interest shall be assessed or collected on any amount of tax due on any redetermination by the Secretary resulting from a refund to the executor of tax claimed as a credit under section 2014, for any period before the receipt of such refund, except to the extent interest was paid by the foreign country on such refund.

[PART III—GROSS ESTATE

[SEC. 2031. DEFINITION OF GROSS ESTATE.

[(a) GENERAL.—The value of the gross estate of the decedent shall be determined by including to the extent provided for in this part, the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated.

[(b) VALUATION OF UNLISTED STOCK AND SECURITIES.—In the case of stock and securities of a corporation the value of which, by reason of their not being listed on an exchange and by reason of the absence of sales thereof, cannot be determined with reference to bid and asked prices or with reference to sales prices, the value thereof shall be determined by taking into consideration, in addition to all other factors, the value of stock or securities of corporations engaged in the same or a similar line of business which are listed on an exchange.

[(c) ESTATE TAX WITH RESPECT TO LAND SUBJECT TO A QUALIFIED CONSERVATION EASEMENT.—

[(1) IN GENERAL.—If the executor makes the election described in paragraph (6), then, except as otherwise provided in this subsection, there shall be excluded from the gross estate the lesser of—

[(A) the applicable percentage of the value of land subject to a qualified conservation easement, reduced by the amount of any deduction under section 2055(f) with respect to such land, or

[(B) the exclusion limitation.

[(2) APPLICABLE PERCENTAGE.—For purposes of paragraph (1), the term "applicable percentage" means 40 percent reduced (butnot below zero) by 2 percentage points for each percentage point (or fraction thereof) by which the value of the qualified conservation easement is less than 30 percent of the value of the land (determined without regard to the value of such easement and reduced by the value of any retained development right (as defined in paragraph (5)).

[(3) EXCLUSION LIMITATION.—For purposes of paragraph (1), the exclusion limitation is the limitation determined in accordance with the following table:

[In the case of estates of The exclusion decedents dying during limitation is:1998 $100,0001999 $200,0002000 $300,0002001 $400,0002002 or thereafter $500,000.

[(4) TREATMENT OF CERTAIN INDEBTEDNESS.—

[(A) IN GENERAL.—The exclusion provided in paragraph (1) shall not apply to the extent that the land is debt-financed property.

[(B) DEFINITIONS.—For purposes of this paragraph—

[(i) DEBT-FINANCED PROPERTY.—The term "debt-financed property" means any property with respect to which there is an acquisition indebtedness (as defined in clause (ii)) on the date of the decedent's death.

[(ii) ACQUISITION INDEBTEDNESS.—The term "acquisition indebtedness" means, with respect to debt-financed property, the unpaid amount of—

[(I) the indebtedness incurred by the donor in acquiring such property,

[(II) the indebtedness incurred before the acquisition of such property if such indebtedness wouldnot have been incurred but for such acquisition,

[(III) the indebtedness incurred after the acquisition of such property if such indebtedness wouldnot have been incurred but for such acquisition and the incurrence of such indebtedness wasreasonably foreseeable at the time of such acquisition, and

[(IV) the extension, renewal, or refinancing of an acquisition indebtedness.

[(5) TREATMENT OF RETAINED DEVELOPMENT RIGHT.—

[(A) IN GENERAL.—Paragraph (1) shall not apply to the value of any development right retained by the donor in the conveyance of a qualified conservation easement.

[(B) TERMINATION OF RETAINED DEVELOPMENT RIGHT.—If every person in being who has an interest (whether or not in possession) in the land executes an agreement to extinguish permanently some or all of any development rights (as defined in subparagraph (D)) retained by the donor on or before the date for filing the return of the tax imposed by section 2001, then any tax imposed by section 2001 shall be reduced accordingly.

Such agreement shall be filed with the return of the tax imposed by section 2001. The agreement shall be in such form as the Secretary shall prescribe.

[(C) ADDITIONAL TAX.—Any failure to implement the agreement described in subparagraph (B) not later than the earlier of—

[(i) the date which is 2 years after the date of the decedent's death, or

[(ii) the date of the sale of such land subject to the qualified conservation easement, shall result in the imposition of an additional tax in the amount of the tax which would have been due on the retained development rights subject to such agreement. Such additional tax shall be due and payable on the last day of the 6th month following such date.

[(D) DEVELOPMENT RIGHT DEFINED.—For purposes of this paragraph, the term "development right" means any right to use the land subject to the qualified conservation easement in which such right is retained for any commercial purpose which is not subordinate to and directly supportive of the use of such land as a farm for farming purposes (within the meaning of section 2032A(e)(5)).

[(6) ELECTION.—The election under this subsection shall be made on or before the due date (including extensions) for filing the return of tax imposed by section 2001 and shall be made on such return.

[(7) CALCULATION OF ESTATE TAX DUE.—An executor making the election described in paragraph (6) shall, for purposes of calculating the amount of tax imposed by section 2001, include the value of any development right (as defined in paragraph (5)) retained by the donor in the conveyance of such qualified conservation easement. The computation of tax on any retained development right prescribed in this paragraph shall be done in such manner and on such forms as the Secretary shall prescribe.

[(8) DEFINITIONS.—For purposes of this subsection—

[(A) LAND SUBJECT TO A QUALIFIED CONSERVATION EASEMENT.—The term "land subject to a qualified conservation easement" means land—

[(i) which is located—

[(I) in or within 25 miles of an area which, on the date of the decedent's death, is a metropolitan area (as defined by the Office of Management and Budget),

[(II) in or within 25 miles of an area which, on the date of the decedent's death, is a national park or wilderness area designated as part of the National Wilderness Preservation System (unless it is determined by the Secretary that land in or within 25 miles of such a park or wilderness area is not under significant development pressure), or

[(III) in or within 10 miles of an area which, on the date of the decedent's death, is an Urban National Forest (as designated by the Forest Service),

[(ii) which was owned by the decedent or a member of the decedent's family at all times during the 3-year period ending on the date of the decedent's death, and

[(iii) with respect to which a qualified conservation easement has been made by an individual described in subparagraph (C), as of the date of the election described in paragraph (6).

[(B) QUALIFIED CONSERVATION EASEMENT.—The term "qualified conservation easement" means a qualified conservation contribution (as defined in section 170(h)(1) of a qualified real property interest (as defined in section 170(h)(2)(C), except that clause (iv) of section 170(h)(4)(A) shall not apply, and the restriction on the use of such interest described in section 170(h)(2)(C) shall include a prohibition on more than a de minimis use for a commercial recreational activity.

[(C) INDIVIDUAL DESCRIBED.—An individual is described in this subparagraph if such individual is—

[(i) the decedent,

[(ii) a member of the decedent's family,

[(iii) the executor of the decedent's estate, or

[(iv) the trustee of a trust the corpus of which includes the land to be subject to the qualifiedconservation easement.

[(D) MEMBER OF FAMILY.—The term "member of the decedent's family" means any member of the family (as defined in section 2032A(e)(2)) of the decedent.

[(9) TREATMENT OF EASEMENTS GRANTED AFTER DEATH.—In any case in which the qualified conservation easement is granted after the date of the decedent's death and on or before the due date (including extensions) for filing the return of tax imposed by section 2001, the deduction under section 2055(f) with respect to such easement shall be allowed to the estate but only if no charitable deduction is allowed under chapter 1 to any person with respect to the grant of such easement.

[(10) APPLICATION OF THIS SECTION TO INTERESTS IN PARTNERSHIPS, CORPORATIONS, AND TRUSTS.—This section shall apply to an interest in a partnership, corporation, or trust if at least 30 percent of the entity is owned (directly or indirectly) by the decedent, as determined under the rules described in section 2057(e)(3).

[(d) CROSS REFERENCE.—

[For executor's right to be furnished on request a statement regarding any valuation made by the Secretary within the gross estate, see section 7517.

[SEC. 2032. ALTERNATE VALUATION.

[(a) GENERAL.—The value of the gross estate may be determined, if the executor so elects, by valuing all the property included in the gross estate as follows:

[(1) In the case of property distributed, sold, exchanged, or otherwise disposed of, within 6 months after the decedent's death such property shall be valued as of the date of distribution, sale, exchange, or other disposition.

[(2) In the case of property not distributed, sold, exchanged, or otherwise disposed of, within 6 months after the decedent's death such property shall be valued as of the date 6 months after the decedent's death.

[(3) 4Any interest or estate which is affected by mere lapse of time shall be included at its value as of the time of death (instead of the later date) with adjustment for any difference in its value as of the later date not due to mere lapse of time.

[(b) SPECIAL RULES.—No deduction under this chapter of any item shall be allowed if allowance for such item is in effect given by the alternate valuation provided by this section. Wherever in any other subsection or section of this chapter reference is made to the value of property at the time of the decedent's death, such reference shall be deemed to refer to the value of such property used in determining the value of the gross estate. In case of an election made by the executor under this section, then—

[(1) for purposes of the charitable deduction under section 2055 or 2106(a)(2), any bequest, legacy, devise, or transfer enumerated therein, and

[(2) for the purpose of the marital deduction under section 2056, any interest in property passing to the surviving spouse, shall be valued as of the date of the decedent's death with adjustment for any difference in value (not due to mere lapse of

time or the occurrence or nonoccurrence of a contingency) of the property as of the date 6 months after the decedent's death (substituting, in the case of property distributed by the executor or trustee, or sold, exchanged, or otherwise disposed of, during such 6-month period, the date thereof).

[(c) ELECTION MUST DECREASE GROSS ESTATE AND ESTATE TAX.—No election may be made under this section with respect to an estate unless such election will decrease—

[(1) the value of the gross estate, and

[(2) the sum of the tax imposed by this chapter and the tax imposed by chapter 13 with respect to property includible in the decedent's gross estate (reduced by credits allowable against such taxes).

[(d) ELECTION.—

[(1) IN GENERAL.—The election provided for in this section shall be made by the executor on the return of the tax imposed by this chapter. Such election, once made, shall be irrevocable.

[(2) EXCEPTION.—No election may be made under this section if such return is filed more than 1 year after the time prescribed by law (including extensions) for filing such return.

[SEC. 2032A. VALUATION OF CERTAIN FARM, ETC., REAL PROPERTY.

[(a) VALUE BASED ON USE UNDER WHICH PROPERTY QUALIFIES.—

[(1) GENERAL RULE.—If—

[(A) the decedent was (at the time of his death) a citizen or resident of the United States, and

[(B) the executor elects the application of this section and files the agreement referred to in subsection (d)(2), then, for purposes of this chapter, the value of qualified real property shall be its value for the use under which it qualifies, under subsection (b), as qualified real property.

[(2) LIMITATION ON AGGREGATE REDUCTION IN FAIR MARKET VALUE.—The aggregate decrease in the value of qualified real property taken into account for purposes of this chapter which results from the application of paragraph (1) with respect to any decedent shall not exceed $750,000.

[(3) INFLATION ADJUSTMENT.—In the case of estates of decedents dying in a calendar year after 1998, the $750,000 amount contained in paragraph (2) shall be increased by an amount equal to—

[(A) $750,000, multiplied by

[(B) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting "calendar year 1997" for "calendar year 1992" in subparagraph (B) thereof.

If any amount as adjusted under the preceding sentence is not a multiple of $10,000, such amount shall be rounded to the next lowest multiple of $10,000.

[(b) QUALIFIED REAL PROPERTY.—

[(1) IN GENERAL.—For purposes of this section, the term "qualified real property" means real property located in the United States which was acquired from or passed from the decedent to a qualified heir of the decedent and which, on the date of the decedent's death, was being used for a qualified use

by the decedent or a member of the decedent's family, but only if—

[(A) 50 percent or more of the adjusted value of the gross estate consists of the adjusted value of real or personal property which—

[(i) on the date of the decedent's death, was being used for a qualified use by the decedent or a member of the decedent's family, and

[(ii) was acquired from or passed from the decedent to a qualified heir of the decedent.

[(B) 25 percent or more of the adjusted value of the gross estate consists of the adjusted value of real property which meets the requirements of subparagraphs (A)(ii) and (C),

[(C) during the 8-year period ending on the date of the decedent's death there have been periods aggregating 5 years or more during which—

[(i) such real property was owned by the decedent or a member of the decedent's family and used for a qualified use by the decedent or a member of the decedent's family, and

[(ii) there was material participation by the decedent or a member of the decedent's family in the operation of the farm or other business, and

[(D) such real property is designated in the agreement referred to in subsection (d)(2).

[(2) QUALIFIED USE.—For purposes of this section, the term "qualified use" means the devotion of the property to any ofthe following:

[(A) use as a farm for farming purposes, or

[(B) use in a trade or business other than the trade or business of farming.

[(3) ADJUSTED VALUE.—For purposes of paragraph (1), the term "adjusted value" means—

[(A) in the case of the gross estate, the value of the gross estate for purposes of this chapter (determined without regard to this section), reduced by any amounts allowable as a deduction under paragraph (4) of section 2053(a), or

[(B) in the case of any real or personal property, the value of such property for purposes of this chapter (determined without regard to this section), reduced by any amounts allowable as a deduction in respect of such property under paragraph (4) of section 2053(a).

[(4) DECEDENTS WHO ARE RETIRED OR DISABLED.—

[(A) IN GENERAL.—If, on the date of the decedent's death, the requirements of paragraph (1)(C)(ii) with respect to the decedent for any property are not met, and the decedent—

[(i) was receiving old-age benefits under title II of the Social Security Act for a continuous period ending on such date, or

[(ii) was disabled for a continuous period ending on such date, then paragraph (1)(C)(ii) shall be applied with respect to such property by substituting "the date

on which the longer of such continuous periods began" for "the date of the decedent's death" in paragraph (1)(C).

[(B) DISABLED DEFINED.—For purposes of subparagraph (A), an individual shall be disabled if such individual has a mental or physical impairment which renders him unable to materially participate in the operation of the farm or other business.

[(C) COORDINATION WITH RECAPTURE.—For purposes of subsection (c)(6)(B)(i), if the requirements of paragraph (1)(C)(ii) are met with respect to any decedent by reason of subparagraph (A), the period ending on the date on which the continuous period taken into account under subparagraph (A) began shall be treated as theperiod immediately before the decedent's death.

[(5) SPECIAL RULES FOR SURVIVING SPOUSES.—

[(A) IN GENERAL.—If property is qualified real property with respect to a decedent (hereinafter in this paragraph referred to as the "first decedent") and such property was acquired from or passed from the first decedent to the surviving spouse of the first decedent, for purposes of applying this subsection and subsection (c) in the case of the estate of such surviving spouse, active management of the farm or other business by the surviving spouse shall be treated as material participation by such surviving spouse in the operation of such farm or business.

[(B) SPECIAL RULE.—For the purposes of subparagraph (A), the determination of whether property is qualified real property with respect to the first decedent shall be made without regard to subparagraph (D) of paragraph (1) and without regard to whether an election under this section was made.

[(C) COORDINATION WITH PARAGRAPH (4).—In any case in which to do so will enable the requirements of paragraph (1)(C)(ii) to be met with respect to the surviving spouse, this subsection and subsection (c) shall be applied by taking into account any application of paragraph (4).

[(c) TAX TREATMENT OF DISPOSITIONS AND FAILURES TO USE FOR QUALIFIED USE.—

[(1) IMPOSITION OF ADDITIONAL ESTATE TAX.—If, within 10 years after the decedent's death and before the death of the qualified heir—

[(A) the qualified heir disposes of any interest in qualified real property (other than by a disposition to a member of his family), or

[(B) the qualified heir ceases to use for the qualified use the qualified real property which was acquired (or passed) from the decedent, then, there is hereby imposed an additional estate tax.

[(2) AMOUNT OF ADDITIONAL TAX.—

[(A) IN GENERAL.—The amount of the additional tax imposed by paragraph (1) with respect to any interest shall be the amount equal to the lesser of—

[(i) the adjusted tax difference attributable to such interest, or

[(ii) the excess of the amount realized with respect to the interest (or, in any case other than a sale or exchange at arm's length, the fair market value of the interest) over the value of the interest determined under subsection (a).

[(B) ADJUSTED TAX DIFFERENCE ATTRIBUTABLE TO INTEREST.—For purposes of subparagraph (A), the adjusted tax difference attributable to an interest is the amount which bears the same ratio to the adjusted tax difference with respect to the estate (determined under subparagraph (C)) as—

[(i) the excess of the value of such interest for purposes of this chapter (determined without regard to subsection (a)) over the value of such interest determined under subsection (a), bears to

[(ii) a similar excess determined for all qualified real property.

[(C) ADJUSTED TAX DIFFERENCE WITH RESPECT TO THE ESTATE.—For purposes of subparagraph (B), the term "adjusted tax difference with respect to the estate" means the excess of what would have been the estate tax liability but for subsection (a) over the estate tax liability. For purposes of this subparagraph, the term "estate tax liability" means the tax imposed by section 2001 reduced by the credits allowable against such tax.

[(D) PARTIAL DISPOSITIONS.—For purposes of this paragraph, where the qualified heir disposes of a portion of the interest acquired by (or passing to) such heir (or a predecessor qualified heir) or there is a cessation of use of such a portion—

[(i) the value determined under subsection (a) taken into account under subparagraph (A)(ii) with respect to such portion shall be its pro rata share of such value of such interest, and

[(ii) the adjusted tax difference attributable to the interest taken into account with respect to the transaction involving the second or any succeeding portion shall be reduced by the amount of the tax imposed by this subsection with respect to all prior transactions involving portions of such interest.

[(E) SPECIAL RULE FOR DISPOSITION OF TIMBER.—In the case of qualified woodland to which an election under subsection (e)(13)(A) applies, if the qualified heir disposes of (or severs) any standing timber on such qualified woodland—

[(i) such disposition (or severance) shall be treated as a disposition of a portion of the interest of the qualified heir in such property, and

[(ii) the amount of the additional tax imposed by paragraph (1) with respect to such disposition shall be an amount equal to the lesser of—

[(I) the amount realized on such disposition (or, in any case other than a sale or exchange at arm's length, the fair market value of the portion of the interest disposed or severed), or

[(II) the amount of additional tax determined under this paragraph (without regard to this subparagraph) if the entire interest of the qualified heir in the qualified woodland had beendisposed of, less the sum of the amount of the additional tax imposed with respect to all prior transactions involving such woodland to which this subparagraph applied.

For purposes of the preceding sentence, the disposition of a right to sever shall be treated as the disposition of the standing timber. The amount of additional tax imposed under paragraph (1) inany case in which a qualified heir disposes of his entire interest in the qualified woodland shall be reduced by any amount determined under this subparagraph with respect to such woodland.

[(3) ONLY 1 ADDITIONAL TAX IMPOSED WITH RESPECT TO ANY 1 PORTION.—In the case of an interest acquired from (or passing from) any decedent, if subparagraph (A) or

[(B) of paragraph (1) applies to any portion of an interest, subparagraph (B) or (A), as the case may be, of paragraph (1) shall not apply with respect to the same portion of such interest.

[(4) DUE DATE.—The additional tax imposed by this subsection shall become due and payable on the day which is 6 months after the date of the disposition or cessation referred to in paragraph (1).

[(5) LIABILITY FOR TAX; FURNISHING OF BOND.—The qualified heir shall be personally liable for the additional tax imposed by this subsection with respect to his interest unless the heir has furnished bond which meets the requirements of subsection (e)(11).

[(6) CESSATION OF QUALIFIED USE.—For purposes of paragraph (1)(B), real property shall cease to be used for the qualified use if—

[(A) such property ceases to be used for the qualified use set forth in subparagraph (A) or (B) of subsection (b)(2) under which the property qualified under subsection (b), or

[(B) during any period of 8 years ending after the date of the decedent's death and before the date of the death of the qualified heir, there had been periods aggregating more than 3 years during which—

[(i) in the case of periods during which the property was held by the decedent, there was no material participation by the decedent or any member of his family in the operation of the farm or other business, and

[(ii) in the case of periods during which the property was held by any qualified heir, there was no material participation by such qualified heir or any member of his family in the operation of the farm or other business.

[(7) SPECIAL RULES.—

[(A) NO TAX IF USE BEGINS WITHIN 2 YEARS.—If the date on which the qualified heir begins to use the qualified real property (hereinafter in this subparagraph referred to as

the commencement date) is before the date 2 years after the decedent's death—

[(i) no tax shall be imposed under paragraph (1) by reason of the failure by the qualified heir to so use such property before the commencement date, and

[(ii) the 10-year period under paragraph (1) shall be extended by the period after the decedent's death and before the commencement date.

[(B) ACTIVE MANAGEMENT BY ELIGIBLE QUALIFIED HEIR TREATED AS MATERIAL PARTICIPATION.—For purposes of paragraph (6)(B)(ii), the active management of a farm or other business by—

[(i) an eligible qualified heir, or

[(ii) a fiduciary of an eligible qualified heir described in clause (ii) or (iii) of subparagraph (C),

shall be treated as material participation by such eligible qualified heir in the operation of such farm or business. In the case of an eligible qualified heir described in clause (ii), (iii), or (iv) of subparagraph (C), the preceding sentence shall apply only during periods during which such heir meets the requirements of such clause.

[(C) ELIGIBLE QUALIFIED HEIR.—For purposes of this paragraph, the term "eligible qualified heir" means a qualified heir who—

[(i) is the surviving spouse of the decedent,

[(ii) has not attained the age of 21,

[(iii) is disabled (within the meaning of subsection (b)(4)(B)), or

[(iv) is a student.

[(D) STUDENT.—For purposes of subparagraph (C), an individual shall be treated as a student with respect to periods during any calendar year if (and only if) such individual is a student (within the meaning of section 151(c)(4)) for such calendar year.

[(E) CERTAIN RENTS TREATED AS QUALIFIED USE.—For purposes of this subsection, a surviving spouse or lineal descendant of the decedent shall not be treated as failing to use qualified real property in a qualified use solely because such spouse or descendant rents such property to a member of the family of such spouse or descendant on a net cash basis. For purposes of the preceding sentence, a legally adopted child of an individual shall be treated as the child of such individual by blood.

[(8) QUALIFIED CONSERVATION CONTRIBUTION IS NOT A DISPOSITION.—A qualified conservation contribution (as defined in section 170(h) by gift or otherwise shall not be deemed a disposition under subsection (c)(1)(A).

[(d) ELECTION; AGREEMENT.—

[(1) ELECTION.—The election under this section shall be made on the return of the tax imposed by section 2001. Such election shall be made in such manner as the Secretary shall by regulations prescribe. Such an election, once made, shall be irrevocable.

[(2) AGREEMENT.—The agreement referred to in this paragraph is a written agreement signed by each person in being

who has an interest (whether or not in possession) in any property designated in such agreement consenting to the application of subsection (c) with respect to such property.

[(3) MODIFICATION OF ELECTION AND AGREEMENT TO BE PERMITTED.—The Secretary shall prescribe procedures which provide that in any case in which the executor makes an election under paragraph (1) (and submits the agreement referred to in paragraph (2)) within the time prescribed therefor, but—

[(A) the notice of election, as filed, does not contain all required information, or

[(B) signatures of 1 or more persons required to enter into the agreement described in paragraph (2) are not included on the agreement as filed, or the agreement does not contain all required information, the executor will have a reasonable period of time (not exceeding 90 days) after notification of such failures to provide such information or signatures.

[(e) DEFINITIONS; SPECIAL RULES.—For purposes of this section—

[(1) QUALIFIED HEIR.—The term "qualified heir" means, with respect to any property, a member of the decedent's family who acquired such property (or to whom such property passed) from the decedent. If a qualified heir disposes of any interest in qualified real property to any member of his family, such member shall thereafter be treated as the qualified heir with respect to such interest.

[(2) MEMBER OF FAMILY.—The term "member of the family" means, with respect to any individual, only—

[(A) an ancestor of such individual,

[(B) the spouse of such individual,

[(C) a lineal descendant of such individual, of such individual's spouse, or of a parent of such individual, or

[(D) the spouse of any lineal descendant described in subparagraph (C).

For purposes of the preceding sentence, a legally adopted child of an individual shall be treated as the child of such individual by blood.

[(3) CERTAIN REAL PROPERTY INCLUDED.—In the case of real property which meets the requirements of subparagraph (C) of subsection (b)(1), residential buildings and related improvements on such real property occupied on a regular basis by the owner or lessee of such real property or by persons employed by such owner or lessee for the purpose of operating or maintaining such real property, and roads, buildings, and other structures and improvements functionally related to the qualified use shall be treated as real property devoted to the qualified use.

[(4) FARM.—The term "farm" includes stock, dairy, poultry, fruit, furbearing animal, and truck farms, plantations, ranches, nurseries, ranges, greenhouses or other similar structures used primarily for the raising of agricultural or horticultural commodities, and orchards and woodlands.

[(5) FARMING PURPOSES.—The term "farming purposes" means—

[(A) cultivating the soil or raising or harvesting any agricultural or horticultural commodity (including the rais-

ing, shearing, feeding, caring for, training, and management of animals) on a farm;

[(B) handling, drying, packing, grading, or storing on a farm any agricultural or horticultural commodity in its unmanufactured state, but only if the owner, tenant, or operator of the farm regularly produces more than one-half of the commodity so treated; and

[(C)(i) the planting, cultivating, caring for, or cutting of trees, or

[(ii) the preparation (other than milling) of trees for market.

[(6) MATERIAL PARTICIPATION.—Material participation shall be determined in a manner similar to the manner used for purposes of paragraph (1) of section 1402(a) (relating to net earnings from self-employment).

[(7) METHOD OF VALUING FARMS.—

[(A) IN GENERAL.—Except as provided in subparagraph (B), the value of a farm for farming purposes shall be determined by dividing—

[(i) the excess of the average annual gross cash rental for comparable land used for farming purposes and located in the locality of such farm over the average annual State and local real estate taxes for such comparable land, by

[(ii) the average annual effective interest rate for all new Federal Land Bank loans.

For purposes of the preceding sentence, each average annual computation shall be made on the basis of the 5 most recent calendar years ending before the date of the decedent's death.

[(B) VALUE BASED ON NET SHARE RENTAL IN CERTAIN CASES.—

[(i) IN GENERAL.—If there is no comparable land from which the average annual gross cash rental may be determined but there is comparable land from which the average net share rental may be determined, subparagraph (A)(i) shall be applied by substituting "average annual net share rental" for "average annual gross cash rental".

[(ii) NET SHARE RENTAL.—For purposes of this paragraph, the term "net share rental" means the excess of—

[(I) the value of the produce received by the lessor of the land on which such produce is grown, over

[(II) the cash operating expenses of growing such produce which, under the lease, are paid by the lessor.

[(C) EXCEPTION.—The formula provided by subparagraph (A) shall not be used—

[(i) where it is established that there is no comparable land from which the average annual gross cash rental may be determined, and that there is no comparable land from which the average net share rental may be determined or

[(ii) where the executor elects to have the value of the farm for farming purposes determined under paragraph (8).

[(8) METHOD OF VALUING CLOSELY HELD BUSINESS INTERESTS, ETC.—In any case to which paragraph (7)(A) does not apply, the following factors shall apply in determining the value of any qualified real property:

[(A) The capitalization of income which the property can be expected to yield for farming or closely held business purposes over a reasonable period of time under prudent management using traditional cropping patterns for the area, taking into account soil capacity, terrain configuration, and similar factors,

[(B) The capitalization of the fair rental value of the land for farm land or closely held business purposes,

[(C) Assessed land values in a State which provides a differential or use value assessment law for farmland or closely held business,

[(D) Comparable sales of other farm or closely held business land in the same geographical area far enough removed from a metropolitan or resort area so that nonagricultural use is not a significant factor in the sales price, and

[(E) Any other factor which fairly values the farm or closely held business value of the property.

[(9) PROPERTY ACQUIRED FROM DECEDENT.—Property shall be considered to have been acquired from or to have passed from the decedent if—

[(A) such property is so considered under section 1014(b) (relating to basis of property acquired from a decedent),

[(B) such property is acquired by any person from the estate, or

[(C) such property is acquired by any person from a trust (to the extent such property is includible in the gross estate of the decedent).

[(10) COMMUNITY PROPERTY.—If the decedent and his surviving spouse at any time held qualified real property as community property, the interest of the surviving spouse in such property shall be taken into account under this section to the extent necessary to provide a result under this section with respect to such property which is consistent with the result which would have obtained under this section if such property had not been community property.

[(11) BOND IN LIEU OF PERSONAL LIABILITY.—If the qualified heir makes written application to the Secretary for determination of the maximum amount of the additional tax which may be imposed by subsection (c) with respect to the qualified heir's interest, the Secretary (as soon as possible, and in any event within 1 year after the making of such application) shall notify the heir of such maximum amount. The qualified heir, on furnishing a bond in such amount and for such period as may be required, shall be discharged from personal liability for any additional tax imposed by subsection (c) and shall be entitled to a receipt or writing showing such discharge.

[(12) ACTIVE MANAGEMENT.—The term "active management" means the making of the management decisions of a business (other than the daily operating decisions).

[(13) SPECIAL RULES FOR WOODLANDS.—

[(A) IN GENERAL.—In the case of any qualified woodland with respect to which the executor elects to have this subparagraph apply, trees growing on such woodland shall not be treated as a crop.

[(B) QUALIFIED WOODLAND.—The term "qualified woodland" means any real property which—

[(i) is used in timber operations, and

[(ii) is an identifiable area of land such as an acre or other area for which records are normally maintained in conducting timber operations.

[(C) TIMBER OPERATIONS.—The term "timber operations" means—

[(i) the planting, cultivating, caring for, or cutting of trees, or

[(ii) the preparation (other than milling) of trees for market.

[(D) ELECTION.—An election under subparagraph (A) shall be made on the return of the tax imposed by section 2001. Such election shall be made in such manner as the Secretary shall by regulations prescribe. Such an election, once made, shall be irrevocable.

[(14) TREATMENT OF REPLACEMENT PROPERTY ACQUIRED IN SECTION 1031 OR 1033 TRANSACTIONS.—

[(A) IN GENERAL.—In the case of any qualified replacement property, any period during which there was ownership, qualified use, or material participation with respect to the replaced property by the decedent or any member of his family shall be treated as a period during which there was such ownership, use, or material participation (as the case may be) with respect to the qualified replacement property.

[(B) LIMITATION.—Subparagraph (A) shall not apply to the extent that the fair market value of the qualified replacement property (as of the date of its acquisition) exceeds the fair market value of the replaced property (as of the date of its disposition).

[(C) DEFINITIONS.—For purposes of this paragraph—

[(i) QUALIFIED REPLACEMENT PROPERTY.—The term "qualified replacement property" means any real property which is—

[(I) acquired in an exchange which qualifies under section 1031, or

[(II) the acquisition of which results in the nonrecognition of gain under section 1033.

[Such term shall only include property which is used for the same qualified use as the replacedproperty was being used before the exchange.

[(ii) REPLACED PROPERTY.—The term "replaced property means—

[(I) the property transferred in the exchange which qualifies under section 1031, or

[(II) the property compulsorily or involuntarily converted (within the meaning of section 1033).

[(f) STATUTE OF LIMITATIONS.—If qualified real property is disposed of or ceases to be used for a qualified use, then—

[(1) the statutory period for the assessment of any additional tax under subsection (c) attributable to such disposition or cessation shall not expire before the expiration of 3 years from the date the Secretary is notified (in such manner as the Secretary may by regulations prescribe) of such disposition or cessation (or if later in the case of an involuntary conversion or exchange to which subsection (h) or (i) applies, 3 years from the date the Secretary is notified of the replacement of the converted property or of an intention not to replace or of the exchange of property), and

[(2) such additional tax may be assessed before the expiration of such 3-year period notwithstanding the provisions of any other law or rule of law which would otherwise prevent such assessment.

[(g) APPLICATION OF THIS SECTION AND SECTION 6324B TO INTERESTS IN PARTNERSHIPS, CORPORATIONS, AND TRUSTS.—The Secretary shall prescribe regulations setting forth the application of this section and section 6324B in the case of an interest in a partnership, corporation, or trust which, with respect to the decedent, is an interest in a closely held business (within the meaning of paragraph (1) of section 6166(b)). For purposes of the preceding sentence, an interest in a discretionary trust all the beneficiaries of which are qualified heirs shall be treated as a present interest.

[(h) SPECIAL RULES FOR INVOLUNTARY CONVERSIONS OF QUALIFIED REAL PROPERTY.—

[(1) TREATMENT OF CONVERTED PROPERTY.—

[(A) IN GENERAL.—If there is an involuntary conversion of an interest in qualified real property—

[(i) no tax shall be imposed by subsection (c) on such conversion if the cost of the qualified replacement property equals or exceeds the amount realized on such conversion, or

[(ii) if clause (i) does not apply, the amount of the tax imposed by subsection (c) on such conversion shall be the amount determined under subparagraph (B).

[(B) AMOUNT OF TAX WHERE THERE IS NOT COMPLETE REINVESTMENT.—The amount determined under this subparagraph with respect to any involuntary conversion is the amount of the tax which (but for this subsection) would have been imposed on such conversion reduced by an amount which—

[(i) bears the same ratio to such tax, as

[(ii) the cost of the qualified replacement property bears to the amount realized on the conversion.

[(2) TREATMENT OF REPLACEMENT PROPERTY.—For purposes of subsection (c)—

[(A) any qualified replacement property shall be treated in the same manner as if it were a portion of the interest in qualified real property which was involuntarily converted; except that with respect to such qualified replacement property the 10-year period under paragraph (1) of

subsection (c) shall be extended by any period, beyond the 2-year period referred to in section 1033(a)(2)(B)(i), during which the qualified heir was allowed to replace the qualified real property,

[(B) any tax imposed by subsection (c) on the involuntary conversion shall be treated as a tax imposed on a partial disposition, and

[(C) paragraph (6) of subsection (c) shall be applied—

[(i) by not taking into account periods after the involuntary conversion and before the acquisition of the qualified replacement property, and

[(ii) by treating material participation with respect to the converted property as material participation with respect to the qualified replacement property.

[(3) DEFINITIONS AND SPECIAL RULES.—For purposes of this subsection—

[(A) INVOLUNTARY CONVERSION.—The term "involuntary conversion" means a compulsory or involuntary conversion within themeaning of section 1033.

[(B) QUALIFIED REPLACEMENT PROPERTY.—The term "qualified replacement property" means—

[(i) in the case of an involuntary conversion described in section 1033(a)(1), any real property into which the qualified real property is converted, or

[(ii) in the case of an involuntary conversion described in section 1033(a)(2), any real property purchased by the qualified heir during the period specified in section 1033(a)(2)(B) for purposes of replacing the qualified real property.

Such term only includes property which is to be used for the qualified use set forth in subparagraph (A) or (B) of subsection (b)(2) under which the qualified real property qualified under subsection (a).

[(4) CERTAIN RULES MADE APPLICABLE.—The rules of the last sentence of section 1033(a)(2)(A) shall apply for purposes of paragraph (3)(B)(ii).

[(i) EXCHANGES OF QUALIFIED REAL PROPERTY.—

[(1) TREATMENT OF PROPERTY EXCHANGED.—

[(A) EXCHANGES SOLELY FOR QUALIFIED EXCHANGE PROPERTY.—If an interest in qualified real property is exchanged solely for an interest in qualified exchange property in a transaction which qualifies under section 1031, no tax shall be imposed by subsection (c) by reason of such exchange.

[(B) EXCHANGES WHERE OTHER PROPERTY RECEIVED.—If an interest in qualified real property is exchanged for an interest in qualified exchange property and other property in a transaction which qualifies under section 1031, the amount of the tax imposed by subsection (c) by reason of such exchange shall be the amount of tax which (but for this subparagraph) would have been imposed on such exchange under subsection (c)(1), reduced by an amount which—

[(i) bears the same ratio to such tax, as

[(ii) the fair market value of the qualified exchange property bears to the fair market value of the qualified real property exchanged.

[For purposes of clause (ii) of the preceding sentence, fair market value shall be determined as of the time of the exchange.

[(2) TREATMENT OF QUALIFIED EXCHANGE PROPERTY.—For purposes of subsection (c)—

[(A) any interest in qualified exchange property shall be treated in the same manner as if it were a portion of the interest in qualified real property which was exchanged,

[(B) any tax imposed by subsection (c) by reason of the exchange shall be treated as a tax imposed on a partial disposition, and

[(C) paragraph (6) of subsection (c) shall be applied by treating material participation with respect to the exchanged property as material participation with respect to the qualified exchange property.

[(3) QUALIFIED EXCHANGE PROPERTY.—For purposes of this subsection, the term "qualified exchange property" means real property which is to be used for the qualified use set forth in subparagraph (A) or (B) of subsection (b)(2) under which the real property exchanged therefor originally qualified under subsection (a).

[SEC. 2033. PROPERTY IN WHICH THE DECEDENT HAD AN INTEREST.

[The value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death.

[SEC. 2034. DOWER OR CURTESY INTERESTS.

[The value of the gross estate shall include the value of all property to the extent of any interest therein of the surviving spouse, existing at the time of the decedent's death as dower or curtesy, or by virtue of a statute creating an estate in lieu of dower or curtesy.

[SEC. 2035. ADJUSTMENTS FOR CERTAIN GIFTS MADE WITHIN 3 YEARS OF DECEDENT'S DEATH.

[(a) INCLUSION OF CERTAIN PROPERTY IN GROSS ESTATE.—If—

[(1) the decedent made a transfer (by trust or otherwise) of an interest in any property, or relinquished a power with respect to any property, during the 3-year period ending on the date of the decedent's death, and

[(2) the value of such property (or an interest therein) would have been included in the decedent's gross estate under section 2036, 2037, 2038, or 2042 if such transferred interest or relinquished power had been retained by the decedent on the date of his death, the value of the gross estate shall include the value of any property (or interest therein) which would have been so included.

[(b) INCLUSION OF GIFT TAX ON GIFTS MADE DURING 3 YEARS BEFORE DECEDENT'S DEATH.—The amount of the gross estate (determined without regard to this subsection) shall be increased by the amount of any tax paid under chapter 12 by the decedent or his estate on any gift made by the decedent or his spouse during the 3-year period ending on the date of the decedent's death.

[(c) OTHER RULES RELATING TO TRANSFERS WITHIN 3 YEARS OF DEATH.—

[(1) IN GENERAL.—For purposes of—

[(A) section 303(b) (relating to distributions in redemption of stock to pay death taxes),

[(B) section 2032A (relating to special valuation of certain farms, etc., real property), and

[(C) subchapter C of chapter 64 (relating to lien for taxes), the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, during the 3-year period ending on the date of the decedent's death.

[(2) COORDINATION WITH SECTION 6166.—An estate shall be treated as meeting the 35 percent of adjusted gross estate requirement of section 6166(a)(1) only if the estate meets such requirement both with and without the application of paragraph (1).

[(3) MARITAL AND SMALL TRANSFERS.—Paragraph (1) shall not apply to any transfer (other than a transfer with respect to a life insurance policy) made during a calendar year to any donee if the decedent was not required by section 6019 (other than by reason of section 6019(2) to file any gift tax return for such year with respect to transfers to such donee.

[(d) EXCEPTION.—Subsection (a) shall not apply to any bona fide sale for an adequate and full consideration in money or money's worth.

[(e) TREATMENT OF CERTAIN TRANSFERS FROM REVOCABLE TRUSTS.—For purposes of this section and section 2038, any transfer from any portion of a trust during any period that such portion was treated under section 676 as owned by the decedent by reason of a power in the grantor (determined without regard to section 672(e) shall be treated as a transfer made directly by the decedent.

[SEC. 2036. TRANSFERS WITH RETAINED LIFE ESTATE.

[(a) GENERAL RULE.—The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death—

[(1) the possession or enjoyment of, or the right to the income from, the property, or

[(2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

[(b) VOTING RIGHTS.—

[(1) IN GENERAL.—For purposes of subsection (a)(1), the retention of the right to vote (directly or indirectly) shares of stock of a controlled corporation shall be considered to be a retention of the enjoyment of transferred property.

[(2) CONTROLLED CORPORATION.—For purposes of paragraph (1), a corporation shall be treated as a controlled corporation if, at any time after the transfer of the property and during the 3-year period ending on the date of the decedent's death, the decedent owned (with the application of section 318), or had

the right (either alone or in conjunction with any person) to vote, stock possessing at least 20 percent of the total combined voting power of all classes of stock.

[(3) COORDINATION WITH SECTION 2035.—For purposes of applying section 2035 with respect to paragraph (1), the relinquishment or cessation of voting rights shall be treated as a transfer of property made by the decedent.

[(c) LIMITATION ON APPLICATION OF GENERAL RULE.—This section shall not apply to a transfer made before March 4, 1931; nor to a transfer made after March 3, 1931, and before June 7, 1932, unless the property transferred would have been includible in the decedent's gross estate by reason of the amendatory language of the joint resolution of March 3, 1931 (46 Stat. 1516).

[SEC. 2037. TRANSFERS TAKING EFFECT AT DEATH.

[(a) GENERAL RULE.—The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time after September 7, 1916, made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, if—

[(1) possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent, and

[(2) the decedent has retained a reversionary interest in the property (but in the case of a transfer made before October 8, 1949, only if such reversionary interest arose by the express terms of the instrument of transfer), and the value of such reversionary interest immediately before the death of the decedent exceeds 5 percent of the value of such property.

[(b) SPECIAL RULES.—For purposes of this section, the term "reversionary interest" includes a possibility that propertytransferred by the decedent—

[(1) may return to him or his estate, or

[(2) may be subject to a power of disposition by him, but such term does not include a possibility that the income alone from such property may return to him or become subject to a power of disposition by him. The value of a reversionary interest immediately before the death of the decedent shall be determined (without regard to the fact of the decedent's death) by usual methods of valuation, including the use of tables of mortality and actuarial principles, under regulations prescribed by the Secretary. In determining the value of a possibility that property may be subject to a power of disposition by the decedent, such possibility shall be valued as if it were a possibility that such property may return to the decedent or his estate. Notwithstanding the foregoing, an interest so transferred shall not be included in the decedent's gross estate under this section if possession or enjoyment of the property could have been obtained by any beneficiary during the decedent's life through the exercise of a general power of appointment (as defined in section 2041) which in fact was exercisable immediately before the decedent's death.

[SEC. 2038. REVOCABLE TRANSFERS.

[(a) IN GENERAL.—The value of the gross estate shall include the value of all property.

[(1) TRANSFERS AFTER JUNE 22, 1936.—To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished during the 3 year period ending on the date of the decedent's death.

[(2) TRANSFERS ON OR BEFORE JUNE 22, 1936.—To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke, or where the decedent relinquished any such power during the 3 year period ending on the date of the decedent's death. Except in the case of transfers made after June 22, 1936, no interest of the decedent of which he has made a transfer shall be included in the gross estate under paragraph (1) unless it is includible under this paragraph.

[(b) DATE OF EXISTENCE OF POWER.—For purposes of this section, the power to alter, amend, revoke, or terminate shall be considered to exist on the date of the decedent's death even though the exercise of the power is subject to a precedent giving of notice or even though the alteration, amendment, revocation, or termination takes effect only on the expiration of a stated period after the exercise of the power, whether or not on or before the date of the decedent's death notice has been given or the power has been exercised. In such cases proper adjustment shall be made representing the interests which would have been excluded from the power if the decedent had lived, and for such purpose, if the notice has not been given or the power has not been exercised on or before the date of his death, such notice shall be considered to have been given, or the power exercised, on the date of his death.

[SEC. 2039. ANNUITIES.

[(a) GENERAL.—The gross estate shall include the value of an annuity or other payment receivable by any beneficiary by reason of surviving the decedent under any form of contract or agreement entered into after March 3, 1931 (other than as insurance under policies on the life of the decedent), if, under such contract or agreement, an annuity or other payment was payable to the decedent, or the decedent possessed the right to receive such annuity or payment, either alone or in conjunction with another for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death.

[(b) AMOUNT INCLUDIBLE.—Subsection (a) shall apply to only such part of the value of the annuity or other payment receivable under such contract or agreement as is proportionate to that part of the purchase price therefor contributed by the decedent. For purposes of this section, any contribution by the decedent's employer or former employer to the purchase price of such contract or agreement (whether or not to an employee's trust or fund forming part of a pension, annuity, retirement, bonus or profit sharing plan) shall be considered to be contributed by the decedent if made by reason of his employment.

[SEC. 2040. JOINT INTERESTS.

[(a) GENERAL RULE.—The value of the gross estate shall include the value of all property to the extent of the interest therein held as joint tenants with right of survivorship by the decedent and any other person, or as tenants by the entirety by the decedent and spouse, or deposited, with any person carrying on the banking business, in their joint names and payable to either or the survivor, except such part thereof as may be shown to have originally belonged to such other person and never to have been received or acquired by the latter from the decedent for less than an adequate and full consideration in money or money's worth: *Provided,* That where such property or any part thereof, or part of the consideration with which such property was acquired, is shown to have been at any time acquired by such other person from the decedent for less than an adequate and full consideration in money or money's worth, there shall be excepted only such part of the value of such property as is proportionate to the consideration furnished by such other person: *Provided further,* That where any property has been acquired by gift, bequest, devise, or inheritance, as a tenancy by the entirety by the decedent and spouse, then to the extent of one-half of the value thereof, or, where so acquired by the decedent and any other person as joint tenants with right of survivorship and their interests are not otherwise specified or fixed by law, then to the extent of the value of a fractional part to be determined by dividing the value of the property by the number of joint tenants with right of survivorship.

[(b) CERTAIN JOINT INTERESTS OF HUSBAND AND WIFE.—

[(1) INTERESTS OF SPOUSE EXCLUDED FROM GROSS ESTATE.—Notwithstanding subsection (a), in the case of any qualified joint interest, the value included in the gross estate with respect to such interest by reason of this section is one-half of the value of such qualified joint interest.

[(2) QUALIFIED JOINT INTEREST DEFINED.—For purposes of paragraph (1), the term "qualified joint interest" means any interest in property held by the decedent and the decedent's spouse as—

[(A) tenants by the entirety, or

[(B) joint tenants with right of survivorship, but only if the decedent and the spouse of the decedent are the only joint tenants.

[SEC. 2041. POWERS OF APPOINTMENT.

[(a) IN GENERAL.—The value of the gross estate shall include the value of all property.

[(1) POWERS OF APPOINTMENT CREATED ON OR BEFORE OCTOBER 21, 1942.—To the extent of any property with respect to which a general power of appointment created on or before October 21, 1942, is exercised by the decedent—

[(A) by will, or

[(B) by a disposition which is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under sections 2035 to 2038, inclusive;

but the failure to exercise such a power or the complete release of such a power shall not be deemed an exercise thereof. If a general power of appointment created on or before October 21, 1942, has been partially released so that it is no longer a general power of appointment, the exercise of such power shall not be deemed to be the exercise of a general power of appointment if—

[(i) such partial release occurred before November 1, 1951, or

[(ii) the donee of such power was under a legal disability to release such power on October 21, 1942, and such partial release occurred not later than 6 months after the termination of such legal disability.

[(2) POWERS CREATED AFTER OCTOBER 21, 1942.—To the extent of any property with respect to which the decedent has at the time of his death a general power of appointment created after October 21, 1942, or with respect to which the decedent has at any time exercised or released such a power of appointment by a disposition which is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under sections 2035 to 2038, inclusive. For purposes of this paragraph (2), the power of appointment shall be considered to exist on the date of the decedent's death even though the exercise of the power is subject to a precedent giving of notice or even though the exercise of the power takes effect only on the expiration of a stated period after its exercise, whether or not on or before the date of the decedent's death notice has been given or the power has been exercised.

[(3) CREATION OF ANOTHER POWER IN CERTAIN CASES.—To the extent of any property with respect to which the decedent—

[(A) by will, or

[(B) by a disposition which is of such nature that if it were a transfer of property owned by the decedent such property would be includible in the decedent's gross estate under section 2035, 2036, or 2037, exercises a power of appointment created after October 21, 1942, by creating another power of appointment which under the applicable local law can be validly exercised so as to postpone the vesting of any estate or interest in such property, or suspend the absolute ownership or power of alienation of such property, for a period ascertainable without regard to the date of the creation of the first power.

[(b) DEFINITIONS.—For purposes of subsection (a)—

[(1) GENERAL POWER OF APPOINTMENT.—The term "general power of appointment" means a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate; except that—

[(A) A power to consume, invade, or appropriate property for the benefit of the decedent which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent shall not be deemed a general power of appointment.

[(B) A power of appointment created on or before October 21, 1942, which is exercisable by the decedent only in conjunction with another person shall not be deemed a general power of appointment.

[(C) In the case of a power of appointment created after October 21, 1942, which is exercisable by the decedent only in conjunction with another person—

[(i) If the power is not exercisable by the decedent except in conjunction with the creator of the power—such power shall not be deemed a general power of appointment.

[(ii) If the power is not exercisable by the decedent except in conjunction with a person having a substantial interest in the property, subject to the power, which is adverse to exercise of the power in favor of the decedent—such power shall not be deemed a general power of appointment. For the purposes of this clause a person who, after the death of the decedent, may be possessed of a power of appointment (with respect to the property subject to the decedent's power) which he may exercise in his own favor shall be deemed as having an interest in the property and such interest shall be deemed adverse to such exercise of the decedent's power.

[(iii) If (after the application of clauses (i) and (ii)) the power is a general power of appointment and is exercisable in favor of such other person—such power shall be deemed a general power of appointment only in respect of a fractional part of the property subject to such power, such part to be determined by dividing the value of such property by the number of such persons (including the decedent) in favor of whom such power is exercisable.

For purposes of clauses (ii) and (iii), a power shall be deemed to be exercisable in favor of a person if it is exercisable in favor of such person, his estate, his creditors, or the creditors of his estate.

[(2) LAPSE OF POWER.—The lapse of a power of appointment created after October 21, 1942, during the life of the individual possessing the power shall be considered a release of such power. The preceding sentence shall apply with respect to the lapse of powers during any calendar year only to the extent that the property, which could have been appointed by exercise of such lapsed powers, exceeded in value, at the time of such lapse, the greater of the following amounts:

[(A) $5,000, or

[(B) 5 percent of the aggregate value, at the time of such lapse, of the assets out of which, or the proceeds of which, the exercise of the lapsed powers could have been satisfied.

[(3) DATE OF CREATION OF POWER.—For purposes of this section, a power of appointment created by a will executed on or before October 21, 1942, shall be considered a power created on or before such date if the person executing such will dies before July 1, 1949, without having republished such will, by codicil or otherwise, after October 21, 1942.

[SEC. 2042. PROCEEDS OF LIFE INSURANCE.

[The value of the gross estate shall include the value of all property—

[(1) RECEIVABLE BY THE EXECUTOR.—To the extent of the amount receivable by the executor as insurance under policies on the life of the decedent.

[(2) RECEIVABLE BY OTHER BENEFICIARIES.—To the extent of the amount receivable by all other beneficiaries as insurance under policies on the life of the decedent with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person. For purposes of the preceding sentence, the term "incident of ownership" includes a reversionary interest (whether arising by the express terms of the policy or other instrument or by operation of law) only if the value of such reversionary interest exceeded 5 percent of the value of the policy immediately before the death of the decedent. As used in this paragraph, the term "reversionary interest" includes a possibility that the policy, or the proceeds of the policy, may return to the decedent or his estate, or may be subject to a power of disposition by him. The value of a reversionary interest at any time shall be determined (without regard to the fact of the decedent's death) by usual methods of valuation, including the use of tables of mortality and actuarial principles, pursuant to regulations prescribed by the Secretary. In determining the value of a possibility that the policy or proceeds thereof may be subject to a power of disposition by the decedent, such possibility shall be valued as if it were a possibility that such policy or proceeds may return to the decedent or his estate.

[SEC. 2043. TRANSFERS FOR INSUFFICIENT CONSIDERATION.

[(a) IN GENERAL.—If any one of the transfers, trusts, interests, rights, or powers enumerated and described in sections 2035 to 2038, inclusive, and section 2041 is made, created, exercised, or relinquished for a consideration in money or money's worth, but is not a bona fide sale for an adequate and full consideration in money or money's worth, there shall be included in the gross estate only the excess of the fair market value at the time of death of the property otherwise to be included on account of such transaction, over the value of the consideration received therefor by the decedent.

[(b) MARITAL RIGHTS NOT TREATED AS CONSIDERATION.—

[(1) IN GENERAL.—For purposes of this chapter, a relinquishment or promised relinquishment of dower or curtesy, or of a statutory estate created in lieu of dower or curtesy, or of other

marital rights in the decedent's property or estate, shall not be considered to any extent a consideration "in money or money's worth".

[(2) EXCEPTION.—For purposes of section 2053 (relating to expenses, indebtedness, and taxes), a transfer of property which satisfies the requirements of paragraph (1) of section 2516 (relating to certain property settlements) shall be considered to be made for an adequate and full consideration in money or money's worth.

[SEC. 2044. CERTAIN PROPERTY FOR WHICH MARITAL DEDUCTION WAS PREVIOUSLY ALLOWED.

[(a) GENERAL RULE.—The value of the gross estate shall include the value of any property to which this section applies in which the decedent had a qualifying income interest for life.

[(b) PROPERTY TO WHICH THIS SECTION APPLIES.—This section applies to any property if—

[(1) a deduction was allowed with respect to the transfer of such property to the decedent—

[(A) under section 2056 by reason of subsection (b)(7) thereof, or

[(B) under section 2523 by reason of subsection (f) thereof, and

[(2) section 2519 (relating to dispositions of certain life estates) did not apply with respect to a disposition by the decedent of part or all of such property.

[(c) PROPERTY TREATED AS HAVING PASSED FROM DECEDENT.—For purposes of this chapter and chapter 13, property includible in the gross estate of the decedent under subsection (a) shall be treated as property passing from the decedent.

[SEC. 2045. PRIOR INTERESTS.

[Except as otherwise specifically provided by law, sections 2034 to 2042, inclusive, shall apply to the transfers, trusts, estates, interests, rights, powers, and relinquishment of powers, as severally enumerated and described therein, whenever made, created, arising, existing, exercised, or relinquished.

[SEC. 2046. DISCLAIMERS.

[For provisions relating to the effect of a qualified disclaimer for purposes of this chapter, see section 2518.

[PART IV—TAXABLE ESTATE

[SEC. 2051. DEFINITION OF TAXABLE ESTATE.

[For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate the deductions provided for in this part.

[SEC. 2053. EXPENSES, INDEBTEDNESS, AND TAXES.

[(a) GENERAL RULE.—For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate such amounts—

[(1) for funeral expenses,

[(2) for administration expenses,

[(3) for claims against the estate, and

[(4) for unpaid mortgages on, or any indebtedness in respect of, property where the value of the decedent's interest therein, undiminished by such mortgage or indebtedness, is included in the value of the gross estate, as are allowable by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered.

[(b) OTHER ADMINISTRATION EXPENSES.—Subject to the limitations in paragraph (1) of subsection (c), there shall be deducted in determining the taxable estate amounts representing expenses incurred in administering property not subject to claims which is included in the gross estate to the same extent such amounts would be allowable as a deduction under subsection (a) if such property were subject to claims, and such amounts are paid before the expiration of the period of limitation for assessment provided in section 6501.

[(c) LIMITATIONS.—

[(1) LIMITATIONS APPLICABLE TO SUBSECTIONS (A) AND (B).—

[(A) CONSIDERATION FOR CLAIMS.—The deduction allowed by this section in the case of claims against the estate, unpaid mortgages, or any indebtedness shall, when founded on a promise or agreement, be limited to the extent that they were contracted bona fide and for an adequate and full consideration in money or money's worth; except that in any case in which any such claim is founded on a promise or agreement of the decedent to make a contribution or gift to or for the use of any donee described in section 2055 for the purposes specified therein, the deduction for such claims shall not be so limited, but shall be limited to the extent that it would be allowable as a deduction under section 2055 if such promise or agreement constituted a bequest.

[(B) CERTAIN TAXES.—Any income taxes on income received after the death of the decedent, or property taxes not accrued before his death, or any estate, succession, legacy, or inheritance taxes, shall not be deductible under this section.

[(C) CERTAIN CLAIMS BY REMAINDERMEN.—No deduction shall be allowed under this section for a claim against the estate by a remainderman relating to any property described in section 2044.

[(D) SECTION 6166 INTEREST.—No deduction shall be allowed under this section for any interest payable under section 6601 on any unpaid portion of the tax imposed by section 2001 for the period during which an extension of time for payment of such tax is in effect under section 6166.

[(2) LIMITATIONS APPLICABLE ONLY TO SUBSECTION (A).—In the case of the amounts described in subsection (a), there shall

be disallowed the amount by which the deductions specified therein exceed the value, at the time of the decedent's death, of property subject to claims, except to the extent that such deductions represent amounts paid before the date prescribed for the filing of the estate tax return. For purposes of this section, the term "property subject to claims" means property includible in the gross estate of the decedent which, or the avails of which, would under the applicable law, bear the burden of the payment of such deductions in the final adjustment and settlement of the estate, except that the value of the property shall be reduced by the amount of the deduction under section 2054 attributable to such property.

[(d) CERTAIN STATE AND FOREIGN DEATH TAXES.—

[(1) GENERAL RULE.—Notwithstanding the provisions of subsection (c)(1)(B) of this section, for purposes of the tax imposed by section 2001 the value of the taxable estate may be determined, if the executor so elects before the expiration of the period of limitation for assessment provided in section 6501, by deducting from the value of the gross estate the amount (as determined in accordance with regulations prescribed by the Secretary) of—

[(A) any estate, succession, legacy, or inheritance tax imposed by a State or the District of Columbia upon a transfer by the decedent for public, charitable, or religious uses described insection 2055 or 2106(a)(2), and

[(B) any estate, succession, legacy, or inheritance tax imposed by and actually paid to any foreign country, in respect of any property situated within such foreign country and included in the gross estate of a citizen or resident of the United States, upon a transfer by the decedent for public, charitable, or religious uses described in section 2055.

The determination under subparagraph (B) of the country within which property is situated shall be made in accordance with the rules applicable under subchapter B (sec. 2101 and following) in determining whether property is situated within or without the United States. Any election under this paragraph shall be exercised in accordance with regulations prescribed by the Secretary.

[(2) CONDITION FOR ALLOWANCE OF DEDUCTION.—No deduction shall be allowed under paragraph (1) for a State death tax or a foreign death tax specified therein unless the decrease in the tax imposed by section 2001 which results from the deduction provided in paragraph (1) will inure solely for the benefit of the public, charitable, or religious transferees described in section 2055 or section 2106(a)(2). In any case where the tax imposed by section 2001 is equitably apportioned among all the transferees of property included in the gross estate, including those described in sections 2055 and 2106(a)(2) (taking into account any exemptions, credits, or deductions allowed by this chapter), in determining such decrease, there shall be disregarded any decrease in the Federal estate tax which any transferees other than those described in sections 2055 and 2106(a)(2) are required to pay.

[(3) EFFECT ON CREDITS FOR STATE AND FOREIGN DEATH TAXES OF DEDUCTION UNDER THIS SUBSECTION.—

[(A) ELECTION.—An election under this subsection shall be deemed a waiver of the right to claim a credit, against the Federal estate tax, under a death tax convention with any foreign country for any tax or portion thereof in respect of which a deduction is taken under this subsection.

[(B) CROSS REFERENCES.—

[See section 2011(e) for the effect of a deduction taken under this subsection on the credit for State death taxes, and see section 2014(f) for the effect of a deduction taken under this subsectionon the credit for foreign death taxes.

[(e) MARITAL RIGHTS.—For provisions treating certain relinquishments of marital rights as consideration in money or money's worth, see section 2043(b)(2).

[SEC. 2054. LOSSES

[For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate losses incurred during the settlement of estates arising from fires, storms, shipwrecks, or other casualties, or from theft, when such losses are not compensated for by insurance or otherwise.

[SEC. 2055. TRANSFERS FOR PUBLIC, CHARITABLE, AND RELIGIOUS USES

[(a) IN GENERAL.—For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises, or transfers—

[(1) to or for the use of the United States, any State, any political subdivision thereof, or the District of Columbia, for exclusively public purposes;

[(2) to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), and the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, which is not disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office;

[(3) to a trustee or trustees, or a fraternal society, order, or association operating under the lodge system, but only if such contributions or gifts are to be used by such trustee or trustees, or by such fraternal society, order, or association, exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, such trust, fraternal society, order, or association would not be disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, and such trustee or trustees, or such fraternal society, order, or as-

sociation, does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office;

[(4) to or for the use of any veterans' organization incorporated by Act of Congress, or of its departments or local chapters or posts, no part of the net earnings of which inures to the benefit of any private shareholder or individual; or

[(5) to an employee stock ownership plan if such transfer qualifies as a qualified gratuitous transfer of qualified employer securities within the meaning of section 664(g).

For purposes of this subsection, the complete termination before the date prescribed for the filing of the estate tax return of a power to consume, invade, or appropriate property for the benefit of an individual before such power has been exercised by reason of the death of such individual or for any other reason shall be considered and deemed to be a qualified disclaimer with the same full force and effect as though he had filed such qualified disclaimer. Rules similar to the rules of section 501(j) shall apply for purposes of paragraph (2).

[(b) POWERS OF APPOINTMENT.—Property includible in the decedent's gross estate under section 2041 (relating to powers of appointment) received by a donee described in this section shall, for purposes of this section, be considered a bequest of such decedent.

[(c) DEATH TAXES PAYABLE OUT OF BEQUESTS.—If the tax imposed by section 2001, or any estate, succession, legacy, or inheritance taxes, are, either by the terms of the will, by the law of the jurisdiction under which the estate is administered, or by the law of the jurisdiction imposing the particular tax, payable in whole or in part out of the bequests, legacies, or devises otherwise deductible under this section, then the amount deductible under this section shall be the amount of such bequests, legacies, or devises reduced by the amount of such taxes.

[(d) LIMITATION ON DEDUCTION.—The amount of the deduction under this section for any transfer shall not exceed the value of the transferred property required to be included in the gross estate.

[(e) DISALLOWANCE OF DEDUCTIONS IN CERTAIN CASES.—

[(1) No deduction shall be allowed under this section for a transfer to or for the use of an organization or trust described in section 508(d) or 4948(c)(4) subject to the conditions specified in such sections.

[(2) Where an interest in property (other than an interest described in section 170(f)(3)(B)) passes or has passed from the decedent to a person, or for a use, described in subsection (a), and an interest (other than an interest which is extinguished upon the decedent's death) in the same property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to a person, or for a use, not described in subsection (a), no deduction shall be allowed under this section for the interest which passes or has passed to the person, or for the use, described in subsection (a) unless—

[(A) in the case of a remainder interest, such interest is in a trust which is a charitable remainder annuity trust or

a charitable remainder unitrust (described in section 664) or a pooled income fund (described in section 642(c)(5)), or

[(B) in the case of any other interest, such interest is in the form of a guaranteed annuity or is a fixed percentage distributed yearly of the fair market value of the property (to be determined yearly).

[(3) REFORMATIONS TO COMPLY WITH PARAGRAPH (2).—

[(A) IN GENERAL.—A deduction shall be allowed under subsection (a) in respect of any qualified reformation.

[(B) QUALIFIED REFORMATION.—For purposes of this paragraph, the term "qualified reformation" means a change of a governing instrument by reformation, amendment, construction, or otherwise which changes a reformable interest into a qualified interest but only if—

[(i) any difference between—

[(I) the actuarial value (determined as of the date of the decedent's death) of the qualified interest, and

[(II) the actuarial value (as so determined) of the reformable interest, does not exceed 5 percent of the actuarial value (as so determined) of the reformable interest,

[(ii) in the case of—

[(I) a charitable remainder interest, the nonremainder interest (before and after the qualified reformation) terminated at the same time, or

[(II) any other interest, the reformable interest and the qualified interest are for the same period, and

[(iii) such change is effective as of the date of the decedent's death.

A nonremainder interest (before reformation) for a term of years in excess of 20 years shall be treated as satisfying subclause (I) of clause (ii) if such interest (after reformation) is for a term of 20 years.

[(C) REFORMABLE INTEREST.—For purposes of this paragraph—

[(i) IN GENERAL.—The term "reformable interest" means any interest for which a deduction would be allowable under subsection (a) at the time of the decedent's death but for paragraph (2).

[(ii) BENEFICIARY'S INTEREST MUST BE FIXED.—The term "reformable interest" does not include any interest unless, before the remainder vests in possession, all payments to persons other than an organization described in subsection (a) are expressed either in specified dollar amounts or a fixed percentage of the fair market value of the property. For purposes of determining whether all such payments are expressed as a fixed percentage of the fair market value of the property, section 664(d)(3) shall be taken into account.

[(iii) SPECIAL RULE WHERE TIMELY COMMENCEMENT OF REFORMATION.—Clause (ii) shall not apply to any interest if a judicial proceeding is commenced to

change such interest into a qualified interest not later than the 90th day after—

[(I) if an estate tax return is required to be filed, the last date (including extensions) for filing such return, or

[(II) if no estate tax return is required to be filed, the last date (including extensions) for filing the income tax return for the 1st taxable year for which such a return is required to be filed by the trust.

[(iv) SPECIAL RULE FOR WILL EXECUTED BEFORE JANUARY 1, 1979, ETC.—In the case of any interest passing under a will executed before January 1, 1979, or under a trust created before such date, clause (ii) shall not apply.

[(D) QUALIFIED INTEREST.—For purposes of this paragraph, the term "qualified interest" means an interest for which a deduction is allowable under subsection (a).

[(E) LIMITATION.—The deduction referred to in subparagraph (A) shall not exceed the amount of the deduction which would have been allowable for the reformable interest but for paragraph (2).

[(F) SPECIAL RULE WHERE INCOME BENEFICIARY DIES.—If (by reason of the death of any individual, or by termination or distribution of a trust in accordance with the terms of the trust instrument) by the due date for filing the estate tax return (including any extension thereof) a reformable interest is in a wholly charitable trust or passes directly to a person or for a use described in subsection (a), a deduction shall be allowed for such reformable interest as if it had met the requirements of paragraph (2) on the date of the decedent's death. For purposes of the preceding sentence, the term "wholly charitable trust" means a charitable trust which, upon the allowance of a deduction, would be described in section 4947(a)(1).

[(G) STATUTE OF LIMITATIONS.—The period for assessing any deficiency of any tax attributable to the application of this paragraph shall not expire before the date 1 year after the date on which the Secretary is notified that such reformation (or other proceeding pursuant to subparagraph (J) has occurred.

[(H) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this paragraph, including regulations providing such adjustments in the application of the provisions of section 508 (relating to special rules relating to section 501(c)(3) organizations), subchapter J (relating to estates, trusts, beneficiaries, and decedents), and chapter 42 (relating to private foundations) as may be necessary by reason of the qualified reformation.

[(I) REFORMATIONS PERMITTED IN CASE OF REMAINDER INTERESTS IN RESIDENCE OR FARM, POOLED INCOME FUNDS, ETC.—The Secretary shall prescribe regulations (consistent with the provisions of this paragraph) permitting reformations in the case of any failure—

[(i) to meet the requirements of section 170(f)(3)(B) (relating to remainder interests in personal residence or farm, etc.), or

[(ii) to meet the requirements of section 642(c)(5).

[(J) VOID OR REFORMED TRUST IN CASES OF INSUFFICIENT REMAINDER INTERESTS.—In the case of a trust that would qualify (or could be reformed to qualify pursuant to subparagraph (B)) but for failure to satisfy the requirement of paragraph (1)(D) or (2)(D) of section 664(d), such trust may be—

[(i) declared null and void ab initio, or

[(ii) changed by reformation, amendment, or otherwise to meet such requirement by reducing the payout rate or the duration (or both) of any noncharitable beneficiary's interest to the extent necessary to satisfy such requirement,

pursuant to a proceeding that is commenced within the period required in subparagraph (C)(iii). In a case described in clause (i), no deduction shall be allowed under this title for any transfer to the trust and any transactions entered into by the trust prior to being declared void shall be treated as entered into by the transferor.

[(4) WORKS OF ART AND THEIR COPYRIGHTS TREATED AS SEPARATE PROPERTIES IN CERTAIN CASES.—

[(A) IN GENERAL.—In the case of a qualified contribution of a work of art, the work of art and the copyright on such work of art shall be treated as separate properties for purposes of paragraph (2).

[(B) WORK OF ART DEFINED.—For purposes of this paragraph, the term "work of art" means any tangible personal property with respect to which there is a copyright under Federal law.

[(C) QUALIFIED CONTRIBUTION DEFINED.—For purposes of this paragraph, the term "qualified contribution" means any transfer of property to a qualified organization if the use of the property by the organization is related to the purpose or function constituting the basis for its exemption under section 501.

[(D) QUALIFIED ORGANIZATION DEFINED.—For purposes of this paragraph, the term "qualified organization" means any organization described in section 501(c)(3) other than a private foundation (as defined in section 509). For purposes of the preceding sentence, a private operating foundation (as defined in section 4942(j)(3)) shall not be treated as a private foundation.

[(f) SPECIAL RULE FOR IRREVOCABLE TRANSFERS OF EASEMENTS IN REAL PROPERTY.—A deduction shall be allowed under subsection (a) in respect of any transfer of a qualified real property interest (as defined in section 170(h)(2)(C)) which meets the requirements of section 170(h) (without regard to paragraph (4)(A) thereof).

[(g) CROSS REFERENCES.—

[(1) For option as to time for valuation for purpose of deduction under this section, see section 2032.

[(2) For treatment of certain organizations providing child care, see section 501(k).

[(3) For exemption of gifts and bequests to or for the benefit of Library of Congress, see section 5 of the Act of March 3, 1925, as amended (2 U.S.C. 161).

[(4) For treatment of gifts and bequests for the benefit of the Naval Historical Center as gifts or bequests to or for the use of the United States, see section 7222 of title 10, United States Code.

[(5) For treatment of gifts and bequests to or for the benefit of National Park Foundation as gifts or bequests to or for the use of the United States, see section 8 of the Act of December 18, 1967 (16 U.S.C. 191).

[(6) For treatment of gifts, devises, or bequests accepted by the Secretary of State, the Director of the International Communication Agency, or the Director of the United States International Development Cooperation Agency as gifts, devises, or bequests to or for the use of the United States, see section 25 of the State Department Basic Authorities Act of 1956.

[(7) For treatment of gifts or bequests of money accepted by the Attorney General for credit to "Commissary Funds, Federal Prisons," as gifts or bequests to or for the use of the United States, see section 4043 of title 18, United States Code.

[(8) For payment of tax on gifts and bequests of United States obligations to the United States, see section 3113(e) of title 31, United States Code.

[(9) For treatment of gifts and bequests for benefit of the Naval Academy as gifts or bequests to or for the use of the United States, see section 6973 of title 10, United States Code.

[(10) For treatment of gifts and bequests for benefit of the Naval Academy Museum as gifts or bequests to or for the use of the United States, see section 6974 of title 10, United States Code.

[(11) For exemption of gifts and bequests received by National Archives Trust Fund Board, see section 2308 of title 44, United States Code.

[(12) For treatment of gifts and bequests to or for the use of Indian tribal governments (or their subdivisions), see section 7871.

[SEC. 2056. BEQUESTS, ETC., TO SURVIVING SPOUSE.

[(a) ALLOWANCE OF MARITAL DEDUCTION.—For purposes of the tax imposed by section 2001, the value of the taxable estate shall, except as limited by subsection (b), be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

[(b) LIMITATION IN THE CASE OF LIFE ESTATE OR OTHER TERMINABLE INTEREST.—

[(1) GENERAL RULE.—Where, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, an interest passing to the surviving spouse will terminate or fail, no deduction shall be allowed under this section with respect to such interest—

[(A) if an interest in such property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to any person other than such surviving spouse (or the estate of such spouse); and

[(B) if by reason of such passing such person (or his heirs or assigns) may possess or enjoy any part of such property after such termination or failure of the interest so passing to the surviving spouse;

and no deduction shall be allowed with respect to such interest (even if such deduction is not disallowed under subparagraphs (A) and (B))—

[(C) if such interest is to be acquired for the surviving spouse, pursuant to directions of the decedent, by his executor or by the trustee of a trust.

For purposes of this paragraph, an interest shall not be considered as an interest which will terminate or fail merely because it is the ownership of a bond, note, or similar contractual obligation, the discharge of which would not have the effect of an annuity for life or for a term.

[(2) INTEREST IN UNIDENTIFIED ASSETS.—Where the assets (included in the decedent's gross estate) out of which, or the proceeds of which, an interest passing to the surviving spouse may be satisfied include a particular asset or assets with respect to which no deduction would be allowed if such asset or assets passed from the decedent to such spouse, then the value of such interest passing to such spouse shall, for purposes of subsection (a), be reduced by the aggregate value of such particular assets.

[(3) INTEREST OF SPOUSE CONDITIONAL ON SURVIVAL FOR LIMITED PERIOD.—For purposes of this subsection, an interest passing to the surviving spouse shall not be considered as an interest which will terminate or fail on the death of such spouse if—

[(A) such death will cause a termination or failure of such interest only if it occurs within a period not exceeding 6 months after the decedent's death, or only if it occurs as a result of a common disaster resulting in the death of the decedent and the surviving spouse, or only if it occurs in the case of either such event; and

[(B) such termination or failure does not in fact occur.

[(4) VALUATION OF INTEREST PASSING TO SURVIVING SPOUSE.—In determining for purposes of subsection (a) the value of any interest in property passing to the surviving spouse for which a deduction is allowed by this section—

[(A) there shall be taken into account the effect which the tax imposed by section 2001, or any estate, succession, legacy, or inheritance tax, has on the net value to the surviving spouse of such interest; and

[(B) where such interest or property is encumbered in any manner, or where the surviving spouse incurs any obligation imposed by the decedent with respect to the passing of such interest, such encumbrance or obligation shall be taken into account in the same manner as if the amount of a gift to such spouse of such interest were being determined.

[(5) LIFE ESTATE WITH POWER OF APPOINTMENT IN SURVIVING SPOUSE.—In the case of an interest in property passing from the decedent, if his surviving spouse is entitled for life to all the income from the entire interest, or all the income from a specific portion thereof, payable annually or at more frequent intervals, with power in the surviving spouse to appoint the entire interest, or such specific portion (exercisable in favor of such surviving spouse, or of the estate of such surviving spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), and with no power in any other person to appoint any part of the interest, or such

specific portion, to any person other than the surviving spouse—

[(A) the interest or such portion thereof so passing shall, for purposes of subsection (a), be considered as passing to the surviving spouse, and

[(B) no part of the interest so passing shall, for purposes of paragraph (1)(A), be considered as passing to any person other than the surviving spouse.

This paragraph shall apply only if such power in the surviving spouse to appoint the entire interest, or such specific portion thereof, whether exercisable by will or during life, is exercisable by such spouse alone and in all events.

[(6) LIFE INSURANCE OR ANNUITY PAYMENTS WITH POWER OF APPOINTMENT IN SURVIVING SPOUSE.—In the case of an interest in property passing from the decedent consisting of proceeds under a life insurance, endowment, or annuity contract, if under the terms of the contract such proceeds are payable in installments or are held by the insurer subject to an agreement to pay interest thereon (whether the proceeds, on the termination of any interest payments, are payable in a lump sum or in annual or more frequent installments), and such installment or interest payments are payable annually or at more frequent intervals, commencing not later than 13 months after the decedent's death, and all amounts, or a specific portion of all such amounts, payable during the life of the surviving spouse are payable only to such spouse, and such spouse has the power to appoint all amounts, or such specific portion, payable under such contract (exercisable in favor of such surviving spouse, or of the estate of such surviving spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), with no power in any other person to appoint such amounts to any person other than the surviving spouse—

[(A) such amounts shall, for purposes of subsection (a), be considered as passing to the surviving spouse, and

[(B) no part of such amounts shall, for purposes of paragraph (1)(A), be considered as passing to any person other than the surviving spouse.

This paragraph shall apply only if, under the terms of the contract, such power in the surviving spouse to appoint such amounts, whether exercisable by will or during life, is exercisable by such spouse alone and in all events.

[(7) ELECTION WITH RESPECT TO LIFE ESTATE FOR SURVIVING SPOUSE.—

[(A) IN GENERAL.—In the case of qualified terminable interest property—

[(i) for purposes of subsection (a), such property shall be treated as passing to the surviving spouse, and

[(ii) for purposes of paragraph (1)(A), no part of such property shall be treated as passing to any person other than the surviving spouse.

[(B) QUALIFIED TERMINABLE INTEREST PROPERTY DEFINED.—For purposes of this paragraph—

[(i) IN GENERAL.—The term "qualified terminable interest property" means property—

[(I) which passes from the decedent,

[(II) in which the surviving spouse has a qualifying income interest for life, and

[(III) to which an election under this paragraph applies.

[(ii) QUALIFYING INCOME INTEREST FOR LIFE.—The surviving spouse has a qualifying income interest for life if—

[(I) the surviving spouse is entitled to all the income from the property, payable annually or at more frequent intervals, or has a usufruct interest for life in the property, and

[(II) no person has a power to appoint any part of the property to any person other than the surviving spouse.

Subclause (II) shall not apply to a power exercisable only at or after the death of the surviving spouse. To the extent provided in regulations, an annuity shall be treated in a manner similar to an income interest in property (regardless of whether the property from which the annuity is payable can be separately identified).

[(iii) PROPERTY INCLUDES INTEREST THEREIN.—The term "property" includes an interest in property.

[(iv) SPECIFIC PORTION TREATED AS SEPARATE PROPERTY.—A specific portion of property shall be treated as separate property.

[(v) ELECTION.—An election under this paragraph with respect to any property shall be made by the executor on the return of tax imposed by section 2001. Such an election, once made, shall be irrevocable.

[(C) TREATMENT OF SURVIVOR ANNUITIES.—In the case of an annuity included in the gross estate of the decedent under section 2039 (or, in the case of an interest in an annuity arising under the community property laws of a State, included in the gross estate of the decedent under section 2033 where only the surviving spouse has the right to receive payments before the death of such surviving spouse—

[(i) the interest of such surviving spouse shall be treated as a qualifying income interest for life, and

[(ii) the executor shall be treated as having made an election under this subsection with respect to such annuity unless the executor otherwise elects on the return of tax imposed by section 2001.

An election under clause (ii), once made, shall be irrevocable.

[(8) SPECIAL RULE FOR CHARITABLE REMAINDER TRUSTS.—

[(A) IN GENERAL.—If the surviving spouse of the decedent is the only beneficiary of a qualified charitable remainder trust who is not a charitable beneficiary nor an ESOP beneficiary, paragraph (1) shall not apply to any interest in such trust which passes or has passed from the decedent to such surviving spouse.

[(B) DEFINITIONS.—For purposes of subparagraph (A)—

[(i) CHARITABLE BENEFICIARY.—The term "charitable beneficiary" means any beneficiary which is an organization described in section 170(c).

[(ii) ESOP BENEFICIARY.—The term "ESOP beneficiary" means any beneficiary which is an employee stock ownership plan (as defined in section 4975(e)(7) that holds a remainder interest in qualified employer securities (as defined in section 664(g)(4) to be transferred to such plan in a qualified gratuitous transfer (as defined in section 664(g)(1).

[(iii) QUALIFIED CHARITABLE REMAINDER TRUST.—The term "qualified charitable remainder trust" means a charitable remainder annuity trust or a charitable remainder unitrust (described in section 664.

[(9) DENIAL OF DOUBLE DEDUCTION.—Nothing in this section or any other provision of this chapter shall allow the value of any interest in property to be deducted under this chapter more than once with respect to the same decedent.

[(10) SPECIFIC PORTION.—For purposes of paragraphs (5), (6), and (7)(B)(iv), the term "specific portion" only includes a portion determined on a fractional or percentage basis.

[(c) DEFINITION.—For purposes of this section, an interest in property shall be considered as passing from the decedent to any person if and only if—

[(1) such interest is bequeathed or devised to such person by the decedent;

[(2) such interest is inherited by such person from the decedent;

[(3) such interest is the dower or curtesy interest (or statutory interest in lieu thereof) of such person as surviving spouse of the decedent;

[(4) such interest has been transferred to such person by the decedent at any time;

[(5) such interest was, at the time of the decedent's death, held by such person and the decedent (or by them and any other person) in joint ownership with right of survivorship;

[(6) the decedent had a power (either alone or in conjunction with any person) to appoint such interest and if he appoints or has appointed such interest to such person, or if such person takes such interest in default on the release or nonexercise of such power; or

[(7) such interest consists of proceeds of insurance on the life of the decedent receivable by such person.

Except as provided in paragraph (5) or (6) of subsection (b), where at the time of the decedent's death it is not possible to ascertain the particular person or persons to whom an interest in property may pass from the decedent, such interest shall, for purposes of subparagraphs (A) and (B) of subsection (b)(1), be considered as passing from the decedent to a person other than the surviving spouse.

[(d) DISALLOWANCE OF MARITAL DEDUCTION WHERE SURVIVING SPOUSE NOT UNITED STATES CITIZEN.—

[(1) IN GENERAL.—Except as provided in paragraph (2), if the surviving spouse of the decedent is not a citizen of the United States—

[(A) no deduction shall be allowed under subsection (a), and

[(B) section 2040(b) shall not apply.

[(2) MARITAL DEDUCTION ALLOWED FOR CERTAIN TRANSFERS IN TRUST.—

[(A) IN GENERAL.—Paragraph (1) shall not apply to any property passing to the surviving spouse in a qualified domestic trust.

[(B) SPECIAL RULE.—If any property passes from the decedent to the surviving spouse of the decedent, for purposes of subparagraph (A), such property shall be treated as passing to such spouse in a qualified domestic trust if—

[(i) such property is transferred to such a trust before the date on which the return of the tax imposed by this chapter is made, or

[(ii) such property is irrevocably assigned to such a trust under an irrevocable assignment made on or before such date which is enforceable under local law.

[(3) ALLOWANCE OF CREDIT TO CERTAIN SPOUSES.—If—

[(A) property passes to the surviving spouse of the decedent (hereinafter in this paragraph referred to as the "first decedent"),

[(B) without regard to this subsection, a deduction would be allowable under subsection (a) with respect to such property, and

[(C) such surviving spouse dies and the estate of such surviving spouse is subject to the tax imposed by this chapter, the Federal estate tax paid (or treated as paid under section 2056A(b)(7)) by the first decedent with respect to such property shall be allowed as a credit under section 2013 to the estate of such surviving spouse and the amount of such credit shall be determined under such section without regard to when the first decedent died and without regard to subsection (d)(3) of such section.

[(4) SPECIAL RULE WHERE RESIDENT SPOUSE BECOMES CITIZEN.—Paragraph (1) shall not apply if—

[(A) the surviving spouse of the decedent becomes a citizen of the United States before the day on which the return of the tax imposed by this chapter is made, and

[(B) such spouse was a resident of the United States at all times after the date of the death of the decedent and before becoming a citizen of the United States.

[(5) REFORMATIONS PERMITTED.—

[(A) IN GENERAL.—In the case of any property with respect to which a deduction would be allowable under subsection (a) but for this subsection, the determination of whether a trust is a qualified domestic trust shall be made—

[(i) as of the date on which the return of the tax imposed by this chapter is made, or

[(ii) if a judicial proceeding is commenced on or before the due date (determined with regard to extensions) for filing such return to change such trust into a trust which is a qualified domestic trust, as of the

time when the changes pursuant to such proceeding are made.

[(B) STATUTE OF LIMITATIONS.—If a judicial proceeding described in subparagraph (A)(ii) is commenced with respect to any trust, the period for assessing any deficiency of tax attributable to any failure of such trust to be a qualified domestic trust shall not expire before the date 1 year after the date on which the Secretary is notified that the trust has been changed pursuant to such judicial proceeding or that such proceeding has been terminated.

[SEC. 2056A. QUALIFIED DOMESTIC TRUST.

[(a) QUALIFIED DOMESTIC TRUST DEFINED.—For purposes of this section and section 2056(d), the term "qualified domestic trust" means, with respect to any decedent, any trust if—

[(1) the trust instrument—

[(A) except as provided in regulations prescribed by the Secretary, requires that at least 1 trustee of the trust be an individual citizen of the United States or a domestic corporation, and

[(B) provides that no distribution (other than a distribution of income) may be made from the trust unless a trustee who is an individual citizen of the United States or a domestic corporation has the right to withhold from such distribution the tax imposed by this section on such distribution,

[(2) such trust meets such requirements as the Secretary may by regulations prescribe to ensure the collection of any tax imposed by subsection (b), and

[(3) an election under this section by the executor of the decedent applies to such trust.

[(b) TAX TREATMENT OF TRUST.—

[(1) IMPOSITION OF ESTATE TAX.—There is hereby imposed an estate tax on—

[(A) any distribution before the date of the death of the surviving spouse from a qualified domestic trust and

[(B) the value of the property remaining in a qualified domestic trust on the date of the death of the surviving spouse.

[(2) AMOUNT OF TAX.—

[(A) IN GENERAL.—In the case of any taxable event, the amount of the estate tax imposed by paragraph (1) shall be the amount equal to—

[(i) the tax which would have been imposed under section 2001 on the estate of the decedent if the taxable estate of the decedent had been increased by the sum of—

[(I) the amount involved in such taxable event, plus

[(II) the aggregate amount involved in previous taxable events with respect to qualified domestic trusts of such decedent, reduced by

[(ii) the tax which would have been imposed under section 2001 on the estate of the decedent if the taxable estate of the decedent had been increased by the amount referred to in clause (i)(II).

[(B) TENTATIVE TAX WHERE TAX OF DECEDENT NOT FINALLY DETERMINED.—

[(i) IN GENERAL.—If the tax imposed on the estate of the decedent under section 2001 is not finally determined before the taxable event, the amount of the tax imposed by paragraph (1) on such event shall be determined by using the highest rate of tax in effect under section 2001 as of the date of the decedent's death.

[(ii) REFUND OF EXCESS WHEN TAX FINALLY DETERMINED.—If—

[(I) the amount of the tax determined under clause (i), exceeds

[(II) the tax determined under subparagraph (A) on the basis of the final determination of the tax imposed by section 2001 on the estate of the decedent,

such excess shall be allowed as a credit or refund (with interest) if claim therefor is filed not later than 1 year after the date of such final determination.

[(C) SPECIAL RULE WHERE DECENDENT HAS MORE THAN 1 QUALIFIED DOMESTIC TRUST.—If there is more than 1 qualified domestic trust with respect to any decedent, the amount of the tax imposed by paragraph (1) with respect to such trusts shall be determined by using the highest rate of tax in effect under section 2001 as of the date of the decedent's death (and the provisions of paragraph (3)(B) shall not apply) unless, pursuant to a designation made by the decedent's executor, there is 1 person—

[(i) who is an individual citizen of the United States or a domestic corporation and is responsible for filing all returns of tax imposed under paragraph (1) with respect to such trusts and for paying all tax so B imposed, and

[(ii) who meets such requirements as the Secretary may by regulations prescribe.

[(3) CERTAIN LIFETIME DISTRIBUTIONS EXEMPT FROM TAX.—

[(A) INCOME DISTRIBUTIONS.—No tax shall be imposed by paragraph (1)(A) on any distribution of income to the surviving spouse.

[(B) HARDSHIP EXEMPTION.—No tax shall be imposed by paragraph (1)(A) on any distribution to the surviving spouse on account of hardship.

[(4) TAX WHERE TRUST CEASES TO QUALIFY.—If any qualified domestic trust ceases to meet the requirements of paragraphs (1) and (2) of subsection (a), the tax imposed by paragraph (1) shall apply as if the surviving spouse died on the date of such cessation.

[(5) DUE DATE.—

[(A) TAX ON DISTRIBUTIONS.—The estate tax imposed by paragraph (1)(A) shall be due and payable on the 15th day of the 4th month following the calendar year in which the taxable event occurs; except that the estate tax imposed by paragraph (1)(A) on distributions during the calendar year in which the surviving spouse dies shall be due and pay-

able not later than the date on which the estate tax imposed by paragraph (1)(B) is due and payable.

[(B) TAX AT DEATH OF SPOUSE.—The estate tax imposed by paragraph (1)(B) shall be due and payable on the date 9 months after the date of such death.

[(6) LIABILITY FOR TAX.—Each trustee shall be personally liable for the amount of the tax imposed by paragraph (1). Rules similar to the rules of section 2204 shall apply for purposes of the preceding sentence.

[(7) TREATMENT OF TAX.—For purposes of section 2056(d), any tax paid under paragraph (1) shall be treated as a tax paid under section 2001 with respect to the estate of the decedent.

[(8) LIEN FOR TAX.—For purposes of section 6324, any tax imposed by paragraph (1) shall be treated as an estate tax imposed under this chapter with respect to a decedent dying on the date of the taxable event (and the property involved shall be treated as the gross estate of such decedent).

[(9) TAXABLE EVENT.—The term "taxable event" means the event resulting in tax being imposed under paragraph (1).

[(10) CERTAIN BENEFITS ALLOWED.—

[(A) IN GENERAL.—If any property remaining in the qualified domestic trust on the date of the death of the surviving spouse is includible in the gross estate of such spouse for purposes of this chapter (or would be includible if such spouse were a citizen or resident of the United States), any benefit which is allowable (or would be allowable if such spouse were a citizen or resident of the United States) with respect to such property to the estate of such spouse under section 2011, 2014, 2032, 2032A, 2055, 2056, or 6166 shall be allowed for purposes of the tax imposed by paragraph (1)(B).

[(B) SECTION 303.—If the estate of the surviving spouse meets the requirements of section 303 with respect to any property described in subparagraph (A), for purposes of section 303, the tax imposed by paragraph (l)(B) with respect to such property shall be treated as a Federal estate tax payable with respect to the estate of the surviving spouse.

[(C) SECTION 6161(A)(2).—The provisions of section 6161(a)(2) shall apply with respect to the tax imposed by paragraph (1)(B), and the reference in such section to the executor shall be treated as a reference to the trustees of the trust.

[(11) SPECIAL RULE WHERE DISTRIBUTION TAX PAID OUT OF TRUST.—For purposes of this subsection, if any portion of the tax imposed by paragraph (l)(A) with respect to any distribution is paid out of the trust, an amount equal to the portion so paid shall be treated as a distribution described in paragraph (1)(A).

[(12) SPECIAL RULE WHERE SPOUSE BECOMES CITIZEN.—If the surviving spouse of the decedent becomes a citizen of the United States and if—

[(A) such spouse was a resident of the United States at all times after the date of the death of the decedent and before such spouse becomes a citizen of the United States,

[(B) no tax was imposed by paragraph (l)(A) with respect to any distribution before such spouse becomes such a citizen, or

[(C) such spouse elects—

[(i) to treat any distribution on which tax was imposed by paragraph (1)(A) as a taxable gift made by such spouse for purposes of—

[(I) section 2001, and

[(II) determining the amount of the tax imposed by section 2501 on actual taxable gifts made bysuch spouse during the year in which the spouse becomes a citizen or any subsequent year, and

[(ii) to treat any reduction in the tax imposed by paragraph (1)(A) by reason of the credit allowable under section 2010 with respect to the decedent as a credit allowable to such survivingspouse under section 2505 for purposes of determining the amount of the credit allowable under section 2505 with respect to taxable gifts made by the surviving spouse during the year in whichthe spouse becomes a citizen or any subsequent year,

paragraph (1)(A) shall not apply to any distributions after such spouse becomes such a citizen (and paragraph (1)(B) shall not apply).

[(13) COORDINATION WITH SECTION 1015.—For purposes of section 1015, any distribution on which tax is imposed by paragraph (1)(A) shall be treated as a transfer by gift, and any tax paid under paragraph (1)(A) shall be treated as a gift tax.

[(14) COORDINATION WITH TERMINABLE INTEREST RULES.—Any interest in a qualified domestic trust shall not be treated as failing to meet the requirements of paragraph (5) or (7) of section 2056(b) merely by reason of any provision of the trust instrument permitting the withholding from any distribution of an amount to pay the tax imposed by paragraph (1) on such distribution.

[(15) NO TAX ON CERTAIN DISTRIBUTIONS.—No tax shall be imposed by paragraph (1) on any distribution to the surviving spouse to the extent such distribution is to reimburse such surviving spouse for any tax imposed by subtitle A on any item of income of the trust to which such surviving spouse is not entitled under the terms of the trust.

[(c) DEFINITIONS.—For purposes of this section—

[(1) PROPERTY INCLUDES INTEREST THEREIN.—The term "property" includes an interest in property.

[(2) INCOME.—Except as provided in regulations, the term "income" has the meaning given to such term by section 643(b).

[(3) TRUST.—To the extent provided in regulations prescribed by the Secretary, the term "trust" includes other arrangements which have substantially the same effect as a trust.

[(d) ELECTION.—An election under this section with respect to any trust shall be made by the executor on the return of the tax imposed by section 2001. Such an election, once made, shall be irrevocable. No election may be made under this section on any re-

turn if such return is filed more than one year after the time prescribed by law (including extensions) for filing such return.

[(e) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including regulations under which there may be treated as a qualified domestic trust any annuity or other payment which is includible in the decedent's gross estate and is by its terms payable for life or a term of years.

[SEC. 2057. FAMILY-OWNED BUSINESS INTERESTS.

[(a) GENERAL RULE.—

[(1) ALLOWANCE DEDUCTION.—For purposes of the tax imposed by section 2001, in the case of an estate of a decedent to which this section applies, the value of the taxable estate shall be determined by deducting from the value of the gross estate the adjusted value of the qualified family-owned business interests of the decedent which are described in subsection (b)(2).

[(2) MAXIMUM DEDUCTION.—The deduction allowed by this section shall not exceed $675,000.

[(3) COORDINATION WITH UNIFIED CREDIT.—

[(A) IN GENERAL.—Except as provided in subparagraph (B), if this section applies to an estate, the applicable exclusion amount under section 2010 shall be $625,000.

[(B) INCREASE IN UNIFIED CREDIT IF DEDUCTION IS LESS THAN $675,000.—If the deduction allowed by this section is less than $675,000, the amount of the applicable exclusion amount under section 2010 shall be increased (but not above the amount which would apply to the estate without regard to this section) by the excess of $675,000 over the amount of the deduction allowed.

[(b) ESTATES TO WHICH SECTION APPLIES.—

[(1) IN GENERAL.—This section shall apply to an estate if—

[(A) the decedent was (at the date of the decedent's death) a citizen or resident of the United States,

[(B) the executor elects the application of this section and files the agreement referred to in subsection (h),

[(C) the sum of—

[(i) the adjusted value of the qualified family-owned business interests described in paragraph (2), plus

[(ii) the amount of the gifts of such interests determined under paragraph (3),

exceeds 50 percent of the adjusted gross estate, and

[(D) during the 8-year period ending on the date of the decedent's death there have been periods aggregating 5 years or more during which—

[(i) such interests were owned by the decedent or a member of the decedent's family, and

[(ii) there was material participation (within the meaning of section 2032A(e)(6)) by the decedent or a member of the decedent's family in the operation of the business to which such interests relate.

[(2) INCLUDIBLE QUALIFIED FAMILY-OWNED BUSINESS INTERESTS.—The qualified family-owned business interests described in this paragraph are the interests which—

[(A) are included in determining the value of the gross estate, and

[(B) are acquired by any qualified heir from, or passed to any qualified heir from, the decedent (within the meaning of section 2032A(e)(9)).

[(3) INCLUDIBLE GIFTS OF INTEREST.—The amount of the gifts of qualified family-owned business interests determined under this paragraph is the sum of—

[(A) the amount of such gifts from the decedent to members of the decedent's family taken into account under section 2001(b)(1)(B), plus

[(B) the amount of such gifts otherwise excluded under section 2503(b),

[to the extent such interests are continuously held by members of such family (other than the decedent's spouse) between the date of the gift and the date of the decedent's death.

[(c) ADJUSTED GROSS ESTATE.—For purposes of this section, the term "adjusted gross estate" means the value of the gross estate—

[(1) reduced by any amount deductible under paragraph (3) or (4) of section 2053(a), and

[(2) increased by the excess of—

[(A) the sum of—

[(i) the amount of gifts determined under subsection (b)(3), plus

[(ii) the amount (if more than de minimis) of other transfers from the decedent to the decedent's spouse (at the time of the transfer) within 10 years of the date of the decedent's death, plus

[(iii) the amount of other gifts (not included under clause (i) or (ii)) from the decedent within 3 years of such date, other than gifts to members of the decedent's family otherwise excluded under section 2503(b), over

[(B) the sum of the amounts described in clauses (i), (ii), and

[(iii) of subparagraph (A) which are otherwise includible in the gross estate.

For purposes of the preceding sentence, the Secretary may provide that de minimis gifts to persons other than members of the decedent's family shall not be taken into account.

[(d) ADJUSTED VALUE OF THE QUALIFIED FAMILY-OWNED BUSINESS INTERESTS.—For purposes of this section, the adjusted value of any qualified family-owned business interest is the value of such interest for purposes of this chapter (determined without regard to this section), reduced by the excess of—

[(1) any amount deductible under paragraph (3) or (4) of section 2053(a), over

[(2) the sum of—

[(A) any indebtedness on any qualified residence of the decedent the interest on which is deductible under section 163(h)(3), plus

[(B) any indebtedness to the extent the taxpayer establishes that the proceeds of such indebtedness were used for the payment of educational and medical expenses of the

decedent, the decedent's spouse, or the decedent's dependents (within the meaning of section 152, plus

[(C) any indebtedness not described in subparagraph (A) or (B), to the extent such indebtedness does not exceed $10,000.

[(e) QUALIFIED FAMILY-OWNED BUSINESS INTEREST.—

[(1) IN GENERAL.—For purposes of this section, the term "qualified family-owned business interest" means—

[(A) an interest as a proprietor in a trade or business carried on as a proprietorship, or

[(B) an interest in an entity carrying on a trade or business, if—

[(i) at least—

[(I) 50 percent of such entity is owned (directly or indirectly) by the decedent and members of the decedent's family,

[(II) 70 percent of such entity is so owned by members of 2 families, or

[(III) 90 percent of such entity is so owned by members of 3 families, and

[(ii) for purposes of subclause (II) or (III) of clause (i), at least 30 percent of such entity is so owned by the decedent and members of the decedent's family.

For purposes of the preceding sentence, a decedent shall be treated as engaged in a trade or business if any member of the decedent's family is engaged in such trade or business.

[(2) LIMITATION.—Such term shall not include—

[(A) any interest in a trade or business the principal place of business of which is not located in the United States,

[(B) any interest in an entity, if the stock or debt of such entity or a controlled group (as defined in section 267(f)(1) of which such entity was a member was readily tradable on an established securities market or secondary market (as defined by the Secretary) at any time within 3 years of the date of the decedent's death,

[(C) any interest in a trade or business not described in section 542(c)(2), if more than 35 percent of the adjusted ordinary gross income of such trade or business for the taxable year which includes the date of the decedent's death would qualify as personal holding company income (as defined in section 543(a) without regard to paragraph (2)(B) thereof) if such trade or business were a corporation,

[(D) that portion of an interest in a trade or business that is attributable to—

[(i) cash or marketable securities, or both, in excess of the reasonably expected day-to-dayworking capital needs of such trade or business, and

[(ii) any other assets of the trade or business (other than assets used in the active conduct of a trade or business described in section 542(c)(2), which produce, or are held for the production of, personal holding company income (as defined in subparagraph (C)) or income described in section 954(c)(1) (determined without regard to subparagraph (A) thereof and by

substituting "trade or business" for "controlled foreign corporation").

In the case of a lease of property on a net cash basis by the decedent to a member of the decedent's family, income from such lease shall not be treated as personal holding company income for purposes of subparagraph (C), and such property shall not be treated as an asset described in subparagraph (D)(ii), if such income and property would not be so treated if the lessor had engaged directly in the activities engaged in by the lessee with respect to such property.

[(3) RULES REGARDING OWNERSHIP.—

[(A) OWNERSHIP OF ENTITIES.—For purposes of paragraph (1)(B)—

[(i) CORPORATIONS.—Ownership of a corporation shall be determined by the holding of stock possessing the appropriate percentage of the total combined voting power of all classes of stock entitled to vote and the appropriate percentage of the total value of shares of all classes of stock.

[(ii) PARTNERSHIPS.—Ownership of a partnership shall be determined by the owning of the appropriate percentage of the capital interest in such partnership.

[(B) OWNERSHIP OF TIERED ENTITIES.—For purposes of this section, if by reason of holding an interest in a trade or business, a decedent, any member of the decedent's family, any qualified heir, or any member of any qualified heir's family is treated as holding an interest in any other trade or business—

[(i) such ownership interest in the other trade or business shall be disregarded in determining if the ownership interest in the first trade or business is a qualified family-owned business interest, and

[(ii) this section shall be applied separately in determining if such interest in any other trade or business is a qualified family-owned business interest.

[(C) INDIVIDUAL OWNERSHIP RULES.—For purposes of this section, an interest owned, directly or indirectly, by or for an entity described in paragraph (1)(B) shall be considered as being owned proportionately by or for the entity's shareholders, partners, or beneficiaries. A person shall be treated as a beneficiary of any trust only if such person has a present interest in such trust.

[(f) TAX TREATMENT OF FAILURE TO MATERIALLY PARTICIPATE IN BUSINESS OR DISPOSITIONS OF INTERESTS.—

[(1) IN GENERAL.—There is imposed an additional estate tax if, within 10 years after the date of the decedent's death and before the date of the qualified heir's death—

[(A) the material participation requirements described in section 2032A(c)(6)(B) are not met with respect to the qualified family-owned business interest which was acquired (or passed) from the decedent,

[(B) the qualified heir disposes of any portion of a qualified family-owned business interest (other than by a disposition to a member of the qualified heir's family or

through a qualified conservation contribution under section 170(h),

[(C) the qualified heir loses United States citizenship (within the meaning of section 877 or with respect to whom an event described in subparagraph (A) or (B) of section 877(e)(1) occurs, and such heir does not comply with the requirements of subsection (g), or

[(D) the principal place of business of a trade or business of the qualified family-owned business interest ceases to be located in the United States.

[(2) ADDITIONAL ESTATE TAX.—

[(A) IN GENERAL.—The amount of the additional estate tax imposed by paragraph (1) shall be equal to—

[(i) the applicable percentage of the adjusted tax difference attributable to the qualified family-owned business interest, plus

[(ii) interest on the amount determined under clause (i) at the underpayment rate established under section 6621 for the period beginning on the date the estate tax liability was due under this chapter and ending on the date such additional estate tax is due.

[(B) APPLICABLE PERCENTAGE.—For purposes of this paragraph, the applicable percentage shall be determined under the following table:

[If the event described in paragraph (1) occurs in following year of material participation:	The applicable percentage is:
1 through 6	100
7	80
8	60
9	40
10	20

[(C) ADJUSTED TAX DIFFERENCE.—For purposes of subparagraph (A)—

[(i) IN GENERAL.—The adjusted tax difference attributable to a qualified family-owned business interest is the amount which bears the same ratio to the adjusted tax difference with respect to the estate (determined under clause (ii)) as the value of such interest bears to the value of all qualified family-owned business interests described in subsection (b)(2).

[(ii) ADJUSTED TAX DIFFERENCE WITH RESPECT TO THE ESTATE.—

[For purposes of clause (i), the term "adjusted tax difference with respect to the estate" means the excess of what would have been the estate tax liability but for the election under this section over the estate tax liability. For purposes of this clause, the term "estate tax liability" means the tax imposed by section 2001 reduced by the credits allowable against such tax.

[(3) USE IN TRADE OR BUSINESS BY FAMILY MEMBERS.—A qualified heir shall not be treated as disposing of an interest described in subsection (e)(1)(A) by reason of ceasing to be engaged in a trade or business so long as the property to which such interest relates is used in a trade or business by any member of such individual's family.

[(g) SECURITY REQUIREMENTS FOR NONCITIZEN QUALIFIED HEIRS.—

[(1) IN GENERAL.—Except upon the application of subparagraph (F) of subsection (i)(3), if a qualified heir is not a citizen of the United States, any interest under this section passing to or acquired by such heir (including any interest held by such heir at a time described in subsection (f)(1)(C)) shall be treated as a qualified family-owned business interest only if the interest passes or is acquired (or is held) in a qualified trust.

[(2) QUALIFIED TRUST.—he term "qualified trust" means a trust—

[(A) which is organized under, and governed by, the laws of the United States or a State, and

[(B) except as otherwise provided in regulations, with respect to which the trust instrument requires that at least 1 trustee of the trust be an individual citizen of the United States or adomestic corporation.

[(h) AGREEMENT.—The agreement referred to in this subsection is a written agreement signed by each person in being who has an interest (whether or not in possession) in any property designated in such agreement consenting to the application of subsection (f) with respect to such property.

[(i) OTHER DEFINITIONS AND APPLICABLE RULES.—For purposes of this section—

[(1) QUALIFIED HEIR.—The term "qualified heir"—

[(A) has the meaning given to such term by section 2032A(e)(1), and

[(B) includes any active employee of the trade or business to which the qualified family-owned business interest relates if such employee has been employed by such trade or business for a period of at least 10 years before the date of the decedent's death.

[(2) MEMBER OF THE FAMILY.—The term "member of the family" has the meaning given to such term by section 2032A(e)(2).

[(3) APPLICABLE RULES.—Rules similar to the following rules shall apply:

[(A) Section 2032A(b)(4) (relating to decedents who are retired or disabled).

[(B) Section 2032A(b)(5) (relating to special rules for surviving spouses).

[(C) Section 2032A(c)(2)(D) (relating to partial dispositions).

[(D) Section 2032A(c)(3) (relating to only 1 additional tax imposed with respect to any 1 portion).

[(E) Section 2032A(c)(4) (relating to due date).

[(F) Section 2032A(c)(5) (relating to liability for tax; furnishing of bond).

[(G) Section 2032A(c)(7) (relating to no tax if use begins within 2 years; active management by eligible qualified heir treated as material participation).

[(H) Paragraphs (1) and (3) of section 2032A(d) (relating to election; agreement).

[(I) Section 2032A(e)(10) (relating to community property).

[(J) Section 2032A(e)(14) (relating to treatment of replacement property acquired in section 1031 or 1033 transactions).

[(K) Section 2032A(f) (relating to statute of limitations).

[(L) Section 2032A(g) (relating to application to interests in partnerships, corporations, and trusts).

[(M) Subsections (h) and (i) of section 2032A.

[(N) Section 6166(b)(3) (relating to farmhouses and certain other structures taken into account).

[(O) Subparagraphs (B), (C), and (D) of section 6166(g)(1) (relating to acceleration of payment).

[(P) Section 6324B (relating to special lien for additional estate tax).

[Subchapter B—Estates of Nonresidents Not Citizens

[SEC. 2101. TAX IMPOSED.

[(a) IMPOSITION.—Except as provided in section 2107, a tax is hereby imposed on the transfer of the taxable estate (determined as provided in section 2106) of every decedent nonresident not a citizen of the United States.

[(b) COMPUTATION OF TAX.—The tax imposed by this section shall be the amount equal to the excess (if any) of—

[(1) a tentative tax computed under section 2001(c) on the sum of—

[(A) the amount of the taxable estate, and

[(B) the amount of the adjusted taxable gifts, over

[(2) a tentative tax computed under section 2001(c) on the amount of the adjusted taxable gifts.

For purposes of the preceding sentence, there shall be appropriate adjustments in the application of section 2001(c)(2) to reflect the difference between the amount of the credit provided under section 2102(c) and the amount of the credit provided under section 2010.

[(c) ADJUSTMENTS FOR TAXABLE GIFTS.—

[(1) ADJUSTED TAXABLE GIFTS DEFINED.—For purposes of this section, the term "adjusted taxable gifts" means the total amount of the taxable gifts (within the meaning of section 2503 as modified by section 2511) made by the decedent after December 31, 1976, other than gifts which are includible in the gross estate of the decedent.

[(2) ADJUSTMENT FOR CERTAIN GIFT TAX.—For purposes of this section, the rules of section 2001(d) shall apply.

[SEC. 2102. CREDITS AGAINST TAX.

[(a) IN GENERAL.—The tax imposed by section 2101 shall be credited with the amounts determined in accordance with sections 2011 to 2013, inclusive (relating to State death taxes, gift tax, and

tax on prior transfers), subject to the special limitation provided in subsection (b).

[(b) SPECIAL LIMITATION.—The maximum credit allowed under section 2011 against the tax imposed by section 2101 for State death taxes paid shall be an amount which bears the same ratio to the credit computed as provided in section 2011(b) as the value of the property, as determined for purposes of this chapter, upon which State death taxes were paid and which is included in the gross estate under section 2103 bears to the value of the total gross estate under section 2103. For purposes of this subsection, the term "State death taxes" means the taxes described in section 2011(a).

[(c) UNIFIED CREDIT.—

[(1) IN GENERAL.—A credit of $13,000 shall be allowed against the tax imposed by section 2101.

[(2) RESIDENTS OF POSSESSIONS OF THE UNITED STATES.—In the case of a decedent who is considered to be a "nonresident not a citizen of the United States" under section 2209, the credit under this subsection shall be the greater of—

[(A) $13,000, or

[(B) that proportion of $46,800 which the value of that part of the decedent's gross estate which at the time of his death is situated in the United States bears to the value of his entire gross estate wherever situated.

[(3) SPECIAL RULES.—

[(A) COORDINATION WITH TREATIES.—To the extent required under any treaty obligation of the United States, the credit allowed under this subsection shall be equal to the amount which bears the same ratio to the applicable credit amount in effect under section 2010(c) for the calendar year which includes the date of death as the value of the part of the decedent's gross estate which at the time of his death is situated in the United States bears to the value of his entire gross estate wherever situated. For purposes of the preceding sentence, property shall not be treated as situated in the United States if such property is exempt from the tax imposed by this subchapter under any treaty obligation of the United States.

[(B) COORDINATION WITH GIFT TAX UNIFIED CREDIT.—If a credit has been allowed under section 2505 with respect to any gift made by the decedent, each dollar amount contained in paragraph (1) or (2) or subparagraph (A) of this paragraph (whichever applies) shall be reduced by the amount so allowed.

[(4) LIMITATION BASED ON AMOUNT OF TAX.—The credit allowed under this subsection shall not exceed the amount of the tax imposed by section 2101.

[(5) APPLICATION OF OTHER CREDITS.—For purposes of subsection (a), sections 2011 to 2013, inclusive, shall be applied as if the credit allowed under this subsection were allowed under section 2010.

[SEC. 2103. DEFINITION OF GROSS ESTATE.

[For the purpose of the tax imposed by section 2101, the value of the gross estate of every decedent nonresident not a citizen of the United States shall be that part of his gross estate (determined

as provided in section 2031) which at the time of his death is situated in the United States.

[SEC. 2104. PROPERTY WITHIN THE UNITED STATES.

[(a) STOCK IN CORPORATION.—For purposes of this subchapter shares of stock owned and held by a nonresident not a citizen of the United States shall be deemed property within the United States only if issued by a domestic corporation.

[(b) REVOCABLE TRANSFERS AND TRANSFERS WITHIN— YEARS OF DEATH.—For purposes of this subchapter, any property of which the decedent has made a transfer, by trust or otherwise, within the meaning of sections 2035 to 2038, inclusive, shall be deemed to be situated in the United States, if so situated either at the time of the transfer or at the time of the decedent's death.

[(c) DEBT OBLIGATIONS.—For purposes of this subchapter, debt obligations of—

[(1) a United States person, or

[(2) the United States, a State or any political subdivision thereof, or the District of Columbia, owned and held by a nonresident not a citizen of the United States shall be deemed property within the United States. With respect to estates of decedents dying after December 31, 1969, deposits with a domestic branch of a foreign corporation, if such branch is engaged in the commercial banking business, shall, for purposes of this subchapter, be deemed property within the United States. This subsection shall not apply to a debt obligation to which section 2105(b) applies or to a debt obligation of a domestic corporation if any interest on such obligation, were such interest received by the decedent at the time of his death, would be treated by reason of section 861(a)(1)(A) as income from sources without the United States.

[SEC. 2105. PROPERTY WITHOUT THE UNITED STATES.

[(a) PROCEEDS OF LIFE INSURANCE.—For purposes of this subchapter, the amount receivable as insurance on the life of a nonresident not a citizen of the United States shall not be deemed property within the United States.

[(b) BANK DEPOSITS AND CERTAIN OTHER DEBT OBLIGATIONS.—For purposes of this subchapter, the following shall not be deemed property within the United States—

[(1) amounts described in section 871(i)(3), if any interest thereon would not be subject to tax by reason of section 871(i)(1) were such interest received by the decedent at the time of his death,

[(2) deposits with a foreign branch of a domestic corporation or domestic partnership, if such branch is engaged in the commercial banking business,

[(3) debt obligations, if, without regard to whether a statement meeting the requirements of section 871(h)(5) has been received, any interest thereon would be eligible for the exemption from tax under section 871(h)(1) were such interest received by the decedent at the time of his death, and

[(4) obligations which would be original issue discount obligations as defined in section 871(g)(1) but for subparagraph (B)(i) thereof, if any interest thereon (were such interest received by the decedent at the time of his death) would not be

effectively connected with the conduct of a trade or business within the United States.

Notwithstanding the preceding sentence, if any portion of the interest on an obligation referred to in paragraph (3) would not be eligible for the exemption referred to in paragraph (3) by reason of section 871(h)(4) if the interest were received by the decedent at the time of his death, then an appropriate portion (as determined in a manner prescribed by the Secretary) of the value (as determined for purposes of this chapter) of such debt obligation shall be deemed property within the United States.

[(c) WORKS OF ART ON LOAN FOR EXHIBITION.—For purposes of this subchapter, works of art owned by a nonresident not a citizen of the United States shall not be deemed property within the United States if such works of art are—

[(1) imported into the United States solely for exhibition purposes,

[(2) loaned for such purposes, to a public gallery or museum, no part of the net earnings of which inures to the benefit of any private stockholder or individual, and

[(3) at the time of the death of the owner, on exhibition, or en route to or from exhibition, in such a public gallery or museum.

[SEC. 2106. TAXABLE ESTATE.

[(a) DEFINITION OF TAXABLE ESTATE.—For purposes of the tax imposed by section 2101, the value of the taxable estate of every decedent nonresident not a citizen of the United States shall be determined by deducting from the value of that part of his gross estate which at the time of his death is situated in the United States—

[(1) EXPENSES, LOSSES, INDEBTEDNESS, AND TAXES.—That proportion of the deductions specified in sections 2053 and 2054 (other than the deductions described in the following sentence) which the value of such part bears to the value of his entire gross estate, wherever situated. Any deduction allowable under section 2053 in the case of a claim against the estate which was founded on a promise or agreement but was not contracted for an adequate and full consideration in money or money's worth shall be allowable under this paragraph to the extent that it would be allowable as a deduction under paragraph (2) if such promise or agreement constituted a bequest.

[(2) TRANSFERS FOR PUBLIC, CHARITABLE, AND RELIGIOUS USES.—

[(A) IN GENERAL.—The amount of all bequests, legacies, devises, or transfers (including the interest which falls into any such bequest, legacy, devise, or transfer as a result of an irrevocable disclaimer of a bequest, legacy, devise, transfer, or power, if the disclaimer is made before the date prescribed for the filing of the estate tax return)—

[(i) to or for the use of the United States, any State, any political subdivision thereof, or the District of Columbia, for exclusively public purposes;

[(ii) to or for the use of any domestic corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art and the prevention

of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, which is not disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office; or

[(iii) to a trustee or trustees, or a fraternal society, order, or association operating under the lodge system, but only if such contributions or gifts are to be used within the United States by such trustee or trustees, or by such fraternal society, order, or association, exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, such trust, fraternal society, order, or association would not be disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, and such trustee or trustees, or such fraternal society, order, or association, does not participate in, orintervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office;

[(B) POWERS OF APPOINTMENT.—Property includible in the decedent's gross estate under section 2041 (relating to powers of appointment) received by a donee described in this paragraph shall, for purposes of this paragraph, be considered a bequest of such decedent.

[(C) DEATH TAXES PAYABLE OUT OF BEQUESTS.—If the tax imposed by section 2101, or any estate, succession, legacy, or inheritance taxes, are, either by the terms of the will, by the law of the jurisdiction under which the estate is administered, or by the law of the jurisdiction imposing the particular tax, payable in whole or in part out of the bequests, legacies, or devises otherwise deductible under this paragraph, then the amount deductible under this paragraph shall be the amount of such bequests, legacies, or devises reduced by the amount of such taxes.

[(D) LIMITATION ON DEDUCTION.—The amount of the deduction under this paragraph for any transfer shall not exceed the value of the transferred property required to be included in the gross estate.

[(E) DISALLOWANCE OF DEDUCTIONS IN CERTAIN CASES.—The provisions of section 2055(e) shall be applied in the determination of the amount allowable as a deduction under this paragraph.

[(F) CROSS REFERENCES.—

[(i) For option as to time for valuation for purposes of deduction under this section, see section 2032.

[(ii) For exemption of certain bequests for the benefit of the United States and for rules of construction for certain bequests, see section 2055(g).

[(iii) For treatment of gifts and bequests to or for the use of Indian tribal governments (or their subdivisions), see section 7871.

[(3) MARITAL DEDUCTION.—The amount which would be deductible with respect to property situated in the United States at the time of the decedent's death under the principles of section 2056.

[(b) CONDITION OF ALLOWANCE OF DEDUCTIONS.—No deduction shall be allowed under paragraphs (1) and (2) of subsection (a) in the case of a nonresident not a citizen of the United States unless the executor includes in the return required to be filed under section 6018 the value at the time of his death of that part of the gross estate of such nonresident not situated in the United States.

[SEC. 2107. EXPATRIATION TO AVOID TAX.

[(a) TREATMENT OF EXPATRIATES.—

[(1) RATE OF TAX.—A tax computed in accordance with the table contained in section 2001 is hereby imposed on the transfer of the taxable estate, determined as provided in section 2106, of every decedent nonresident not a citizen of the United States if, within the 10-year period ending with the date of death, such decedent lost United States citizenship, unless such loss did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle A—

[(2) CERTAIN INDIVIDUALS TREATED AS HAVING TAX AVOIDANCE PURPOSE.—

[(A) IN GENERAL.—For purposes of paragraph (1), an individual shall be treated as having a principal purpose to avoid such taxes if such individual is so treated under section 877(a)(2).

[(B) EXCEPTION.—Subparagraph (A) shall not apply to a decedent meeting the requirements of section 877(c)(1).

[(b) GROSS ESTATE.—For purposes of the tax imposed by subsection (a), the value of the gross estate of every decedent to whom subsection (a) applies shall be determined as provided in section 2103, except that—

[(1) if such decedent owned (within the meaning of section 958(a)) at the time of his death 10 percent or more of the total combined voting power of all classes of stock entitled to vote of a foreign corporation, and

[(2) if such decedent owned (within the meaning of section 958(a)), or is considered to have owned (by applying the ownership rules of section 958(b)), at the time of his death, more than 50 percent of—

[(A) the total combined voting power of all classes of stock entitled to vote of such corporation, or

[(B) the total value of the stock of such corporation,

then that proportion of the fair market value of the stock of such foreign corporation owned (within the meaning of section 958(a)) by such decedent at the time of his death, which the fair market value of any assets owned by such foreign corporation and situated in the United States, at the time of his death, bears to the total fair market value of all assets owned by such foreign corporation at the time of his death, shall be included in the gross estate of such decedent. For purposes of the preceding sentence, a decedent shall be treated as owning stock of a foreign corporation at the time of his death if, at the time of a transfer, by trust or otherwise, within the meaning of sections 2035 to 2038, inclusive, he owned such stock.

[(c) CREDITS.—

[(1) UNIFIED CREDIT.—

[(A) IN GENERAL.—A credit of $13,000 shall be allowed against the tax imposed by subsection (a).

[(B) LIMITATION BASED ON AMOUNT OF TAX.—The credit allowed under this paragraph shall not exceed the amount of the tax imposed by subsection (a).

[(2) CREDIT FOR FOREIGN DEATH TAXES.—

[(A) IN GENERAL.—The tax imposed by subsection (a) shall be credited with the amount of any estate, inheritance, legacy, or succession taxes actually paid to any foreign country in respect of any property which is included in the gross estate solely by reason of subsection (b).

[(B) LIMITATION ON CREDIT.—The credit allowed by subparagraph (A) for such taxes paid to a foreign country shall not exceed the lesser of—

[(i) the amount which bears the same ratio to the amount of such taxes actually paid to such foreign country as the value of the property subjected to such taxes by such foreign country and included in the gross estate solely by reason of subsection (b) bears to the value of all property subjected to such taxes by such foreign country, or

[(ii) such property's proportionate share of the excess of—

[(I) the tax imposed by subsection (a), over

[(II) the tax which would be imposed by section 2101 but for this section.

[(C) PROPORTIONATE SHARE.—In the case of property which is included in the gross estate solely by reason of subsection (b), such property's proportionate share is the percentage which the value of such property bears to the total value of all property included in the gross estate solely by reason of subsection (b).

[(3) OTHER CREDITS.—The tax imposed by subsection (a) shall be credited with the amounts determined in accordance with subsections (a) and (b) of section 2102. For purposes of subsection (a) of section 2102, sections 2011 to 2013, inclusive, shall be applied as if the credit allowed under paragraph (1) were allowed under section 2010.

[(d) BURDEN OF PROOF.—If the Secretary establishes that it is reasonable to believe that an individual's loss of United States citizenship would, but for this section, result in a substantial reduction in the estate, inheritance, legacy, and succession taxes in respect of the transfer of his estate, the burden of proving that such loss of citizenship did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle A shall be on the executor of such individual's estate.

[(e) CROSS REFERENCE.—

[For comparable treatment of long-term lawful permanent residents who ceased to be taxed as residents, see section 877(e).

[SEC. 2108. APPLICATION OF PRE-1967 ESTATE TAX PROVISIONS.

[(a) IMPOSITION OF MORE BURDENSOME TAX BY FOREIGN COUNTRY.—Whenever the President finds that—

[(1) under the laws of any foreign country, considering the tax system of such foreign country, a more burdensome tax is

imposed by such foreign country on the transfer of estates of decedents who were citizens of the United States and not residents of such foreign country than the tax imposed by this subchapter on the transfer of estates of decedents who were residents of such foreign country,

[(2) such foreign country, when requested by the United States to do so, has not acted to revise or reduce such tax so that it is no more burdensome than the tax imposed by this subchapter on the transfer of estates of decedents who were residents of such foreign country, and

[(3) it is in the public interest to apply pre-1967 tax provisions in accordance with this section to the transfer of estates of decedents who were residents of such foreign country, the President shall proclaim that the tax on the transfer of the estate of every decedent who was a resident of such foreign country at the time of his death shall, in the case of decedents dying after the date of such proclamation, be determined under this subchapter without regard to amendments made to sections 2101 (relating to tax imposed), 2102 (relating to credits against tax), 2106 (relating to taxable estate), and 6018 (relating to estate tax returns) on or after November 13, 1966.

[(b) ALLEVIATION OF MORE BURDENSOME TAX.—Whenever the President finds that the laws of any foreign country with respect to which the President has made a proclamation under subsection (a) have been modified so that the tax on the transfer of estates of decedents who were citizens of the United States and not residents of such foreign country is no longer more burdensome than the tax imposed by this subchapter on the transfer of estates of decedents who were residents of such foreign country, he shall proclaim that the tax on the transfer of the estate of every decedent who was a resident of such foreign country at the time of his death shall, in the case of decedents dying after the date of such proclamation, be determined under this subchapter without regard to subsection (a).

[(c) NOTIFICATION OF CONGRESS REQUIRED.—No proclamation shall be issued by the President pursuant to this section unless, at least 30 days prior to such proclamation, he has notified the Senate and the House of Representatives of his intention to issue such proclamation.

[(d) IMPLEMENTATION BY REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to implement this section.

[Subchapter C—Miscellaneous

[SEC. 2201. MEMBERS OF THE ARMED FORCES DYING IN COMBAT ZONE OR BY REASON OF COMBAT-ZONE-INCURRED WOUNDS, ETC.

[The additional estate tax as defined in section 2011(d) shall not apply to the transfer of the taxable estate of a citizen or resident of the United States dying while in active service as a member of the Armed Forces of the United States, if such decedent—

[(1) was killed in action while serving in a combat zone, as determined under section 112(c); or

[(2) died as a result of wounds, disease, or injury suffered, while serving in a combat zone (as determined under section 112(c)), and while in line of duty, by reason of a hazard to which he was subjected as an incident of such service.

[SEC. 2203. DEFINITION OF EXECUTOR.

[The term "executor" wherever it is used in this title in connection with the estate tax imposed by this chapter means the executor or administrator of the decedent, or, if there is no executor or administrator appointed, qualified, and acting within the United States, then any person in actual or constructive possession of any property of the decedent.

[SEC. 2204. DISCHARGE OF FIDUCIARY FROM PERSONAL LIABILITY.

[(a) GENERAL RULE.—If the executor makes written application to the Secretary for determination of the amount of the tax and discharge from personal liability therefor, the Secretary (as soon as possible, and in any event within 9 months after the making of such application, or, if the application is made before the return is filed, then within 9 months after the return is filed, but not after the expiration of the period prescribed for the assessment of the tax in section 6501) shall notify the executor of the amount of the tax. The executor, on payment of the amount of which he is notified (other than any amount the time for payment of which is extended under section 6161, 6163, or 6166), and on furnishing any bond which may be required for any amount for which the time for payment is extended, shall be discharged from personal liability for any deficiency in tax thereafter found to be due and shall be entitled to a receipt or writing showing such discharge.

[(b) FIDUCIARY OTHER THAN THE EXECUTOR.—If a fiduciary (not including a fiduciary in respect of the estate of a nonresident decedent) other than the executor makes written application to the Secretary for determination of the amount of any estate tax for which the fiduciary may be personally liable, and for discharge from personal liability therefor, the Secretary upon the discharge of the executor from personal liability under subsection (a), or upon the expiration of 6 months after the making of such application by the fiduciary, if later, shall notify the fiduciary (1) of the amount of such tax for which it has been determined the fiduciary is liable, or (2) that it has been determined that the fiduciary is not liable for any such tax. Such application shall be accompanied by a copy of the instrument, if any, under which such fiduciary is acting, a description of the property held by the fiduciary, and such other information for purposes of carrying out the provisions of this section

as the Secretary may require by regulations. On payment of the amount of such tax for which it has been determined the fiduciary is liable (other than any amount the time for payment of which has been extended under section 6161, 6163, or 6166), and on furnishing any bond which may be required for any amount for which the time for payment has been extended, or on receipt by him of notification of a determination that he is not liable for any such tax, the fiduciary shall be discharged from personal liability for any deficiency in such tax thereafter found to be due and shall be entitled to a receipt or writing evidencing such discharge.

[(c) SPECIAL LIEN UNDER SECTION 6324A.—For purposes of the second sentence of subsection (a) and the last sentence of subsection (b), an agreement which meets the requirements of section 6324A (relating to special lien for estate tax deferred under section 6166) shall be treated as the furnishing of bond with respect to the amount for which the time for payment has been extended under section 6166.

[(d) GOOD FAITH RELIANCE ON GIFT TAX RETURNS.—If the executor in good faith relies on gift tax returns furnished under section 6103(e)(3) for determining the decedent's adjusted taxable gifts, the executor shall be discharged from personal liability with respect to any deficiency of the tax imposed by this chapter which is attributable to adjusted taxable gifts which—

[(1) are made more than 3 years before the date of the decedent's death, and

[(2) are not shown on such returns.

[SEC. 2205. REIMBURSEMENT OUT OF ESTATE.

[If the tax or any part thereof is paid by, or collected out of, that part of the estate passing to or in the possession of any person other than the executor in his capacity as such, such person shall be entitled to reimbursement out of any part of the estate still undistributed or by a just and equitable contribution by the persons whose interest in the estate of the decedent would have been reduced if the tax had been paid before the distribution of the estate or whose interest is subject to equal or prior liability for the payment of taxes, debts, or other charges against the estate, it being the purpose and intent of this chapter that so far as is practicable and unless otherwise directed by the will of the decedent the tax shall be paid out of the estate before its distribution.

[SEC. 2206. LIABILITY OF LIFE INSURANCE BENEFICIARIES.

[Unless the decedent directs otherwise in his will, if any part of the gross estate on which tax has been paid consists of proceeds of policies of insurance on the life of the decedent receivable by a beneficiary other than the executor, the executor shall be entitled to recover from such beneficiary such portion of the total tax paid as the proceeds of such policies bear to the taxable estate. If there is more than one such beneficiary, the executor shall be entitled to recover from such beneficiaries in the same ratio. In the case of such proceeds receivable by the surviving spouse of the decedent for which a deduction is allowed under section 2056 (relating to marital deduction), this section shall not apply to such proceeds except as to the amount thereof in excess of the aggregate amount of the marital deductions allowed under such section.

[SEC. 2207. LIABILITY OF RECIPIENT OF PROPERTY OVER WHICH DECEDENT HAD POWER OF APPOINTMENT.

[Unless the decedent directs otherwise in his will, if any part of the gross estate on which the tax has been paid consists of the value of property included in the gross estate under section 2041, the executor shall be entitled to recover from the person receiving such property by reason of the exercise, nonexercise, or release of a power of appointment such portion of the total tax paid as the value of such property bears to the taxable estate. If there is more than one such person, the executor shall be entitled to recover from such persons in the same ratio. In the case of such property received by the surviving spouse of the decedent for which a deduction is allowed under section 2056 (relating to marital deduction), this section shall not apply to such property except as to the value thereof reduced by an amount equal to the excess of the aggregate amount of the marital deductions allowed under section 2056 over the amount of proceeds of insurance upon the life of the decedent receivable by the surviving spouse for which proceeds a marital deduction is allowed under such section.

[SEC. 2207A. RIGHT OF RECOVERY IN THE CASE OF CERTAIN MARITAL DEDUCTION PROPERTY.

[(a) RECOVERY WITH RESPECT TO ESTATE TAX.—

[(1) IN GENERAL.—If any part of the gross estate consists of property the value of which is includible in the gross estate by reason of section 2044 (relating to certain property for which marital deduction was previously allowed), the decedent's estate shall be entitled to recover from the person receiving the property the amount by which—

[(A) the total tax under this chapter which has been paid, exceeds

[(B) the total tax under this chapter which would have been payable if the value of such property had not been included in the gross estate.

[(2) DECEDENT MAY OTHERWISE DIRECT.—Paragraph (1) shall not apply with respect to any property to the extent that the decedent in his will (or a revocable trust) specifically indicates an intent to waive any right of recovery under this subchapter with respect to such property.

[(b) RECOVERY WITH RESPECT TO GIFT TAX.—If for any calendar year tax is paid under chapter 12 with respect to any person by reason of property treated as transferred by such person under section 2519, such person shall be entitled to recover from the person receiving the property the amount by which—

[(1) the total tax for such year under chapter 12, exceeds

[(2) the total tax which would have been payable under such chapter for such year if the value of such property had not been taken into account for purposes of chapter 12.

[(c) MORE THAN ONE RECIPIENT OF PROPERTY.—For purposes of this section, if there is more than one person receiving the property, the right of recovery shall be against each such person.

[(d) TAXES AND INTEREST.—In the case of penalties and interest attributable to additional taxes described in subsections (a) and (b), rules similar to subsections (a), (b), and (c) shall apply.

[SEC. 2207B. RIGHT OF RECOVERY WHERE DECEDENT RETAINED INTEREST.

[(a) ESTATE TAX.—

[(1) IN GENERAL.—If any part of the gross estate on which tax has been paid consists of the value of property included in the gross estate by reason of section 2036 (relating to transfers with retained life estate), the decedent's estate shall be entitled to recover from the person receiving the property the amount which bears the same ratio to the total tax under this chapter which has been paid as—

[(A) the value of such property, bears to

[(B) the taxable estate.

[(2) DECEDENT MAY OTHERWISE DIRECT.—Paragraph (1) shall not apply with respect to any property to the extent that the decedent in his will (or a revocable trust) specifically indicates an intent to waive any right of recovery under this subchapter with respect to such property.

[(b) MORE THAN ONE RECIPIENT.—For purposes of this section, if there is more than 1 person receiving the property, the right of recovery shall be against each such person.

[(c) PENALTIES AND INTEREST.—In the case of penalties and interest attributable to the additional taxes described in subsection (a), rules similar to the rules of subsections (a) and (b) shall apply.

[(d) NO RIGHT OF RECOVERY AGAINST CHARITABLE REMAINDER TRUSTS.—No person shall be entitled to recover any amount by reason of this section from a trust to which section 664 applies (determined without regard to this section).

[SEC. 2208. CERTAIN RESIDENTS OF POSSESSIONS CONSIDERED CITIZENS OF THE UNITED STATES.

[A decedent who was a citizen of the United States and a resident of a possession thereof at the time of his death shall, for purposes of the tax imposed by this chapter, be considered a "citizen" of the United States within the meaning of that term wherever used in this title unless he acquired his United States citizenship solely by reason of (1) his being a citizen of such possession of the United States, or (2) his birth or residence within such possession of the United States.

[SEC. 2209. CERTAIN RESIDENTS OF POSSESSIONS CONSIDERED NONRESIDENTS NOT CITIZENS OF THE UNITED STATES.

[A decedent who was a citizen of the United States and a resident of a possession thereof at the time of his death shall, for purposes of the tax imposed by this chapter, be considered a "nonresident not a citizen of the United States" within the meaning of that term wherever used in this title, but only if such person acquired his United States citizenship solely by reason of (1) his being a citizen of such possession of the United States, or (2) his birth or residence within such possession of the United States.

[CHAPTER 12—GIFT TAX

[Subchapter A—Determination of Tax Liability

[SEC. 2501. IMPOSITION OF TAX.

[(a) TAXABLE TRANSFERS.—

[(1) GENERAL RULE.—A tax, computed as provided in section 2502, is hereby imposed for each calendar year on the transfer of property by gift during such calendar year by any individual resident or nonresident.

[(2) TRANSFERS OF INTANGIBLE PROPERTY.—Except as provided in paragraph (3), paragraph (1) shall not apply to the transfer of intangible property by a nonresident not a citizen of the United States.

[(3) EXCEPTION.—

[(A) CERTAIN INDIVIDUALS.—Paragraph (2) shall not apply in the case of a donor who, within the 10-year period ending with the date of transfer, lost United States citizenship, unless such loss did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle A.

[(B) CERTAIN INDIVIDUALS TREATED AS HAVING TAX AVOIDANCE PURPOSE.—For purposes of subparagraph (A), an individual shall be treated as having a principal purpose to avoid such taxes if such individual is so treated under section 877(a)(2).

[(C) EXCEPTION FOR CERTAIN INDIVIDUALS.—Subparagraph (B) shall not apply to a donor meeting the requirements of section 877(c)(1).

[(D) CREDIT FOR FOREIGN GIFT TAXES.—The tax imposed by this section solely by reason of this paragraph shall be credited with the amount of any gift tax actually paid to any foreign country in respect of any gift which is taxable under this section solely by reason of this paragraph.

[(E) CROSS REFERENCE.—For comparable treatment of long-term lawful permanent residents who ceased to be taxed as residents, see section 877(e).

[(4) BURDEN OF PROOF.—If the Secretary establishes that it is reasonable to believe that an individual's loss of United

[States citizenship would, but for paragraph (3), result in a substantial reduction for the calendar year in the taxes on the transfer of property by gift, the burden of proving that such loss of citizenship did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle A shall be on such individual.

[(5) TRANSFERS TO POLITICAL ORGANIZATIONS.—Paragraph (1) shall not apply to the transfer of money or other property to a political organization (within the meaning of section 527(e)(1)) for the use of such organization.

[(b) CERTAIN RESIDENTS OF POSSESSIONS CONSIDERED CITIZENS OF THE UNITED STATES.—A donor who is a citizen of the United States and a resident of a possession thereof shall, for purposes of

the tax imposed by this chapter, be considered a "citizen" of the United States within the meaning of that term wherever used in this title unless he acquired his United States citizenship solely by reason of (1) his being a citizen of such possession of the United States, or

[(2) his birth or residence within such possession of the United States.

[(c) CERTAIN RESIDENTS OF POSSESSIONS CONSIDERED NONRESIDENTS NOT CITIZENS OF THE UNITED STATES.—A donor who is a citizen of the United States and a resident of a possession thereof shall, for purposes of the tax imposed by this chapter, be considered a "nonresident not a citizen of the United States" within the meaning of that term wherever used in this title, but only if such donor acquired his United States citizenship solely by reason of (1) his being a citizen of such possession of the United States, or

[(2) his birth or residence within such possession of the United States.

[(d) CROSS REFERENCES.—

[(1) For increase in basis of property acquired by gift for gift tax paid, see section 1015(d).

[(2) For exclusion of transfers of property outside the United States by a nonresident who is not a citizen of the United States, see section 2511(a).

[SEC. 2502. RATE OF TAX.

[(a) COMPUTATION OF TAX.—The tax imposed by section 2501 for each calendar year shall be an amount equal to the excess of—

[(1) a tentative tax, computed under section 2001(c), on the aggregate sum of the taxable gifts for such calendar year and for each of the preceding calendar periods, over

[(2) a tentative tax, computed under such section, on the aggregate sum of the taxable gifts for each of the preceding calendar periods.

[(b) PRECEDING CALENDAR PERIOD.—Whenever used in this title in connection with the gift tax imposed by this chapter, the term "preceding calendar period" means—

[(1) calendar years 1932 and 1970 and all calendar years intervening between calendar year 1932 and calendar year 1970,

[(2) the first calendar quarter of calendar year 1971 and all calendar quarters intervening between such calendar quarter and the first calendar quarter of calendar year 1982, and

[(3) all calendar years after 1981 and before the calendar year for which the tax is being computed.

For purposes of paragraph (1), the term "calendar year 1932" includes only that portion of such year after June 6, 1932.

[(c) TAX TO BE PAID BY DONOR.—The tax imposed by section 2501 shall be paid by the donor.

[SEC. 2503. TAXABLE GIFTS.

[(a) GENERAL DEFINITION.—The term "taxable gifts" means the total amount of gifts made during the calendar year, less the deductions provided in subchapter C (section 2522 and following).

[(b) EXCLUSIONS FROM GIFTS.—

[(1) IN GENERAL.—In the case of gifts (other than gifts of future interests in property) made to any person by the donor during the calendar year, the first $10,000 of such gifts to such

person shall not, for purposes of subsection (a), be included in the total amount of gifts made during such year. Where there has been a transfer to any person of a present interest in property, the possibility that such interest may be diminished by the exercise of a power shall be disregarded in applying this subsection, if no part of such interest will at any time pass to any other person.

[(2) INFLATION ADJUSTMENT.—In the case of gifts made in a calendar year after 1998, the $10,000 amount contained in paragraph (1) shall be increased by an amount equal to—

[(A) $10,000, multiplied by

[(B) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by

substituting "calendar year 1997" for "calendar year 1992" in subparagraph (B) thereof. If any amount as adjusted under the preceding sentence is not a multiple of $1,000, such amount shall be rounded to the next lowest multiple of $1,000.

[(c) TRANSFER FOR THE BENEFIT OF MINOR.—No part of a gift to an individual who has not attained the age of 21 years on the date of such transfer shall be considered a gift of a future interest in property for purposes of subsection (b) if the property and the income therefrom—

[(1) may be expended by, or for the benefit of, the donee before his attaining the age of 21 years, and

[(2) will to the extent not so expended—

[(A) pass to the donee on his attaining the age of 21 years, and

[(B) in the event the donee dies before attaining the age of 21 years, be payable to the estate of the donee or as he may appoint under a general power of appointment as defined in section 2514(c).

[(e) EXCLUSION FOR CERTAIN TRANSFERS FOR EDUCATIONAL EXPENSES OR MEDICAL EXPENSES.—

[(1) IN GENERAL.—Any qualified transfer shall not be treated as a transfer of property by gift for purposes of this chapter.

[(2) QUALIFIED TRANSFER.—For purposes of this subsection, the term "qualified transfer" means any amount paid on behalf of an individual—

[(A) as tuition to an educational organization described in section 170(b)(1)(A)(ii) for the education or training of such individual, or

[(B) to any person who provides medical care (as defined in section 213(d)) with respect to such individual as payment for such medical care.

[(f) WAIVER OF CERTAIN PENSION RIGHTS.—If any individual waives, before the death of a participant, any survivor benefit, or right to such benefit, under section 401(a)(11) or 417, such waiver shall not be treated as a transfer of property by gift for purposes of this chapter.

[(g) TREATMENT OF CERTAIN LOANS OF ARTWORKS.—

[(1) IN GENERAL.—For purposes of this subtitle, any loan of a qualified work of art shall not be treated as a transfer (and the value of such qualified work of art shall be determined as if such loan had not been made) if—

[(A) such loan is to an organization described in section 501(c)(3) and exempt from tax undersection 501(c) (other than a private foundation), and

[(B) the use of such work by such organization is related to the purpose or function constituting the basis for its exemption under section 501.

[(2) DEFINITIONS.—For purposes of this section—

[(A) QUALIFIED WORK OF ART.—The term "qualified work of art" means any archaeological, historic, or creative tangible personal property.

[(B) PRIVATE FOUNDATION.—The term "private foundation" has the meaning given such term by section 509, except that such term shall not include any private operating foundation (as defined in section 4942(j)(3)).

[SEC. 2504. TAXABLE GIFTS FOR PRECEDING CALENDAR PERIODS.

[(a) IN GENERAL.—In computing taxable gifts for preceding calendar periods for purposes of computing the tax for any calendar year—

[(1) there shall be treated as gifts such transfers as were considered to be gifts under the gift tax laws applicable to the calendar period in which the transfers were made,

[(2) there shall be allowed such deductions as were provided for under such laws, and

[(3) the specific exemption in the amount (if any) allowable under section 2521 (as in effect before its repeal by the Tax Reform Act of 1976) shall be applied in all computations in respect of preceding calendar periods ending before January 1, 1977, for purposes of computing the tax for any calendar year.

[(b) EXCLUSIONS FROM GIFTS FOR PRECEDING CALENDAR PERIODS.—In the case of gifts made to any person by the donor during preceding calendar periods, the amount excluded, if any, by the provisions of gift tax laws applicable to the periods in which the gifts were made shall not, for purposes of subsection (a), be included in the total amount of the gifts made during such preceding calendar periods.

[(c) VALUATION OF GIFTS.—If the time has expired under section 6501 within which a tax may be assessed under this chapter 12 (or under corresponding provisions of prior laws) on—

[(1) the transfer of property by gift made during a preceding calendar period (as defined in section 2502(b)); or

[(2) an increase in taxable gifts required under section 2701(d), the value thereof shall, for purposes of computing the tax under this chapter, be the value as finally determined (within the meaning of section 2001(f)(2)) for purposes of this chapter.

[(d) NET GIFTS.—The term "net gifts" as used in corresponding provisions of prior laws shall be read as "taxable gifts" for purposes of this chapter.

[SEC. 2505. UNIFIED CREDIT AGAINST GIFT TAX.

[(a) GENERAL RULE.—In the case of a citizen or resident of the United States, there shall be allowed as a credit against the tax imposed by section 2501 for each calendar year an amount equal to—

[(1) the applicable credit amount in effect under section 2010(c) for such calendar year, reduced by

[(2) the sum of the amounts allowable as a credit to the individual under this section for all preceding calendar periods.

[(b) ADJUSTMENT TO CREDIT FOR CERTAIN GIFTS MADE BEFORE 1977.—The amount allowable under subsection (a) shall be reduced by an amount equal to 20 percent of the aggregate amount allowed as a specific exemption under section 2521 (as in effect before its repeal by the Tax Reform Act of 1976) with respect to gifts made by the individual after September 8, 1976.

[(c) LIMITATION BASED ON AMOUNT OF TAX.—The amount of the credit allowed under subsection (a) for any calendar year shall not exceed the amount of the tax imposed by section 2501 for such calendar year.

[Subchapter B—Transfers

[SEC. 2511. TRANSFERS IN GENERAL.

[(a) SCOPE.—Subject to the limitations contained in this chapter, the tax imposed by section 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible; but in the case of a nonresident not a citizen of the United States, shall apply to a transfer only if the property is situated within the United States.

[(b) INTANGIBLE PROPERTY.—For purposes of this chapter, in the case of a nonresident not a citizen of the United States who is excepted from the application of section 2501(a)(2)—

[(1) shares of stock issued by a domestic corporation, and

[(2) debt obligations of—

[(A) a United States person, or

[(B) the United States, a State or any political subdivision thereof, or the District of Columbia,

which are owned and held by such nonresident shall be deemed to be property situated within the United States.

[SEC. 2512. VALUATION OF GIFTS.

[(a) If the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift.

[(b) Where property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall be deemed a gift, and shall be included in computing the amount of gifts made during the calendar year.

[(c) CROSS REFERENCE.—For individual's right to be furnished on request a statement regarding any valuation made by the Secretary of a gift by that individual, see section 7517.

[SEC. 2513. GIFT BY HUSBAND OR WIFE TO THIRD PARTY.

[(a) CONSIDERED AS MADE ONE-HALF BY EACH.—

[(1) IN GENERAL.—A gift made by one spouse to any person other than his spouse shall, for the purposes of this chapter, be considered as made one-half by him and one-half by his spouse, but only if at the time of the gift each spouse is a citizen or resident of the United States. This paragraph shall not apply with respect to a gift by a spouse of an interest in property if he creates in his spouse a general power of appointment, as defined in section 2514(c), over such interest. For purposes of this section, an individual shall be considered as the spouse of another individual only if he is married to such individual at the time of the gift and does not remarry during the remainder of the calendar year.

[(2) CONSENT OF BOTH SPOUSES.—Paragraph (1) shall apply only if both spouses have signified (under the regulations provided for in subsection (b)) their consent to the application of paragraph (1) in the case of all such gifts made during the calendar year by either while married to the other.

[(b) MANNER AND TIME OF SIGNIFYING CONSENT.—

[(1) MANNER.—A consent under this section shall be signified in such manner as is provided under regulations prescribed by the Secretary.

[(2) TIME.—Such consent may be so signified at any time after the close of the calendar year in which the gift was made, subject to the following limitations—

[(A) The consent may not be signified after the 15th day of April following the close of such year, unless before such 15th day no return has been filed for such year by either spouse, in which case the consent may not be signified after a return for such year is filed by either spouse.

[(B) The consent may not be signified after a notice of deficiency with respect to the tax for such year has been sent to either spouse in accordance with section 6212(a).

[(c) REVOCATION OF CONSENT.—Revocation of a consent previously signified shall be made in such manner as is provided under regulations prescribed by the Secretary, but the right to revoke a consent previously signified with respect to a calendar year—

[(1) shall not exist after the 15th day of April following the close of such year if the consent was signified on or before such 15th day; and

[(2) shall not exist if the consent was not signified until after such 15th day.

[(d) JOINT AND SEVERAL LIABILITY FOR TAX.—If the consent required by subsection (a)(2) is signified with respect to a gift made in any calendar year, the liability with respect to the entire tax imposed by this chapter of each spouse for such year shall be joint and several.

[SEC. 2514. POWERS OF APPOINTMENT.

[(a) POWERS CREATED ON OR BEFORE OCTOBER 21, 1942.—An exercise of a general power of appointment created on or before October 21, 1942, shall be deemed a transfer of property by the individual possessing such power; but the failure to exercise such a power or the complete release of such a power shall not be deemed

an exercise thereof. If a general power of appointment created on or before October 21, 1942, has been partially released so that it is no longer a general power of appointment, the subsequent exercise of such power shall not be deemed to be the exercise of a general power of appointment if—

[(1) such partial release occurred before November 1, 1951, or

[(2) the donee of such power was under a legal disability to release such power on October 21, 1942, and such partial release occurred not later than six months after the termination of such legal disability.

[(b) POWERS CREATED AFTER OCTOBER 21, 1942.—The exercise or release of a general power of appointment created after October 21, 1942, shall be deemed a transfer of property by the individual possessing such power.

[(c) DEFINITION OF GENERAL POWER OF APPOINTMENT.—For purposes of this section, the term "general power of appointment" means a power which is exercisable in favor of the individual possessing the power (hereafter in this subsection referred to as the "possessor"), his estate, his creditors, or the creditors of his estate; except that—

[(1) A power to consume, invade, or appropriate property for the benefit of the possessor which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the possessor shall not be deemed a general power of appointment.

[(2) A power of appointment created on or before October 21, 1942, which is exercisable by the possessor only in conjunction with another person shall not be deemed a general power of appointment.

[(3) In the case of a power of appointment created after October 21, 1942, which is exercisable by the possessor only in conjunction with another person—

[(A) if the power is not exercisable by the possessor except in conjunction with the creator of the power—such power shall not be deemed a general power of appointment;

[(B) if the power is not exercisable by the possessor except in conjunction with a person having a substantial interest, in the property subject to the power, which is adverse to exercise of the power in favor of the possessor—such power shall not be deemed a general power of appointment. For the purposes of this subparagraph a person who, after the death of the possessor, may be possessed of a power of appointment (with respect to the property subject to the possessor's power) which he may exercise in his own favor shall be deemed as having an interest in the property and such interest shall be deemed adverse to such exercise of the possessor's power;

[(C) if (after the application of subparagraphs (A) and (B)) the power is a general power of appointment and is exercisable in favor of such other person—such power shall be deemed a general power of appointment only in respect of a fractional part of the property subject to such power, such part to be determined by dividing the value of such

property by the number of such persons (including the possessor) in favor of whom such power is exercisable.

For purposes of subparagraphs (B) and (C), a power shall be deemed to be exercisable in favor of a person if it is exercisable in favor of such person, his estate, his creditors, or the creditors of his estate.

[(d) CREATION OF ANOTHER POWER IN CERTAIN CASES.—If a power of appointment created after October 21, 1942, is exercised by creating another power of appointment which, under the applicable local law, can be validly exercised so as to postpone the vesting of any estate or interest in the property which was subject to the first power, or suspend the absolute ownership or power of alienation of such property, for a period ascertainable without regard to the date of the creation of the first power, such exercise of the first power shall, to the extent of the property subject to the second power, be deemed a transfer of property by the individual possessing such power.

[(e) LAPSE OF POWER.—The lapse of a power of appointment created after October 21, 1942, during the life of the individual possessing the power shall be considered a release of such power. The rule of the preceding sentence shall apply with respect to the lapse of powers during any calendar year only to the extent that the property which could have been appointed by exercise of such lapsed powers exceeds in value the greater of the following amounts:

[(1) $5,000, or

[(2) 5 percent of the aggregate value of the assets out of which, or the proceeds of which, the exercise of the lapsed powers could be satisfied.

[(f) DATE OF CREATION OF POWER.—For purposes of this section a power of appointment created by a will executed on or before October 21, 1942, shall be considered a power created on or before such date if the person executing such will dies before July 1, 1949, without having republished such will, by codicil or otherwise, after October 21, 1942.

[SEC. 2515. TREATMENT OF GENERATION-SKIPPING TRANSFER TAX.

[In the case of any taxable gift which is a direct skip (within the meaning of chapter 13), the amount of such gift shall be increased by the amount of any tax imposed on the transferor under chapter 13 with respect to such gift.

[SEC. 2516. CERTAIN PROPERTY SETTLEMENTS.

[Where a husband and wife enter into a written agreement relative to their marital and property rights and divorce occurs within the 3-year period beginning on the date 1 year before such agreement is entered into (whether or not such agreement is approved by the divorce decree), any transfers of property or interests in property made pursuant to such agreement—

[(1) to either spouse in settlement of his or her marital or property rights, or

[(2) to provide a reasonable allowance for the support of issue of the marriage during minority, shall be deemed to be transfers made for a full and adequate consideration in money or money's worth.

[SEC. 2518. DISCLAIMERS.

[(a) GENERAL RULE.—For purposes of this subtitle, if a person makes a qualified disclaimer with respect to any interest in property, this subtitle shall apply with respect to such interest as if the interest had never been transferred to such person.

[(b) QUALIFIED DISCLAIMER DEFINED.—For purposes of subsection (a), the term "qualified disclaimer" means an irrevocable and unqualified refusal by a person to accept an interest in property but only if—

[(1) such refusal is in writing,

[(2) such writing is received by the transferor of the interest, his legal representative, or the holder of the legal title to the property to which the interest relates not later than the date which is 9 months after the later of—

[(A) the day on which the transfer creating the interest in such person is made, or

[(B) the day on which such person attains age 21,

[(3) such person has not accepted the interest or any of its benefits, and

[(4) as a result of such refusal, the interest passes without any direction on the part of the person making the disclaimer and passes either—

[(A) to the spouse of the decedent, or

[(B) to a person other than the person making the disclaimer.

[(c) OTHER RULES.—For purposes of subsection (a)—

[(1) DISCLAIMER OF UNDIVIDED PORTION OF INTEREST.—A disclaimer with respect to an undivided portion of an interest which meets the requirements of the preceding sentence shall be treated as a qualified disclaimer of such portion of the interest.

[(2) POWERS.—A power with respect to property shall be treated as an interest in such property.

[(3) CERTAIN TRANSFERS TREATED AS DISCLAIMERS.—A written transfer of the transferor's entire interest in the property—

[(A) which meets requirements similar to the requirements of paragraphs (2) and (3) of subsection (b), and

[(B) which is to a person or persons who would have received the property had the transferor made a qualified disclaimer (within the meaning of subsection (b)), shall be treated as a qualified disclaimer.

[SEC. 2519. DISPOSITIONS OF CERTAIN LIFE ESTATES.

[(a) GENERAL RULE.—For purposes of this chapter and chapter 11, any disposition of all or part of a qualifying income interest for life in any property to which this section applies shall be treated as a transfer of all interests in such property other than the qualifying income interest.

[(b) PROPERTY TO WHICH THIS SUBSECTION APPLIES.—This section applies to any property if a deduction was allowed with respect to the transfer of such property to the donor—

[(1) under section 2056 by reason of subsection (b)(7) thereof, or

[(2) under section 2523 by reason of subsection (f) thereof.

[(c) CROSS REFERENCE.—For right of recovery for gift tax in the case of property treated as transferred under this section,see section 2207A(b).

[Subchapter C—Deductions

[SEC. 2522. CHARITABLE AND SIMILAR GIFTS.

[(a) CITIZENS OR RESIDENTS.—In computing taxable gifts for the calendar year, there shall be allowed as a deduction in the case of a citizen or resident the amount of all gifts made during such year to or for the use of—

[(1) the United States, any State, or any political subdivision thereof, or the District of Columbia, for exclusively public purposes;

[(2) a corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), including the encouragement of art and the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, which is not disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office;

[(3) a fraternal society, order, or association, operating under the lodge system, but only if such gifts are to be used exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals;

[(4) posts or organizations of war veterans, or auxiliary units or societies of any such posts or organizations, if such posts, organizations, units, or societies are organized in the United States or any of its possessions, and if no part of their net earnings inures to the benefit of any private shareholder or individual.

Rules similar to the rules of section 501(j) shall apply for purposes of paragraph (2).

[(b) NONRESIDENTS.—In the case of a nonresident not a citizen of the United States, there shall be allowed as a deduction the amount of all gifts made during such year to or for the use of—

[(1) the United States, any State, or any political subdivision thereof, or the District of Columbia, for exclusively public purposes;

[(2) a domestic corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private share-

holder or individual, which is not disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office;

[(3) a trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office; but only if such gifts are to be used within the United States exclusively for such purposes;

[(4) a fraternal society, order, or association, operating under the lodge system, but only if such gifts are to be used within the United States exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals;

[(5) posts or organizations of war veterans, or auxiliary units or societies of any such posts or organizations, if such posts, organizations, units, or societies are organized in the United States or any of its possessions, and if no part of their net earnings inures to the benefit of any private shareholder or individual.

[(c) DISALLOWANCE OF DEDUCTIONS IN CERTAIN CASES.—

[(1) No deduction shall be allowed under this section for a gift to or for the use of an organization or trust described in section 508(d) or 4948(c)(4) subject to the conditions specified in such sections.

[(2) Where a donor transfers an interest in property (other than an interest described in section 170(f)(3)(B)) to a person, or for a use, described in subsection (a) or (b) and an interest in the same property is retained by the donor, or is transferred or has been transferred (for less than an adequate and full consideration in money or money's worth) from the donor to a person, or for a use, not described in subsection (a) or (b), no deduction shall be allowed under this section for the interest which is, or has been transferred to the person, or for the use, described in subsection (a) or (b), unless—

[(A) in the case of a remainder interest, such interest is in a trust which is a charitable remainder annuity trust or a charitable remainder unitrust (described in section 664) or a pooled income fund (described in section 642(c)(5)), or

[(B) in the case of any other interest, such interest is in the form of a guaranteed annuity or is a fixed percentage distributed yearly of the fair market value of the property (to be determinedyearly).

[(3) Rules similar to the rules of section 2055(e)(4) shall apply for purposes of paragraph (2).

[(4) Reformations to comply with paragraph (2)

[(A) IN GENERAL.—A deduction shall be allowed under subsection (a) in respect of any qualified reformation (within the meaning of section 2055(e)(3)(B)).

[(B) RULES SIMILAR TO SECTION 2055(E)(3) TO APPLY.—For purposes of this paragraph, rules similar to the rules of section 2055(e)(3) shall apply.

[(d) SPECIAL RULE FOR IRREVOCABLE TRANSFERS OF EASEMENTS IN REAL PROPERTY.—A deduction shall be allowed under subsection (a) in respect of any transfer of a qualified real property interest (as defined in section 170(h)(2)(C)) which meets the requirements of section 170(h) (without regard to paragraph (4)(A) thereof).

[(e) CROSS REFERENCES.—

[(1) For treatment of certain organizations providing child care, see section 501(k).

[(2) For exemption of certain gifts to or for the benefit of the United States and for rules of construction with respect to certain bequests, see section 2055(f).

[(3) For treatment of gifts to or for the use of Indian tribal governments (or their subdivisions), see section 7871.

[SEC. 2523. GIFT TO SPOUSE.

[(a) ALLOWANCE OF DEDUCTION.—Where a donor transfers during the calendar year by gift an interest in property to a donee who at the time of the gift is the donor's spouse, there shall be allowed as a deduction in computing taxable gifts for the calendar year an amount with respect to such interest equal to its value.

[(b) LIFE ESTATE OR OTHER TERMINABLE INTEREST.—Where, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, such interest transferred to the spouse will terminate or fail, no deduction shall be allowed with respect to such interest—

[(1) if the donor retains in himself, or transfers or has transferred (for less than an adequate and full consideration in money or money's worth) to any person other than such donee spouse (or the estate of such spouse), an interest in such property, and if by reason of such retention or transfer the donor (or his heirs or assigns) or such person (or his heirs or assigns) may possess or enjoy any part of such property after such termination or failure of the interest transferred to the donee spouse; or

[(2) if the donor immediately after the transfer to the donee spouse has a power to appoint an interest in such property which he can exercise (either alone or in conjunction with any person) in such manner that the appointee may possess or enjoy any part of such property after such termination or failure of the interest transferred to the donee spouse. For purposes of this paragraph, the donor shall be considered as having immediately after the transfer to the donee spouse such power to appoint even though such power cannot be exercised until after the lapse of time, upon the occurrence of an event or contingency, or on the failure of an event or contingency to occur.

An exercise or release at any time by the donor, either alone or in conjunction with any person, of a power to appoint an interest in property, even though not otherwise a transfer, shall, for purposes of paragraph (1), be considered as a transfer by him. Except as provided in subsection (e), where at the time of the transfer it is im-

possible to ascertain the particular person or persons who may receive from the donor an interest in property so transferred by him, such interest shall, for purposes of paragraph (1), be considered as transferred to a person other than the donee's spouse.

[(c) INTEREST IN UNIDENTIFIED ASSETS.—Where the assets out of which, or the proceeds of which, the interest transferred to the donee spouse may be satisfied include a particular asset or assets with respect to which no deduction would be allowed if such asset or assets were transferred from the donor to such spouse, then the value of the interest transferred to such spouse shall, for purposes of subsection (a), be reduced by the aggregate value of such particular assets.

[(d) JOINT INTERESTS.—If the interest is transferred to the donee spouse as sole joint tenant with the donor or as tenant by the entirety, the interest of the donor in the property which exists solely by reason of the possibility that the donor may survive the donee spouse, or that there may occur a severance of the tenancy, shall not be considered for purposes of subsection (b) as an interest retained by the donor in himself.

[(e) LIFE ESTATE WITH POWER OF APPOINTMENT IN DONEE SPOUSE.—Where the donor transfers an interest in property, if by such transfer his spouse is entitled for life to all of the income from the entire interest, or all the income from a specific portion thereof, payable annually or at more frequent intervals, with power in the donee spouse to appoint the entire interest, or such specific portion (exercisable in favor of such donee spouse, or of the estate of such donee spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), and with no power in any other person to appoint any part of such interest, or such portion, to any person other than the donee spouse—

[(1) the interest, or such portion, so transferred shall, for purposes of subsection (a) be considered as transferred to the donee spouse, and

[(2) no part of the interest, or such portion, so transferred shall, for purposes of subsection (b)(1), be considered as retained in the donor or transferred to any person other than the donee spouse.

This subsection shall apply only if, by such transfer, such power in the donee spouse to appoint the interest, or such portion, whether exercisable by will or during life, is exercisable by such spouse alone and in all events. For purposes of this subsection, the term "specific portion" only includes a portion determined on a fractional or percentage basis.

[(f) ELECTION WITH RESPECT TO LIFE ESTATE FOR DONEE SPOUSE.—

[(1) IN GENERAL.—In the case of qualified terminable interest property—

[(A) for purposes of subsection (a), such property shall be treated as transferred to the donee spouse, and

[(B) for purposes of subsection (b)(1), no part of such property shall be considered as retained in the donor or transferred to any person other than the donee spouse.

[(2) QUALIFIED TERMINABLE INTEREST PROPERTY.—For purposes of this subsection, the term "qualified terminable interest property" means any property—

[(A) which is transferred by the donor spouse,

[(B) in which the donee spouse has a qualifying income interest for life, and

[(C) to which an election under this subsection applies.

[(3) CERTAIN RULES MADE APPLICABLE.—For purposes of this subsection, rules similar to the rules of clauses (ii), (iii), and (iv) of section 2056(b)(7)(B) shall apply and the rules of section 2056(b)(10) shall apply.

[(4) ELECTION.—

[(A) TIME AND MANNER.—An election under this subsection with respect to any property shall be made on or before the date prescribed by section 6075(b) for filing a gift tax return with respect to the transfer (determined without regard to section 6019(2)) and shall be made in such manner as the Secretary shall by regulations prescribe.

[(B) ELECTION IRREVOCABLE.—An election under this subsection, once made, shall be irrevocable.

[(5) TREATMENT OF INTEREST RETAINED BY DONOR SPOUSE.—

[(A) IN GENERAL.—In the case of any qualified terminable interest property—

[(i) such property shall not be includible in the gross estate of the donor spouse, and

[(ii) any subsequent transfer by the donor spouse of an interest in such property shall not be treated as a transfer for purposes of this chapter.

[(B) SUBPARAGRAPH (A) NOT TO APPLY AFTER TRANSFER BY DONEE SPOUSE.—Subparagraph (A) shall not apply with respect to any property after the donee spouse is treated as having transferred such property under section 2519, or such property is includible in the donee spouse's gross estate under section 2044.

[(6) TREATMENT OF JOINT AND SURVIVOR ANNUITIES.—In the case of a joint and survivor annuity where only the donor spouse and donee spouse have the right to receive payments before the death of the last spouse to die—

[(A) the donee spouse's interest shall be treated as a qualifying income interest for life,

[(B) the donor spouse shall be treated as having made an election under this subsection with respect to such annuity unless the donor spouse otherwise elects on or before the date specified inparagraph (4)(A),

[(C) paragraph (5) and section 2519 shall not apply to the donor spouse's interest in the annuity, and

[(D) if the donee spouse dies before the donor spouse, no amount shall be includible in the gross estate of the donee spouse under section 2044 with respect to such annuity.

An election under subparagraph (B), once made, shall be irrevocable.

[(g) SPECIAL RULE FOR CHARITABLE REMAINDER TRUSTS.—

[(1) IN GENERAL.—If, after the transfer, the donee spouse is the only noncharitable beneficiary (other than the donor) of a qualified charitable remainder trust, subsection (b) shall not apply to the interest in such trust which is transferred to the donee spouse.

[(2) DEFINITIONS.—For purposes of paragraph (1), the terms "noncharitable beneficiary" and "qualified charitable remainder trust" have the meanings given to such terms by section 2056(b)(8)(B).

[(h) DENIAL OF DOUBLE DEDUCTION.—Nothing in this section or any other provision of this chapter shall allow the value of any interest in property to be deducted under this chapter more than once with respect to the same donor.

[(i) DISALLOWANCE OF MARITAL DEDUCTION WHERE SPOUSE NOT CITIZEN.—If the spouse of the donor is not a citizen of the United States—

[(1) no deduction shall be allowed under this section,

[(2) section 2503(b) shall be applied with respect to gifts which are made by the donor to such spouse and with respect to which a deduction would be allowable under this section but for paragraph (1) by substituting "$100,000" for "$10,000", and

[(3) the principles of sections 2515 and 2515A (as such sections were in effect before their repeal by the Economic Recovery Tax Act of 1981) shall apply, except that the provisions of such section 2515 providing for an election shall not apply.

This subsection shall not apply to any transfer resulting from the acquisition of rights under a joint and survivor annuity described in subsection (f)(6).

[SEC. 2524. EXTENT OF DEDUCTIONS.

[The deductions provided in sections 2522 and 2523 shall be allowed only to the extent that the gifts therein specified are included in the amount of gifts against which such deductions are applied.

[CHAPTER 13—TAX ON CERTAIN GENERATION-SKIPPING TRANSFERS

[Subchapter A—Tax Imposed

[SEC. 2601. TAX IMPOSED.

[A tax is hereby imposed on every generation-skipping transfer (within the meaning of subchapter B).

[SEC. 2602. AMOUNT OF TAX.

[The amount of the tax imposed by section 2601 is—

[(1) the taxable amount (determined under subchapter C), multiplied by

[(2) the applicable rate (determined under subchapter E).

[SEC. 2603. LIABILITY FOR TAX.

[(a) PERSONAL LIABILITY.—

[(1) TAXABLE DISTRIBUTIONS.—In the case of a taxable distribution, the tax imposed by section 2601 shall be paid by the transferee.

[(2) TAXABLE TERMINATION.—In the case of a taxable termination or a direct skip from a trust, the tax shall be paid by the trustee.

[(3) DIRECT SKIP.—In the case of a direct skip (other than a direct skip from a trust), the tax shall be paid by the transferor.

[(b) SOURCE OF TAX.—Unless otherwise directed pursuant to the governing instrument by specific reference to the tax imposed by this chapter, the tax imposed by this chapter on a generation-skipping transfer shall be charged to the property constituting such transfer.

[(c) CROSS REFERENCE.—For provisions making estate and gift tax provisions with respect to transferee liability, liens, and related matters applicable to the tax imposed by section 2601, see section 2661.

[SEC. 2604. CREDIT FOR CERTAIN STATE TAXES.

[(a) GENERAL RULE.—If a generation-skipping transfer (other than a direct skip) occurs at the same time as and as a result of the death of an individual, a credit against the tax imposed by section 2601 shall be allowed in an amount equal to the generation-skipping transfer tax actually paid to any State in respect to any property included in the generation-skipping transfer.

[(b) LIMITATION.—The aggregate amount allowed as a credit under this section with respect to any transfer shall not exceed 5 percent of the amount of the tax imposed by section 2601 on such transfer.

[Subchapter B—Generation-Skipping Transfers

[SEC. 2611. GENERATION-SKIPPING TRANSFER DEFINED.

[(a) IN GENERAL.—For purposes of this chapter, the term "generation-skipping transfer" means—

[(1) a taxable distribution,

[(2) a taxable termination, and

[(3) a direct skip.

[(b) CERTAIN TRANSFERS EXCLUDED.—The term "generation-skipping transfer" does not include—

[(1) any transfer which, if made inter vivos by an individual, would not be treated as a taxable gift by reason of section 2503(e) (relating to exclusion of certain transfers for educational or medical expenses), and

[(2) any transfer to the extent—

[(A) the property transferred was subject to a prior tax imposed under this chapter,

[(B) the transferee in the prior transfer was assigned to the same generation as (or a lower generation than) the generation assignment of the transferee in this transfer, and

[(C) such transfers do not have the effect of avoiding tax under this chapter with respect to any transfer.

[SEC. 2612. TAXABLE TERMINATION; TAXABLE DISTRIBUTION; DIRECT SKIP.

[(a) TAXABLE TERMINATION.—

[(1) GENERAL RULE.—For purposes of this chapter, the term "taxable termination" means the termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in a trust unless—

[(A) immediately after such termination, a non-skip person has an interest in such property, or

[(B) at no time after such termination may a distribution (including distributions on termination) be made from such trust to a skip person.

[(2) CERTAIN PARTIAL TERMINATIONS TREATED AS TAXABLE.—If, upon the termination of an interest in property held in trust by reason of the death of a lineal descendant of the transferor, a specified portion of the trust's assets are distributed to 1 or more skip persons (or 1 or more trusts for the exclusive benefit of such persons), such termination shall constitute a taxable termination with respect to such portion of the trust property.

[(b) TAXABLE DISTRIBUTION.—For purposes of this chapter, the term "taxable distribution" means any distribution from a trust to a skip person (other than a taxable termination or a direct skip).

[(c) DIRECT SKIP.—For purposes of this chapter—

[(1) IN GENERAL.—The term "direct skip" means a transfer subject to a tax imposed by chapter 11 or 12 of an interest in property to a skip person.

[(2) LOOK-THRU RULES NOT TO APPLY.—Solely for purposes of determining whether any transfer to a trust is a direct skip, the rules of section 2651(f)(2) shall not apply.

[SEC. 2613. SKIP PERSON AND NON-SKIP PERSON DEFINED.

[(a) SKIP PERSON.—For purposes of this chapter, the term "skip person" means—

[(1) a natural person assigned to a generation which is 2 or more generations below the generation assignment of the transferor, or

[(2) a trust—

[(A) if all interests in such trust are held by skip persons, or

[(B) if—

[(i) there is no person holding an interest in such trust, and

[(ii) at no time after such transfer may a distribution (including distributions on termination) be made from such trust to a nonskip person.

[(b) NON-SKIP PERSON.—For purposes of this chapter, the term "non-skip person" means any person who is not a skipperson.

[Subchapter C—Taxable Amount

[SEC. 2621. TAXABLE AMOUNT IN CASE OF TAXABLE DISTRIBUTION.

[(a) IN GENERAL.—For purposes of this chapter, the taxable amount in the case of any taxable distribution shall be—

[(1) the value of the property received by the transferee, reduced by

[(2) any expense incurred by the transferee in connection with the determination, collection, or refund of the tax imposed by this chapter with respect to such distribution.

[(b) PAYMENT OF GST TAX TREATED AS TAXABLE DISTRIBUTION.—For purposes of this chapter, if any of the tax imposed by this chapter with respect to any taxable distribution is paid out of the trust, an amount equal to the portion so paid shall be treated as a taxable distribution.

[SEC. 2622. TAXABLE AMOUNT IN CASE OF TAXABLE TERMINATION.

[(a) IN GENERAL.—For purposes of this chapter, the taxable amount in the case of a taxable termination shall be—

[(1) the value of all property with respect to which the taxable termination has occurred, reduced by

[(2) any deduction allowed under subsection (b).

[(b) DEDUCTION FOR CERTAIN EXPENSES.—For purposes of subsection (a), there shall be allowed a deduction similar to the deduction allowed by section 2053 (relating to expenses, indebtedness, and taxes) for amounts attributable to the property with respect to which the taxable termination has occurred.

[SEC. 2623. TAXABLE AMOUNT IN CASE OF DIRECT SKIP.

[For purposes of this chapter, the taxable amount in the case of a direct skip shall be the value of the property received by the transferee.

[SEC. 2624. VALUATION.

[(a) GENERAL RULE.—Except as otherwise provided in this chapter, property shall be valued as of the time of the generation-skipping transfer.

[(b) ALTERNATE VALUATION AND SPECIAL USE VALUATION ELECTIONS APPLY TO CERTAIN DIRECT SKIPS.—In the case of any direct skip of property which is included in the transferor's gross estate, the value of such property for purposes of this chapter shall be the same as its value for purposes of chapter 11 (determined with regard to sections 2032 and 2032A).

[(c) ALTERNATE VALUATION ELECTION PERMITTED IN THE CASE OF TAXABLE TERMINATIONS OCCURRING AT DEATH.—If 1 or more taxable terminations with respect to the same trust occur at the same time as and as a result of the death of an individual, an election may be made to value all of the property included in such terminations in accordance with section 2032.

[(d) REDUCTION FOR CONSIDERATION PROVIDED BY TRANSFEREE.—For purposes of this chapter, the value of the property transferred shall be reduced by the amount of any consideration provided by the transferee.

[Subchapter D—GST Exemption

[SEC. 2631. GST EXEMPTION.

[(a) GENERAL RULE.—For purposes of determining the inclusion ratio, every individual shall be allowed a GST exemption of $1,000,000 which may be allocated by such individual (or his executor) to any property with respect to which such individual is the transferor.

[(b) ALLOCATIONS IRREVOCABLE.—Any allocation under subsection (a), once made, shall be irrevocable.

[(c) INFLATION ADJUSTMENT.—

[(1) IN GENERAL.—In the case of any calendar year after 1998, the $1,000,000 amount contained in subsection (a) shall be increased by an amount equal to—

[(A) $1,000,000, multiplied by

[(B) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting "calendar year 1997" for "calendar year 1992" in subparagraph (B) thereof.

If any amount as adjusted under the preceding sentence is not a multiple of $10,000, such amount shall be rounded to the next lowest multiple of $10,000.

[(2) ALLOCATION OF INCREASE.—Any increase under paragraph (1) for any calendar year shall apply only to generation-skipping transfers made during or after such calendar year; except that no such increase for calendar years after the calendar year in which the transferor dies shall apply to transfers by such transferor.

[SEC. 2632. SPECIAL RULES FOR ALLOCATION OF GST EXEMPTION.

[(a) TIME AND MANNER OF ALLOCATION.—

[(1) TIME.—Any allocation by an individual of his GST exemption under section 2631(a) may be made at any time on or before the date prescribed for filing the estate tax return for such individual's estate (determined with regard to extensions), regardless of whether such a return is required to be filed.

[(2) MANNER.—The Secretary shall prescribe by forms or regulations the manner in which any allocation referred to in paragraph (1) is to be made.

[(b) DEEMED ALLOCATION TO CERTAIN LIFETIME DIRECT SKIPS.—

[(1) IN GENERAL.—If any individual makes a direct skip during his lifetime, any unused portion of such individual's GST exemption shall be allocated to the property transferred to the extent necessary to make the inclusion ratio for such property zero. If the amount of the direct skip exceeds such unused portion, the entire unused portion shall be allocated to the property transferred.

[(2) UNUSED PORTION.—For purposes of paragraph (1), the unused portion of an individual's GST exemption is that portion of such exemption which has not previously been allocated by such individual (or treated as allocated under paragraph (1) with respect to a prior direct skip).

[(3) SUBSECTION NOT TO APPLY IN CERTAIN CASES.—An individual may elect to have this subsection not apply to a transfer.

[(c) ALLOCATION OF UNUSED GST EXEMPTION.—

[(1) IN GENERAL.—Any portion of an individual's GST exemption which has not been allocated within the time pre-

scribed by subsection (a) shall be deemed to be allocated as follows—

[(A) first, to property which is the subject of a direct skip occurring at such individual's death, and

[(B) second, to trusts with respect to which such individual is the transferor and from which a taxable distribution or a taxable termination might occur at or after such individual's death.

[(2) ALLOCATION WITHIN CATEGORIES.—

[(A) IN GENERAL.—The allocation under paragraph (1) shall be made among the properties described in subparagraph (A) thereof and the trusts described in subparagraph (B) thereof, as the case may be, in proportion to the respective amounts (at the time of allocation) of the nonexempt portions of such properties or trusts.

[(B) NONEXEMPT PORTION.—For purposes of subparagraph (A), the term "nonexempt portion" means the value (at the time of allocation) of the property or trust, multiplied by the inclusion ratio with respect to such property or trust.

[Subchapter E—Applicable Rate; Inclusion Ratio

[SEC. 2641. APPLICABLE RATE.

[(a) GENERAL RULE.—For purposes of this chapter, the term "applicable rate" means, with respect to any generation-skipping transfer, the product of—

[(1) the maximum Federal estate tax rate, and

[(2) the inclusion ratio with respect to the transfer.

[(b) MAXIMUM FEDERAL ESTATE TAX RATE.—For purposes of subsection (a), the term "maximum Federal estate tax rate" means the maximum rate imposed by section 2001 on the estates of decedents dying at the time of the taxable distribution, taxable termination, or direct skip, as the case may be.

[SEC. 2642. INCLUSION RATIO.

[(a) INCLUSION RATIO DEFINED.—For purposes of this chapter—

[(1) IN GENERAL.—Except as otherwise provided in this section, the inclusion ratio with respect to any property transferred in a generation-skipping transfer shall be the excess (if any) of 1 over—

[(A) except as provided in subparagraph (B), the applicable fraction determined for the trust from which such transfer is made, or

[(B) in the case of a direct skip, the applicable fraction determined for such skip.

[(2) APPLICABLE FRACTION.—For purposes of paragraph (1), the applicable fraction is a fraction—

[(A) the numerator of which is the amount of the GST exemption allocated to the trust (or in the case of a direct skip, allocated to the property transferred in such skip), and

[(B) the denominator of which is—

[(i) the value of the property transferred to the trust (or involved in the direct skip), reduced by

[(ii) the sum of—

[(I) any Federal estate tax or State death tax actually recovered from the trust attributable to suchproperty, and

[(II) any charitable deduction allowed under section 2055 or 2522 with respect to such property.

[(b) VALUATION RULES, ETC.—Except as provided in subsection (f)—

[(1) GIFTS FOR WHICH GIFT TAX RETURN FILED OR DEEMED ALLOCATION MADE.—If the allocation of the GST exemption to any property is made on a gift tax return filed on or before the date prescribed by section 6075(b) or is deemed to be made under section 2632(b)(1)—

[(A) the value of such property for purposes of subsection (a) shall be its value for purposes of chapter 12, and

[(B) such allocation shall be effective on and after the date of such transfer.

[(2) TRANSFERS AND ALLOCATIONS AT OR AFTER DEATH.—

[(A) TRANSFERS AT DEATH.—If property is transferred as a result of the death of the transferor, the value of such property for purposes of subsection (a) shall be its value for purposes of chapter 11; except that, if the requirements prescribed by the Secretary respecting allocation of post-death changes in value are not met, the value of such property shall be determined as of the time of the distribution concerned.

[(B) ALLOCATIONS TO PROPERTY TRANSFERRED AT DEATH OF TRANSFEROR.—Any allocation to property transferred as a result of the death of the transferor shall be effective on and after the date of the death of the transferor.

[(3) ALLOCATIONS TO INTER VIVOS TRANSFERS NOT MADE ON TIMELY FILED GIFT TAX RETURN.—If any allocation of the GST exemption to any property not transferred as a result of the death of the transferor is not made on a gift tax return filed on or before the date prescribed by section 6075(b) and is not deemed to be made under section 2632(b)(1)—

[(A) the value of such property for purposes of subsection (a) shall be determined as of the time such allocation is filed with the Secretary, and

[(B) such allocation shall be effective on and after the date on which such allocation is filed with the Secretary.

[(4) QTIP TRUSTS.—If the value of property is included in the estate of a spouse by virtue of section 2044, and if such spouse is treated as the transferor of such property under section 2652(a), the value of such property for purposes of subsection (a) shall be its value for purposes of chapter 11 in the estate of such spouse.

[(c) TREATMENT OF CERTAIN DIRECT SKIPS WHICH ARE NONTAXABLE GIFTS.—

[(1) IN GENERAL.—In the case of a direct skip which is a nontaxable gift, the inclusion ratio shall be zero.

[(2) EXCEPTION FOR CERTAIN TRANSFERS IN TRUST.—Paragraph (1) shall not apply to any transfer to a trust for the benefit of an individual unless—

[(A) during the life of such individual, no portion of the corpus or income of the trust may be distributed to (or for the benefit of) any person other than such individual, and

[(B) if the trust does not terminate before the individual dies, the assets of such trust will be includible in the gross estate of such individual.

Rules similar to the rules of section 2652(c)(3) shall apply for purposes of subparagraph (A).

[(3) NONTAXABLE GIFT.—For purposes of this subsection, the term "nontaxable gift" means any transfer of property to the extent such transfer is not treated as a taxable gift by reason of—

[(A) section 2503(b) (taking into account the application of section 2513), or

[(B) section 2503(e).

[(d) SPECIAL RULES WHERE MORE THAN 1 TRANSFER MADE TO TRUST.—

[(1) IN GENERAL.—If a transfer of property is made to a trust in existence before such transfer, the applicable fraction for such trust shall be recomputed as of the time of such transfer in the manner provided in paragraph (2).

[(2) APPLICABLE FRACTION.—In the case of any such transfer, the recomputed applicable fraction is a fraction—

[(A) the numerator of which is the sum of—

[(i) the amount of the GST exemption allocated to property involved in such transfer, plus

[(ii) the nontax portion of such trust immediately before such transfer, and

[(B) the denominator of which is the sum of—

[(i) the value of the property involved in such transfer reduced by the sum of—

[(I) any Federal estate tax or State death tax actually recovered from the trust attributable to suchproperty, and

[(II) any charitable deduction allowed under section 2055 or 2522 with respect to such property, and

[(ii) the value of all of the property in the trust (immediately before such transfer).

[(3) NONTAX PORTION.—For purposes of paragraph (2), the term "nontax portion" means the product of—

[(A) the value of all of the property in the trust, and

[(B) the applicable fraction in effect for such trust.

[(4) SIMILAR RECOMPUTATION IN CASE OF CERTAIN LATE ALLOCATIONS.—If—

[(A) any allocation of the GST exemption to property transferred to a trust is not made on a timely filed gift tax return required by section 6019, and

[(B) there was a previous allocation with respect to property transferred to such trust, the applicable fraction for such trust shall be recomputed as of the time of such allocation under rules similar to the rules of paragraph (2).

[(e) SPECIAL RULES FOR CHARITABLE LEAD ANNUITY TRUSTS.—

[(1) IN GENERAL.—For purposes of determining the inclusion ratio for any charitable lead annuity trust, the applicable fraction shall be a fraction—

[(A) the numerator of which is the adjusted GST exemption, and

[(B) the denominator of which is the value of all of the property in such trust immediately after the termination of the charitable lead annuity.

[(2) ADJUSTED GST EXEMPTION.—For purposes of paragraph (1), the adjusted GST exemption is an amount equal to the GST exemption allocated to the trust increased by interest determined—

[(A) at the interest rate used in determining the amount of the deduction under section 2055 or 2522 (as the case may be) for the charitable lead annuity, and

[(B) for the actual period of the charitable lead annuity.

[(3) DEFINITIONS.—For purposes of this subsection—

[(A) CHARITABLE LEAD ANNUITY TRUST.—The term "charitable lead annuity trust" means any trust in which there is a charitable lead annuity.

[(B) CHARITABLE LEAD ANNUITY.—The term "charitable lead annuity" means any interest in the form of a guaranteed annuity with respect to which a deduction was allowed under section 2055 or 2522 (as the case may be).

[(4) COORDINATION WITH SUBSECTION (D).—Under regulations, appropriate adjustments shall be made in the application of subsection (d) to take into account the provisions of this subsection.

[(f) SPECIAL RULES FOR CERTAIN INTER VIVOS TRANSFERS.—Except as provided in regulations—

[(1) IN GENERAL.—For purposes of determining the inclusion ratio, if—

[(A) an individual makes an inter vivos transfer of property, and

[(B) the value of such property would be includible in the gross estate of such individual under chapter 11 if such individual died immediately after making such transfer (other than by reasonof section 2035), any allocation of GST exemption to such property shall not be made before the close of the estate tax inclusion period (and the value of such property shall be determined under paragraph (2)). If such transfer is a direct skip, such skip shall be treated as occurring as of the close of the estate tax inclusion period.

[(2) VALUATION.—In the case of any property to which paragraph (1) applies, the value of such property shall be—

[(A) if such property is includible in the gross estate of the transferor (other than by reason ofsection 2035), its value for purposes of chapter 11, or

[(B) if subparagraph (A) does not apply, its value as of the close of the estate tax inclusion period (or, if any allocation of GST exemption to such property is not made on a timely filed gift tax return for the calendar year in which

such period ends, its value as of the time such allocation is filed with the Secretary).

[(3) ESTATE TAX INCLUSION PERIOD.—For purposes of this subsection, the term "estate tax inclusion period" means any period after the transfer described in paragraph (1) during which the value of the property involved in such transfer would be includible in the gross estate of the transferor under chapter 11 if he died. Such period shall in no event extend beyond the earlier of—

[(A) the date on which there is a generation-skipping transfer with respect to such property, or

[(B) the date of the death of the transferor.

[(4) TREATMENT OF SPOUSE.—Except as provided in regulations, any reference in this subsection to an individual or transferor shall be treated as including a reference to the spouse of such individual or transferor.

[(5) COORDINATION WITH SUBSECTION (D).—Under regulations, appropriate adjustments shall be made in the application of subsection (d) to take into account the provisions of this subsection.

[Subchapter F—Other Definitions and Special Rules

[SEC. 2651. GENERATION ASSIGNMENT.

[(a) IN GENERAL.—For purposes of this chapter, the generation to which any person (other than the transferor) belongs shall be determined in accordance with the rules set forth in this section.

[(b) LINEAL DESCENDANTS.—

[(1) IN GENERAL.—An individual who is a lineal descendant of a grandparent of the transferor shall be assigned to that generation which results from comparing the number of generations between the grandparent and such individual with the number of generations between the grandparent and the transferor.

[(2) ON SPOUSE'S SIDE.—An individual who is a lineal descendant of a grandparent of a spouse (or former spouse) of the transferor (other than such spouse) shall be assigned to that generation which results from comparing the number of generations between such grandparent and such individual with the number of generations between such grandparent and such spouse.

[(3) TREATMENT OF LEGAL ADOPTIONS, ETC.—For purposes of this subsection—

[(A) LEGAL ADOPTIONS.—A relationship by legal adoption shall be treated as a relationship by blood.

[(B) RELATIONSHIPS BY HALF-BLOOD.—A relationship by the half-blood shall be treated as a relationship of the whole-blood.

[(c) MARITAL RELATIONSHIP.—

[(1) MARRIAGE TO TRANSFEROR.—An individual who has been married at any time to the transferor shall be assigned to thetransferor's generation.

[(2) MARRIAGE TO OTHER LINEAL DESCENDANTS.—An individual who has been married at any time to an individual described in subsection (b) shall be assigned to the generation of the individual so described.

[(d) PERSONS WHO ARE NOT LINEAL DESCENDANTS.—An individual who is not assigned to a generation by reason of the foregoing provisions of this section shall be assigned to a generation on the basis of the date of such individual's birth with—

[(1) an individual born not more than 12-1/2 years after the date of the birth of the transferor assigned to the transferor's generation,

[(2) an individual born more than 12-1/2 years but not more than 37-1/2 years after the date of the birth of the transferor assigned to the first generation younger than the transferor, and

[(3) similar rules for a new generation every 25 years.

[(e) SPECIAL RULE FOR PERSONS WITH A DECEASED PARENT.—

[(1) IN GENERAL.—For purposes of determining whether any transfer is a generation-skipping transfer, if—

[(A) an individual is a descendant of a parent of the transferor (or the transferor's spouse or former spouse), and

[(B) such individual's parent who is a lineal descendant of the parent of the transferor (or the transferor's spouse or former spouse) is dead at the time the transfer (from which an interest of such individual is established or derived) is subject to a tax imposed by chapter 11 or 12 upon the transferor (and if there shall be more than 1 such time, then at the earliest such time), such individual shall be treated as if such individual were a member of the generation which is 1 generation below the lower of the transferor's generation or the generation assignment of the youngest living ancestor of such individual who is also a descendant of the parent of the transferor (or the transferor's spouse or former spouse), and the generation assignment of any descendant of such individual shall be adjusted accordingly.

[(2) LIMITED APPLICATION OF SUBSECTION TO COLLATERAL HEIRS.—This subsection shall not apply with respect to a transfer to any individual who is not a lineal descendant of the transferor (or the transferor's spouse or former spouse) if, at the time of the transfer, such transferor has any living lineal descendant.

[(f) OTHER SPECIAL RULES.—

[(1) INDIVIDUALS ASSIGNED TO MORE THAN 1 GENERATION.—Except as provided in regulations, an individual who, but for this subsection, would be assigned to more than 1 generation shall be assigned to the youngest such generation.

[(2) INTERESTS THROUGH ENTITIES.—Except as provided in paragraph (3), if an estate, trust, partnership, corporation, or other entity has an interest in property, each individual having a beneficial interest in such entity shall be treated as having

an interest in such property and shall be assigned to a generation under the foregoing provisions of this subsection.

[(3) TREATMENT OF CERTAIN CHARITABLE ORGANIZATIONS AND GOVERNMENTAL ENTITIES.—Any—

[(A) organization described in section 511(a)(2),

[(B) charitable trust described in section 511(b)(2), and

[(C) governmental entity,

shall be assigned to the transferor's generation.

[SEC. 2652. OTHER DEFINITIONS.

[(a) TRANSFEROR.—For purposes of this chapter—

[(1) IN GENERAL.—Except as provided in this subsection or section 2653(a), the term "transferor" means—

[(A) in the case of any property subject to the tax imposed by chapter 11, the decedent, and

[(B) in the case of any property subject to the tax imposed by chapter 12, the donor.

An individual shall be treated as transferring any property with respect to which such individual is the transferor.

[(2) GIFT-SPLITTING BY MARRIED COUPLES.—If, under section 2513, one-half of a gift is treated as made by an individual and one-half of such gift is treated as made by the spouse of such individual, such gift shall be so treated for purposes of this chapter.

[(3) SPECIAL ELECTION FOR QUALIFIED TERMINABLE INTEREST PROPERTY.—In the case of—

[(A) any trust with respect to which a deduction is allowed to the decedent under section 2056 by reason of subsection (b)(7) thereof, and

[(B) any trust with respect to which a deduction to the donor spouse is allowed under section 2523 by reason of subsection (f) thereof, the estate of the decedent or the donor spouse, as the case may be, may elect to treat all of the property in such trust for purposes of this chapter as if the election to be treated as qualified terminable interest property had not been made.

[(b) TRUST AND TRUSTEE.—

[(1) TRUST.—The term "trust" includes any arrangement (other than an estate) which, although not a trust, has substantially the same effect as a trust.

[(2) TRUSTEE.—In the case of an arrangement which is not a trust but which is treated as a trust under this subsection, the term "trustee" shall mean the person in actual or constructive possession of the property subject to such arrangement.

[(3) EXAMPLES.—Arrangements to which this subsection applies include arrangements involving life estates and remainders, estates for years, and insurance and annuity contracts.

[(c) INTEREST.—

[(1) IN GENERAL.—A person has an interest in property held in trust if (at the time the determination is made) such person—

[(A) has a right (other than a future right) to receive income or corpus from the trust,

[(B) is a permissible current recipient of income or corpus from the trust and is not described in section 2055(a), or

[(C) is described in section 2055(a) and the trust is—

[(i) a charitable remainder annuity trust,

[(ii) a charitable remainder unitrust within the meaning of section 664, or

[(iii) a pooled income fund within the meaning of section 642(c)(5).

[(2) CERTAIN INTERESTS DISREGARDED.—For purposes of paragraph (1), an interest which is used primarily to postpone or avoid any tax imposed by this chapter shall be disregarded.

[(3) CERTAIN SUPPORT OBLIGATIONS DISREGARDED.—The fact that income or corpus of the trust may be used to satisfy an obligation of support arising under State law shall be disregarded in determining whether a person has an interest in the trust, if—

[(A) such use is discretionary, or

[(B) such use is pursuant to the provisions of any State law substantially equivalent to the Uniform Gifts to Minors Act.

[(d) EXECUTOR.—For purposes of this chapter, the term "executor" has the meaning given such term by section 2203.

[SEC. 2653. TAXATION OF MULTIPLE SKIPS.

[(a) GENERAL RULE.—For purposes of this chapter, if—

[(1) there is a generation-skipping transfer of any property, and

[(2) immediately after such transfer such property is held in trust,

for purposes of applying this chapter (other than section 2651) to subsequent transfers from the portion of such trust attributable to such property, the trust will be treated as if the transferor of such property were assigned to the first generation above the highest generation of any person who has an interest in such trust immediately after the transfer.

[(b) TRUST RETAINS INCLUSION RATIO.—

[(1) IN GENERAL.—Except as provided in paragraph (2), the provisions of subsection (a) shall not affect the inclusion ratio determined with respect to any trust. Under regulations prescribed by the Secretary, notwithstanding the preceding sentence, proper adjustment shall be made to the inclusion ratio with respect to such trust to take into account any tax under this chapter borne by such trust which is imposed by this chapter on the transfer described in subsection (a).

[(2) SPECIAL RULE FOR POUR-OVER TRUST.—

[(A) IN GENERAL.—If the generation-skipping transfer referred to in subsection (a) involves the transfer of property from 1 trust to another trust (hereinafter in this paragraph referred to as the "pour-over trust"), the inclusion ratio for the pour-over trust shall be determined by treating the nontax portion of such distribution as if it were a part of a GST exemption allocated to such trust.

[(B) NONTAX PORTION.—For purposes of subparagraph (A), the nontax portion of any distribution is the amount of such distribution multiplied by the applicable fraction which applies to such distribution.

[SEC. 2654. SPECIAL RULES.

[(a) BASIS ADJUSTMENT.—

[(1) IN GENERAL.—Except as provided in paragraph (2), if property is transferred in a generation-skipping transfer, the basis of such property shall be increased (but not above the fair market value of such property) by an amount equal to that portion of the tax imposed by section 2601 (computed without regard to section 2604) with respect to the transfer which is attributable to the excess of the fair market value of such property over its adjusted basis immediately before the transfer. The preceding shall be applied after any basis adjustment under section 1015 with respect to the transfer.

[(2) CERTAIN TRANSFERS AT DEATH.—If property is transferred in a taxable termination which occurs at the same time as and as a result of the death of an individual, the basis of such property shall be adjusted in a manner similar to the manner provided under section 1014(a); except that, if the inclusion ratio with respect to such property is less than 1, any increase or decrease in basis shall be limited by multiplying such increase or decrease (as the case may be) by the inclusion ratio.

[(b) CERTAIN TRUSTS TREATED AS SEPARATE TRUSTS.—For purposes of this chapter—

[(1) the portions of a trust attributable to transfers from different transferors shall be treated as separate trusts, and

[(2) substantially separate and independent shares of different beneficiaries in a trust shall be treated as separate trusts.

Except as provided in the preceding sentence, nothing in this chapter shall be construed as authorizing a single trust to be treated as 2 or more trusts. For purposes of this subsection, a trust shall be treated as part of an estate during any period that the trust is so treated under section 645.

[(c) DISCLAIMERS.—For provisions relating to the effect of a qualified disclaimer for purposes of this chapter, see section 2518.

[(d) LIMITATION ON PERSONAL LIABILITY OF TRUSTEE.—A trustee shall not be personally liable for any increase in the tax imposed by section 2601 which is attributable to the fact that—

[(1) section 2642(c) (relating to exemption of certain nontaxable gifts) does not apply to a transfer to the trust which was made during the life of the transferor and for which a gift tax return was not filed, or

[(2) the inclusion ratio with respect to the trust is greater than the amount of such ratio as computed on the basis of the return on which was made (or was deemed made) an allocation of the GST exemption to property transferred to such trust.

The preceding sentence shall not apply if the trustee has knowledge of facts sufficient reasonably to conclude that a gift tax return was required to be filed or that the inclusion ratio was erroneous.

[Subchapter G—Administration

[SEC. 2661. ADMINISTRATION.

[Insofar as applicable and not inconsistent with the provisions of this chapter—

[(1) except as provided in paragraph (2), all provisions of subtitle F (including penalties) applicable to the gift tax, to chapter 12, or to section 2501, are hereby made applicable in respect of the generation-skipping transfer tax, this chapter, or section 2601, as the case may be, and

[(2) in the case of a generation-skipping transfer occurring at the same time as and as a result of the death of an individual, all provisions of subtitle F (including penalties) applicable to the estate tax, to chapter 11, or to section 2001 are hereby made applicable in respect of the generation-skipping transfer tax, this chapter, or section 2601 (as the case may be).

[SEC. 2662. RETURN REQUIREMENTS.

[(a) IN GENERAL.—The Secretary shall prescribe by regulations the person who is required to make the return with respect to the tax imposed by this chapter and the time by which any such return must be filed. To the extent practicable, such regulations shall provide that—

[(1) the person who is required to make such return shall be the person liable under section 2603(a) for payment of such tax, and

[(2) the return shall be filed—

[(A) in the case of a direct skip (other than from a trust), on or before the date on which an estate or gift tax return is required to be filed with respect to the transfer, and

[(B) in all other cases, on or before the 15th day of the 4th month after the close of the taxable year of the person required to make such return in which such transfer occurs.

[(b) INFORMATION RETURNS.—The Secretary may by regulations require a return to be filed containing such information as he determines to be necessary for purposes of this chapter.

[SEC. 2663. REGULATIONS.

[The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this chapter, including—

[(1) such regulations as may be necessary to coordinate the provisions of this chapter with the recapture tax imposed under section 2032A(c),

[(2) regulations (consistent with the principles of chapters 11 and 12) providing for the application of this chapter in the case of transferors who are nonresidents not citizens of the United States, and

[(3) regulations providing for such adjustments as may be necessary to the application of this chapter in the case of any arrangement which, although not a trust, is treated as a trust under section 2652(b).

[CHAPTER 14—SPECIAL VALUATION RULES

[SEC. 2701. SPECIAL VALUATION RULES IN CASE OF TRANSFERS OF CERTAIN INTERESTS IN CORPORATIONS OR PARTNERSHIPS.

[(a) VALUATION RULES.—

[(1) IN GENERAL.—Solely for purposes of determining whether a transfer of an interest in a corporation or partnership to (or for the benefit of) a member of the transferor's family is a gift (and the value of such transfer), the value of any right—

[(A) which is described in subparagraph (A) or (B) of subsection (b)(1), and

[(B) which is with respect to any applicable retained interest that is held by the transferor or an applicable family member immediately after the transfer, shall be determined under paragraph (3). This paragraph shall not apply to the transfer of any interest for which market quotations are readily available (as of the date of transfer) on an established securities market.

[(2) EXCEPTIONS FOR MARKETABLE RETAINED INTERESTS, ETC.—Paragraph (1) shall not apply to any right with respect to an applicable retained interest if—

[(A) market quotations are readily available (as of the date of the transfer) for such interest on an established securities market,

[(B) such interest is of the same class as the transferred interest, or

[(C) such interest is proportionally the same as the transferred interest, without regard to nonlapsing differences in voting power (or, for a partnership, nonlapsing differences with respect to management and limitations on liability).

Subparagraph (C) shall not apply to any interest in a partnership if the transferor or an applicable family member has the right to alter the liability of the transferee of the transferred property. Except as provided by the Secretary, any difference described in subparagraph (C) which lapses by reason of any Federal or State law shall be treated as a nonlapsing difference for purposes of such subparagraph.

[(3) VALUATION OF RIGHTS TO WHICH PARAGRAPH (1) APPLIES.—

[(A) IN GENERAL.—The value of any right described in paragraph (1), other than a distribution right which consists of a right to receive a qualified payment, shall be treated as being zero.

[(B) VALUATION OF CERTAIN QUALIFIED PAYMENTS.—If—

[(i) any applicable retained interest confers a distribution right which consists of the right to a qualified payment, and

[(ii) there are 1 or more liquidation, put, call, or conversion rights with respect to such interest, the value of all such rights shall be determined as if each liquidation, put, call, or conversion right were exercised in the manner resulting in the lowest value being determined for all such rights.

[(C) VALUATION OF QUALIFIED PAYMENTS WHERE NO LIQUIDATION, ETC. RIGHTS.—In the case of an applicable retained interest which is described in subparagraph (B)(i) but not subparagraph (B)(ii), the value of the distribution right shall be determined without regard to this section.

[(4) MINIMUM VALUATION OF JUNIOR EQUITY.—

[(A) IN GENERAL.—In the case of a transfer described in paragraph (1) of a junior equity interest in a corporation or partnership, such interest shall in no event be valued at an amount less than the value which would be determined if the total value of all of the junior equity interests in the entity were equal to 10 percent of the sum of—

[(i) the total value of all of the equity interests in such entity, plus

[(ii) the total amount of indebtedness of such entity to the transferor (or an applicable family member).

[(B) DEFINITIONS.—For purposes of this paragraph—

[(i) JUNIOR EQUITY INTEREST.—The term "junior equity interest" means common stock or, in the case of a partnership, any partnership interest under which the rights as to income and capital (or, to the extent provided in regulations, the rights as to either income or capital) are junior to the rights of all other classes of equity interests.

[(ii) EQUITY INTEREST.—The term "equity interest" means stock or any interest as a partner, as the case may be.

[(b) APPLICABLE RETAINED INTERESTS.—For purposes of this section—

[(1) IN GENERAL.—The term "applicable retained interest" means any interest in an entity with respect to which there is—

[(A) a distribution right, but only if, immediately before the transfer described in subsection (a)(1), the transferor and applicable family members hold (after application of subsection (e)(3)) control of the entity, or

[(B) a liquidation, put, call, or conversion right.

[(2) CONTROL.—For purposes of paragraph (1)—

[(A) CORPORATIONS.—In the case of a corporation, the term "control" means the holding of at least 50 percent (by vote or value) of the stock of the corporation.

[(B) PARTNERSHIPS.—In the case of a partnership, the term "control" means—

[(i) the holding of at least 50 percent of the capital or profits interests in the partnership, or

[(ii) in the case of a limited partnership, the holding of any interest as a general partner.

[(C) APPLICABLE FAMILY MEMBER.—For purposes of this subsection, the term "applicable family member" includes

any lineal descendant of any parent of the transferor or the transferor's spouse.

[(c) DISTRIBUTION AND OTHER RIGHTS; QUALIFIED PAYMENTS.—For purposes of this section—

[(1) DISTRIBUTION RIGHT.—

[(A) IN GENERAL.—The term "distribution right" means—

[(i) a right to distributions from a corporation with respect to its stock, and

[(ii) a right to distributions from a partnership with respect to a partner's interest in the partnership.

[(B) EXCEPTIONS.—The term "distribution right" does not include—

[(i) a right to distributions with respect to any interest which is junior to the rights of the transferred interest,

[(ii) any liquidation, put, call, or conversion right, or

[(iii) any right to receive any guaranteed payment described in section 707(c) of a fixed amount.

[(2) LIQUIDATION, ETC., RIGHTS.—

[(A) IN GENERAL.—The term "liquidation, put, call, or conversion right" means any liquidation, put, call, or conversion right, or any similar right, the exercise or nonexercise of which affects the value of the transferred interest.

[(B) EXCEPTION FOR FIXED RIGHTS.—

[(i) IN GENERAL.—The term "liquidation, put, call, or conversion right" does not include any right which must be exercised at a specific time and at a specific amount.

[(ii) TREATMENT OF CERTAIN RIGHTS.—If a right is assumed to be exercised in a particular manner under subsection (a)(3)(B), such right shall be treated as so exercised for purposes of clause (i).

[(C) EXCEPTION FOR CERTAIN RIGHTS TO CONVERT.—The term "liquidation, put, call, or conversion right" does not include any right which—

[(i) is a right to convert into a fixed number (or a fixed percentage) of shares of the same class of stock in a corporation as the transferred stock in such corporation under subsection (a)(1) (or stock which would be of the same class but for nonlapsing differences in voting power),

[(ii) is nonlapsing,

[(iii) is subject to proportionate adjustments for splits, combinations, reclassifications, and similar changes in the capital stock, and

[(iv) is subject to adjustments similar to the adjustments under subsection (d) for accumulated but unpaid distributions.

A rule similar to the rule of the preceding sentence shall apply for partnerships.

[(3) QUALIFIED PAYMENT.—

[(A) IN GENERAL.—Except as otherwise provided in this paragraph, the term "qualified payment" means any dividend payable on a periodic basis under any cumulative

preferred stock (or a comparable payment under any partnership interest) to the extent that such dividend (or comparable payment) is determined at a fixed rate.

[(B) TREATMENT OF VARIABLE RATE PAYMENTS.—For purposes of subparagraph (A), a payment shall be treated as fixed as to rate if such payment is determined at a rate which bears a fixed relationship to a specified market interest rate.

[(C) ELECTION.—

[(i) IN GENERAL.—Payments under any interest held by a transferor which (without regard to this subparagraph) are qualified payments shall be treated as qualified payments unless the transferor elects not to treat such payments as qualified payments. Payments described in the preceding sentence which are held by an applicable family member shall be treated as qualified payments only if such member elects to treat such payments as qualified payments.

[(ii) ELECTION TO HAVE INTEREST AS QUALIFIED PAYMENT.—A transferor or applicable family member holding any distribution right which (without regard to this subparagraph) is not a qualified payment may elect to treat such right as a qualified payment, to be paid in the amounts and at the times specified in such election. The preceding sentence shall apply only to the extent that the amounts and times so specified are not inconsistent with the underlying legal instrument giving rise to such right.

[(iii) ELECTION IRREVOCABLE.—Any election under this subparagraph with respect to an interest shall, once made, be irrevocable.

[(d) TRANSFER TAX TREATMENT OF CUMULATIVE BUT UNPAID DISTRIBUTIONS.—

[(1) IN GENERAL.—If a taxable event occurs with respect to any distribution right to which subsection (a)(3)(B) or (C) applied, the following shall be increased by the amount determined under paragraph (2):

[(A) The taxable estate of the transferor in the case of a taxable event described in paragraph (3)(A)(i).

[(B) The taxable gifts of the transferor for the calendar year in which the taxable event occurs in the case of a taxable event described in paragraph (3)(A)(ii) or (iii).

[(2) AMOUNT OF INCREASE.—

[(A) IN GENERAL.—The amount of the increase determined under this paragraph shall be the excess (if any) of—

[(i) the value of the qualified payments payable during the period beginning on the date of the transfer under subsection (a)(1) and ending on the date of the taxable event determined as if—

[(I) all such payments were paid on the date payment was due, and

[(II) all such payments were reinvested by the transferor as of the date of payment at a yield equal to the discount rate used in determining the

value of the applicable retained interest described in subsection (a)(1), over

[(ii) the value of such payments paid during such period computed under clause (i) on the basis of the time when such payments were actually paid.

[(B) LIMITATION ON AMOUNT OF INCREASE.—

[(i) IN GENERAL.—The amount of the increase under subparagraph (A) shall not exceed the applicable percentage of the excess (if any) of—

[(I) the value (determined as of the date of the taxable event) of all equity interests in the entity which are junior to the applicable retained interest, over

[(II) the value of such interests (determined as of the date of the transfer to which subsection (a)(1) applied).

[(ii) APPLICABLE PERCENTAGE.—For purposes of clause (i), the applicable percentage is the percentage determined by dividing—

[(I) the number of shares in the corporation held (as of the date of the taxable event) by the transferor which are applicable retained interests of the same class, by

[(II) the total number of shares in such corporation (as of such date) which are of the same class as the class described in subclause (I).

A similar percentage shall be determined in the case of interests in a partnership.

[(iii) DEFINITION.—For purposes of this subparagraph, the term "equity interest" has the meaning given such term by subsection (a)(4)(B).

[(C) GRACE PERIOD.—For purposes of subparagraph (A), any payment of any distribution during the 4-year period beginning on its due date shall be treated as having been made on such due date.

[(3) TAXABLE EVENTS.—For purposes of this subsection—

[(A) IN GENERAL.—The term "taxable event" means any of the following:

[(i) The death of the transferor if the applicable retained interest conferring the distribution right is includible in the estate of the transferor.

[(ii) The transfer of such applicable retained interest.

[(iii) At the election of the taxpayer, the payment of any qualified payment after the period described in paragraph (2)(C), but only with respect to such payment.

[(B) EXCEPTION WHERE SPOUSE IS TRANSFEREE.—

[(i) DEATHTIME TRANSFERS.—Subparagraph (A)(i) shall not apply to any interest includible in the gross estate of the transferor if a deduction with respect to such interest is allowable under section 2056 or 2106(a)(3).

[(ii) LIFETIME TRANSFERS.—A transfer to the spouse of the transferor shall not be treated as a taxable

event under subparagraph (A)(ii) if such transfer does not result in a taxable gift by reason of—

[(I) any deduction allowed under section 2523, or the exclusion under section 2503(b), or

[(II) consideration for the transfer provided by the spouse.

[(iii) SPOUSE SUCCEEDS TO TREATMENT OF TRANSFEROR.—If an event is not treated as a taxable event by reason of this subparagraph, the transferee spouse or surviving spouse (as the case may be) shall be treated in the same manner as the transferor in applying this subsection with respect to the interest involved.

[(4) SPECIAL RULES FOR APPLICABLE FAMILY MEMBERS.—

[(A) FAMILY MEMBER TREATED IN SAME MANNER AS TRANSFEROR.—For purposes of this subsection, an applicable family member shall be treated in the same manner as the transferor with respect to any distribution right retained by such family member to which subsection (a)(3)(B) or (C) applied.

[(B) TRANSFER TO APPLICABLE FAMILY MEMBER.—In the case of a taxable event described in paragraph (3)(A)(ii) involving the transfer of an applicable retained interest to an applicable family member (other than the spouse of the transferor), the applicable family member shall be treated in the same manner as the transferor in applying this subsection to distributions accumulating with respect to such interest after such taxable event.

[(C) TRANSFER TO TRANSFERORS.—In the case of a taxable event described in paragraph (3)(A)(ii) involving a transfer of an applicable retained interest from an applicable family member to a transferor, this subsection shall continue to apply to the transferor during any period the transferor holds such interest.

[(5) TRANSFER TO INCLUDE TERMINATION.—For purposes of this subsection, any termination of an interest shall be treated as a transfer.

[(e) OTHER DEFINITIONS AND RULES.—For purposes of this section—

[(1) MEMBER OF THE FAMILY.—The term "member of the family" means, with respect to any transferor—

[(A) the transferor's spouse,

[(B) a lineal descendant of the transferor or the transferor's spouse, and

[(C) the spouse of any such descendant.

[(2) APPLICABLE FAMILY MEMBER.—The term "applicable family member" means, with respect to any transferor—

[(A) the transferor's spouse,

[(B) an ancestor of the transferor or the transferor's spouse, and

[(C) the spouse of any such ancestor.

[(3) ATTRIBUTION OF INDIRECT HOLDINGS AND TRANSFERS.—An individual shall be treated as holding any interest to the extent such interest is held indirectly by such individual through a corporation, partnership, trust, or other entity. If

any individual is treated as holding any interest by reason of the preceding sentence, any transfer which results in such interest being treated as no longer held by such individual shall be treated as a transfer of such interest.

[(4) EFFECT OF ADOPTION.—A relationship by legal adoption shall be treated as a relationship by blood.

[(5) CERTAIN CHANGES TREATED AS TRANSFERS.—Except as provided in regulations, a contribution to capital or a redemption, recapitalization, or other change in the capital structure of a corporation or partnership shall be treated as a transfer of an interest in such entity to which this section applies if the taxpayer or an applicable family member—

[(A) receives an applicable retained interest in such entity pursuant to such transaction, or

[(B) under regulations, otherwise holds, immediately after such transaction, an applicable retained interest in such entity.

This paragraph shall not apply to any transaction (other than a contribution to capital) if the interests in the entity held by the transferor, applicable family members, and members of the transferor's family before and after the transaction are substantially identical.

[(6) ADJUSTMENTS.—Under regulations prescribed by the Secretary, if there is any subsequent transfer, or inclusion in the gross estate, of any applicable retained interest which was valued under the rules of subsection (a), appropriate adjustments shall be made for purposes of chapter 11, 12, or 13 to reflect the increase in the amount of any prior taxable gift made by the transferor or decedent by reason of such valuation or to reflect the application of subsection (d).

[(7) TREATMENT AS SEPARATE INTERESTS.—The Secretary may by regulation provide that any applicable retained interest shall be treated as 2 or more separate interests for purposes of this section.

[SEC. 2702. SPECIAL VALUATION RULES IN CASE OF TRANSFERS OF INTERESTS IN TRUSTS.

[(a) VALUATION RULES.—

[(1) IN GENERAL.—Solely for purposes of determining whether a transfer of an interest in trust to (or for the benefit of) a member of the transferor's family is a gift (and the value of such transfer), the value of any interest in such trust retained by the transferor or any applicable family member (as defined in section 2701(e)(2)) shall be determined as provided in paragraph (2).

[(2) VALUATION OF RETAINED INTERESTS.—

[(A) IN GENERAL.—The value of any retained interest which is not a qualified interest shall be treated as being zero.

[(B) VALUATION OF QUALIFIED INTEREST.—The value of any retained interest which is a qualified interest shall be determined under section 7520.

[(3) EXEMPTIONS.—

[(A) IN GENERAL.—This subsection shall not apply to any transfer—

[(i) if such transfer is an incomplete gift,

[(ii) if such transfer involves the transfer of an interest in trust all the property in which consists of a residence to be used as a personal residence by persons holding term interests in such trust, or

[(iii) to the extent that regulations provide that such transfer is not inconsistent with the purposes of this section.

[(B) INCOMPLETE GIFT.—For purposes of subparagraph (A), the term "incomplete gift" means any transfer which would not be treated as a gift whether or not consideration was received for such transfer.

[(b) QUALIFIED INTEREST.—For purposes of this section, the term "qualified interest" means—

[(1) any interest which consists of the right to receive fixed amounts payable not less frequently than annually,

[(2) any interest which consists of the right to receive amounts which are payable not less frequently than annually and are a fixed percentage of the fair market value of the property in the trust (determined annually), and

[(3) any noncontingent remainder interest if all of the other interests in the trust consist of interests described in paragraph (1) or (2).

[(c) CERTAIN PROPERTY TREATED AS HELD IN TRUST.—For purposes of this section—

[(1) IN GENERAL.—The transfer of an interest in property with respect to which there is 1 or more term interests shall be treated as a transfer of an interest in a trust.

[(2) JOINT PURCHASES.—If 2 or more members of the same family acquire interests in any property described in paragraph (1) in the same transaction (or a series of related transactions), the person (or persons) acquiring the term interests in such property shall be treated as having acquired the entire property and then transferred to the other persons the interests acquired by such other persons in the transaction (or series of transactions). Such transfer shall be treated as made in exchange for the consideration (if any) provided by such other persons for the acquisition of their interests in such property.

[(3) TERM INTEREST.—The term "term interest" means—

[(A) a life interest in property, or

[(B) an interest in property for a term of years.

[(4) VALUATION RULE FOR CERTAIN TERM INTERESTS.—If the nonexercise of rights under a term interest in tangible property would not have a substantial effect on the valuation of the remainder interest in such property—

[(A) subparagraph (A) of subsection (a)(2) shall not apply to such term interest, and

[(B) the value of such term interest for purposes of applying subsection (a)(1) shall be the amount which the holder of the term interest establishes as the amount for which such interest could be sold to an unrelated third party.

[(d) TREATMENT OF TRANSFERS OF INTERESTS IN PORTION OF TRUST.—In the case of a transfer of an income or remainder interest with respect to a specified portion of the property in a trust,

only such portion shall be taken into account in applying this section to such transfer.

[(e) MEMBER OF THE FAMILY.—For purposes of this section, the term "member of the family" shall have the meaning given suchterm by section 2704(c)(2).

[SEC. 2703. CERTAIN RIGHTS AND RESTRICTIONS DISREGARDED.

[(a) GENERAL RULE.—For purposes of this subtitle, the value of any property shall be determined without regard to—

[(1) any option, agreement, or other right to acquire or use the property at a price less than the fair market value of the property (without regard to such option, agreement, or right), or

[(2) any restriction on the right to sell or use such property.

[(b) EXCEPTIONS.—Subsection (a) shall not apply to any option, agreement, right, or restriction which meets each of the following requirements:

[(1) It is a bona fide business arrangement.

[(2) It is not a device to transfer such property to members of the decedent's family for less than full and adequate consideration in money or money's worth.

[(3) Its terms are comparable to similar arrangements entered into by persons in an arms' length transaction.

[SEC. 2704. TREATMENT OF CERTAIN LAPSING RIGHTS AND RESTRICTIONS.

[(a) TREATMENT OF LAPSED VOTING OR LIQUIDATION RIGHTS.—

[(1) IN GENERAL.—For purposes of this subtitle, if—

[(A) there is a lapse of any voting or liquidation right in a corporation or partnership, and

[(B) the individual holding such right immediately before the lapse and members of such individual's family hold, both before and after the lapse, control of the entity, such lapse shall be treated as a transfer by such individual by gift, or a transfer which is includible in the gross estate of the decedent, whichever is applicable, in the amount determined under paragraph (2).

[(2) AMOUNT OF TRANSFER.—For purposes of paragraph (1), the amount determined under this paragraph is the excess (if any) of—

[(A) the value of all interests in the entity held by the individual described in paragraph (1) immediately before the lapse (determined as if the voting and liquidation rights were nonlapsing), over

[(B) the value of such interests immediately after the lapse.

[(3) SIMILAR RIGHTS.—The Secretary may by regulations apply this subsection to rights similar to voting and liquidation rights.

[(b) CERTAIN RESTRICTIONS ON LIQUIDATION DISREGARDED.—

[(1) IN GENERAL.—For purposes of this subtitle, if—

[(A) there is a transfer of an interest in a corporation or partnership to (or for the benefit of) a member of the transferor's family, and

[(B) the transferor and members of the transferor's family hold, immediately before the transfer, control of the en-

tity, any applicable restriction shall be disregarded in determining the value of the transferred interest.

[(2) APPLICABLE RESTRICTION.—For purposes of this subsection, the term "applicable restriction" means any restriction—

[(A) which effectively limits the ability of the corporation or partnership to liquidate, and

[(B) with respect to which either of the following applies:

[(i) The restriction lapses, in whole or in part, after the transfer referred to in paragraph (1).

[(ii) The transferor or any member of the transferor's family, either alone or collectively, has the right after such transfer to remove, in whole or in part, the restriction.

[(3) EXCEPTIONS.—The term "applicable restriction" shall not include—

[(A) any commercially reasonable restriction which arises as part of any financing by the corporation or partnership with a person who is not related to the transferor or transferee, or a member of the family of either, or

[(B) any restriction imposed, or required to be imposed, by any Federal or State law.

[(4) OTHER RESTRICTIONS.—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.

[(c) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

[(1) CONTROL.—The term "control" has the meaning given such term by section 2701(b)(2).

[(2) MEMBER OF THE FAMILY.—The term "member of the family" means, with respect to any individual—

[(A) such individual's spouse,

[(B) any ancestor or lineal descendant of such individual or such individual's spouse,

[(C) any brother or sister of the individual, and

[(D) any spouse of any individual described in subparagraph (B) or (C).

[(3) ATTRIBUTION.—The rule of section 2701(e)(3) shall apply for purposes of determining the interests held by any individual.]

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Subtitle D—Miscellaneous Excise Taxes

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CHAPTER 42—PRIVATE FOUNDATIONS & CERTAIN OTHER TAX-EXEMPT ORGANIZATIONS

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Subchapter A—Private Foundations

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SEC. 4947. APPLICATION OF TAXES TO CERTAIN NONEXEMPT TRUSTS.

(a) APPLICATION OF TAX.—

(1) * * *

(2) SPLIT-INTEREST TRUSTS.—In the case of a trust which is not exempt from tax under section 501(a), not all of the unexpired interests in which are devoted to one or more of the purposes described in section 170(c)(2)(B), and which has amounts in trust for which a deduction was allowed under section 170, 545(b)(2), 556(b)(2), 642(c), 2055, 2106(a)(2), or 2522, section 507 (relating to termination of private foundation status), section 508(e) (relating to governing instruments) to the extent applicable to a trust described in this paragraph, section 4941 (relating to taxes on self-dealing), section 4943 (relating to taxes on excess business holdings) except as provided in subsection (b)(3), section 4944 (relating to investments which jeopardize charitable purpose) except as provided in subsection (b)(3), and section 4945 (relating to taxes on taxable expenditures) shall apply as if such trust were a private foundation. This paragraph shall not apply with respect to—

(A) any amounts payable under the terms of such trust to income beneficiaries, unless a deduction was allowed under section 170(f)(2)(B), *642(c),* 2055(e)(2)(B), or 2522(c)(2)(B),

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Subtitle F—Procedure and Administration

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CHAPTER 61—INFORMATION AND RETURNS

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Subchapter A—Returns and Records

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PART II—TAX RETURNS OR STATEMENTS

Subpart A. General requirement.

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[Subpart C. Estate and gift tax returns.]
Subpart C. Returns relating to transfers during life or at death.

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[Subpart C—Estate and Gift Tax Returns

[SEC. 6018. ESTATE TAX RETURNS.

[(a) RETURNS BY EXECUTOR.—

[(1) CITIZENS OR RESIDENTS.—In all cases where the gross estate at the death of a citizen or resident exceeds the applicable exclusion amount in effect under section 2010(c) for the calendar year which includes the date of death, the executor shall make a return with respect to the estate tax imposed by subtitle B.

[(2) NONRESIDENTS NOT CITIZENS OF THE UNITED STATES.—In the case of the estate of every nonresident not a citizen of the United States if that part of the gross estate which is situated in the United States exceeds $60,000, the executor shall make a return with respect to the estate tax imposed by subtitle B.

[(3) ADJUSTMENT FOR CERTAIN GIFTS.—The amount applicable under paragraph (1) and the amount set forth in paragraph (2) shall each be reduced (but not below zero) by the sum of—

[(A) the amount of the adjusted taxable gifts (within the meaning of section 2001(b)) made by the decedent after December 31, 1976, plus

[(B) the aggregate amount allowed as a specific exemption under section 2521 (as in effect before its repeal by the Tax Reform Act of 1976) with respect to gifts made by the decedent after September 8, 1976.

[(b) RETURNS BY BENEFICIARIES.—If the executor is unable to make a complete return as to any part of the gross estate of the decedent, he shall include in his return a description of such part and the name of every person holding a legal or beneficial interest therein. Upon notice from the Secretary such person shall in like manner make a return as to such part of the gross estate.

[SEC. 6019. GIFT TAX RETURNS.

[Any individual who in any calendar year makes any transfer by gift other than—

[(1) a transfer which under subsection (b) or (e) of section 2503 is not to be included in the total amount of gifts for such year,

[(2) a transfer of an interest with respect to which a deduction is allowed under section 2523, or

[(3) a transfer with respect to which a deduction is allowed under section 2522 but only if—

[(A)(i) such transfer is of the donor's entire interest in the property transferred, and

[(ii) no other interest in such property is or has been transferred (for less than adequate and full consideration in money or money's worth) from the donor to a person, or for a use, not described in subsection (a) or (b) of section 2522, or

[(B) such transfer is described in section 2522(d), shall make a return for such year with respect to the gift tax imposed by subtitle B.]

Subpart C—Returns Relating to Transfers During Life or at Death

SEC. 6018. RETURNS RELATING TO LARGE TRANSFERS AT DEATH.

(a) IN GENERAL.—If this section applies to property acquired from a decedent, the executor of the estate of such decedent shall make a return containing the information specified in subsection (c) with respect to such property.

(b) PROPERTY TO WHICH SECTION APPLIES.—

(1) LARGE TRANSFERS.—This section shall apply to all property (other than cash) acquired from a decedent if the fair market value of such property acquired from the decedent exceeds the dollar amount applicable under section 1022(b)(2)(B) (without regard to section 1022(b)(2)(C)).

(2) TRANSFERS OF CERTAIN GIFTS RECEIVED BY DECEDENT WITHIN 3 YEARS OF DEATH.—This section shall apply to any appreciated property acquired from the decedent if—

(A) subsections (b) and (c) of section 1022 do not apply to such property by reason of section 1022(d)(1)(C), and

(B) such property was required to be included on a return required to be filed under section 6019.

(3) NONRESIDENTS NOT CITIZENS OF THE UNITED STATES.—In the case of a decedent who is a nonresident not a citizen of the United States, paragraphs (1) and (2) shall be applied—

(A) by taking into account only—

(i) tangible property situated in the United States, and

(ii) other property acquired from the decedent by a United States person, and

(B) by substituting the dollar amount applicable under section 1022(b)(3) for the dollar amount referred to in paragraph (1).

(4) RETURNS BY TRUSTEES OR BENEFICIARIES.—If the executor is unable to make a complete return as to any property acquired from or passing from the decedent, the executor shall include in the return a description of such property and the name of every person holding a legal or beneficial interest therein. Upon notice from the Secretary such person shall in like manner make a return as to such property.

(c) INFORMATION REQUIRED TO BE FURNISHED.—The information specified in this subsection with respect to any property acquired from the decedent is—

(1) the name and TIN of the recipient of such property,

(2) an accurate description of such property,

(3) the adjusted basis of such property in the hands of the decedent and its fair market value at the time of death,

(4) the decedent's holding period for such property,

(5) sufficient information to determine whether any gain on the sale of the property would be treated as ordinary income,

(6) the amount of basis increase allocated to the property under subsection (b) or (c) of section 1022, and

(7) such other information as the Secretary may by regulations prescribe.

(d) PROPERTY ACQUIRED FROM DECEDENT.—For purposes of this section, section 1022 shall apply for purposes of determining the property acquired from a decedent.

(e) STATEMENTS TO BE FURNISHED TO CERTAIN PERSONS.—Every person required to make a return under subsection (a) shall furnish to each person whose name is required to be set forth in such return (other than the person required to make such return) a written statement showing—

(1) the name, address, and phone number of the person required to make such return, and

(2) the information specified in subsection (c) with respect to property acquired from, or passing from, the decedent to the person required to receive such statement.

The written statement required under the preceding sentence shall be furnished not later than 30 days after the date that the return required by subsection (a) is filed.

SEC. 6019. RETURNS RELATING TO LARGE LIFETIME GIFTS.

(a) IN GENERAL.—If the value of the aggregate gifts of property made by an individual to any United States person during a calendar year exceeds $25,000, such individual shall make a return for such year setting forth—

(1) the name and TIN of the donee,

(2) an accurate description of such property,

(3) the adjusted basis of such property in the hands of the donor at the time of the gift,

(4) the donor's holding period for such property,

(5) sufficient information to determine whether any gain on the sale of the property would be treated as ordinary income, and

(6) such other information as the Secretary may by regulations prescribe.

(b) EXCEPTIONS.—Subsection (a) shall not apply to—

(1) CASH.—Any gift of cash.

(2) GIFTS TO CHARITY.—Any gift to an organization described in section 501(c) and exempt from tax under section 501(a) but only if no interest in the property is held for the benefit of any person other than such an organization.

(3) WAIVER OF CERTAIN PENSION RIGHTS individual waives, before the death of a participant, any survivor benefit, or right to such benefit, under section 401(a)(11) or 417, subsection (a) shall not apply to such waiver.

(4) REPORTING ELSEWHERE.—Any gift required to be reported to the Secretary under any other provision of this title.

(c) STATEMENTS TO BE FURNISHED TO CERTAIN PERSONS.—Every person required to make a return under subsection (a) shall furnish to each person whose name is required to be set forth in such return a written statement showing—

(1) the name, address, and phone number of the person required to make such return, and

(2) the information specified in subsection (a) with respect to property received by the person required to receive such statement.

The written statement required under the preceding sentence shall be furnished on or before January 31 of the year following the cal-

endar year for which the return under subsection (a) was required to be made.

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PART V—TIME FOR FILING RETURNS AND OTHER DOCUMENTS

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SEC. 6075. TIME FOR FILING ESTATE AND GIFT TAX RETURNS.

[(a) ESTATE TAX RETURNS.—Returns made under section 6018(a) (relating to estate taxes) shall be filed within 9 months after the date of the decedent's death.**]**

(a) RETURNS RELATING TO LARGE TRANSFERS AT DEATH.—The return required by section 6018 with respect to a decedent shall be filed with the return of the tax imposed by chapter 1 for the decedent's last taxable year or such later date specified in regulations prescribed by the Secretary.

[(b) GIFT TAX RETURNS.—**]**

(b) RETURNS RELATING TO LARGE LIFETIME GIFTS.—

(1) GENERAL RULE.—Returns made under section 6019 **[**(relating to gift taxes)**]** *(relating to returns relating to large lifetime gifts)* shall be filed on or before the 15th day of April following the close of the calendar year.

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(3) COORDINATION WITH DUE DATE FOR **[**ESTATE TAX RETURN**]** *SECTION 6018 RETURN*.—Notwithstanding paragraphs (1) and (2), the time for filing the return made under section 6019 for the calendar year which includes the date of death of the donor shall not be later than the time (including extensions) for filing the return made under section 6018 **[**(relating to estate tax returns)**]** *(relating to returns relating to large transfers at death)* with respect to such donor.

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CHAPTER 68—ADDITIONS TO THE TAX, ADDITIONAL AMOUNTS, AND ASSESSABLE PENALTIES

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Subchapter B—Assessable Penalties

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PART I—GENERAL PROVISIONS

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SEC. 6716. FAILURE TO FILE INFORMATION WITH RESPECT TO CERTAIN TRANSFERS AT DEATH AND GIFTS.

(a) INFORMATION REQUIRED TO BE FURNISHED TO THE SECRETARY.—Any person required to furnish any information under section 6018 or 6019 who fails to furnish such information on the date prescribed therefor (determined with regard to any extension of time for filing) shall pay a penalty of $10,000 ($500 in the case of information required to be furnished under section 6018(b)(2) or 6019) for each such failure.

(b) INFORMATION REQUIRED TO BE FURNISHED TO BENEFICIARIES.—Any person required to furnish in writing to each person described in section 6018(e) or 6019(c) the information required under such section who fails to furnish such information shall pay a penalty of $50 for each such failure.

(c) REASONABLE CAUSE EXCEPTION.—No penalty shall be imposed under subsection (a) or (b) with respect to any failure if it is shown that such failure is due to reasonable cause.

(d) INTENTIONAL DISREGARD.—If any failure under subsection (a) or (b) is due to intentional disregard of the requirements under sections 6018 and 6019, the penalty under such subsection shall be 5 percent of the fair market value (as of the date of death or, in the case of section 6019, the date of the gift) of the property with respect to which the information is required.

(e) DEFICIENCY PROCEDURES NOT TO APPLY.—Subchapter B of chapter 63 (relating to deficiency procedures for income, estate, gift, and certain excise taxes) shall not apply in respect of the assessment or collection of any penalty imposed by this section.

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CHAPTER 79—DEFINITIONS

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SEC. 7701. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

(1) * * *

* * * * * * *

(47) EXECUTOR.—The term "executor" means the executor or administrator of the decedent, or, if there is no executor or administrator appointed, qualified, and acting within the United States, then any person in actual or constructive possession of any property of the decedent.

* * * * * * *

(n) PURPORTED GIFTS MAY BE DISREGARDED.—For purposes of subtitle A, the Secretary may treat a transfer which purports to be a gift as having never been transferred if, in connection with such transfer—

(1)(A) the transferor (or any person related to or designated by the transferor or such person) has received anything of value in connection with such transfer from the transferee directly or indirectly, or

(B) there is an understanding or expectation that the transferor (or such person) will receive anything of value in connection with such transfer from the transferee directly or indirectly, and

(2) the Secretary determines that such treatment is appropriate to prevent avoidance of tax imposed by subtitle A.

[(n)] *(o)* CROSS REFERENCES.—

(1) * * *

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VII. DISSENTING VIEWS ON H.R. 8, THE DEATH TAX ELIMINATION ACT OF 2001, APRIL 3, 2001

The Republican Members of the Committee were very convincing during the Committee markup when they argued that immediate repeal of estate and gift taxes would be fiscally irresponsible. The revenue estimates provided by the staff of the Joint Committee on Taxation indicate clearly that they were correct. Those estimates indicate that repeal effective on January 1, 2002, would cost $662.2 billion over the next 10 years. The cost approaches $100 billion per year before the end of the 10-year budget window. The estimates show costs increasing in every year, so it is clear that the total cost in the second 10 years would be well in excess of $1 trillion.

The first argument we have with Committee Republicans is that we do not understand why they seem confident that the repeal will be fiscally responsible when it finally takes effect under the Committee bill in the year 2011. The Congressional Budget Office has been clear in stating that its budget projections have very high levels of uncertainty in the later part of the budget window. However, the demographic trends in this country are certain. The Social Security and Medicare Trust Funds will face increasing pressures as the baby boom generation begins to reach retirement age after 2010. The repeal of estate and gift taxes under the Committee bill would finally take effect at that time. In our view, the Committee bill may promise to repeal the "death tax" but it also threatens the imposition of a large "retirement tax" in the form of reduced Medicare benefits and Social Security benefits. We can not support it.

We recognize that there are problems with the current estate and gift taxes. They impose compliance and liquidity burdens that can and should be reduced. The burdens fall more heavily on the less wealthy estates. We believe that relief should be focused on those estates and take effect immediately. Our substitute would repeal immediately the estate tax for over two-thirds of those currently subject to that tax. The tax would be eliminated for approximately 99% of all farms. Our substitute would accomplish this by increasing the estate tax exclusion to $2 million effective January 1, 2002 from its current level of $675,000. For a married couple who does some estate tax planning, our substitute would result in an effective exclusion of $4 million. The substitute would provide further increases in the exclusion, ultimately reaching $2.5 million (effectively $5 million for married couples).

Like our substitute, H.R. 8 (as introduced) would have provided immediate relief to small estates by increasing the exclusion from $675,000 to $1.3 million effective January 1, 2001. However, the Committee-reported bill contains no increase in the exclusion in order to reduce the cost of the bill. The strategy is clear. Immediate increases in the exclusion for small and moderate sized estates might undercut the drive to repeal the tax for the wealthiest seg-

ment of our society and, therefore, will be opposed by proponents of repeal.

The difference in strategy is clear. Under the Democratic substitute, immediate and total repeal would be provided to two-thirds of those currently liable for the tax, leaving only the wealthiest one-half of one percent of our society subject to the tax. Instead of immediate relief, the Committee bill makes an unfunded, nonbinding promise to provide repeal ten years in the future. Small and moderate sized estates are denied immediate relief, in effect held hostage to ensure that the wealthiest receive the full benefit.

Before discussing some of the more technical aspects of the Committee bill, we would like to take this opportunity to point out that Committee action on tax legislation to date already has used virtually all of the $1.6 trillion set aside in the budget resolution for tax reductions over 10 years. President Bush campaigned as a compassionate conservative. The tax agenda so far followed by the House clearly is conservative, large tax reductions to the wealthiest of our society. The compassionate side of the President's tax agenda such as his refundable credit for health insurance expenses and incentives for charitable giving have been ignored.

BURDEN OF TEN-YEAR PHASE-OUT

One of the arguments made by the proponents of repeal involves the burdens of estate tax planning. Those proponents ignore the fact that the 10-year phase-in contained in the Committee bill will result in an increase, not a decrease, in compliance burdens for at least the next 10 years. The complex carryover basis rules that accompany repeal may result in permanent increases in compliance burdens. Every estate tax plan in the country will have to be rewritten at least once in the next 10 years, perhaps many times. The new estate tax plan will be far more complex and much more expensive for the client because there would be total uncertainty as to what would be the law when the individual died.

Some have suggested that estate tax lawyers oppose repeal because it is bad for their business. The opposite is true. The total uncertainty created by the committee bill could create an extraordinary increase in the demand for estate tax lawyers and planners. As in the past, those burdens will be the heaviest for the small and moderate sized estates that would receive immediate repeal of the tax under the Democratic substitute.

INCOME TAX AVOIDANCE

The Joint Committee on Taxation's estimates of the cost of immediate repeal of estate and gift taxes contain a fact that is surprising to most. Their estimate of $662 billion over the next 10 years is $250 billion greater than the amount projected to be collected under the estate and gift tax system over the same period. That $250 billion is due to the potential for income tax avoidance created by the repeal. The cost estimate for the year 2011 indicates that total repeal would cost 180% of the revenues raised under the estate and gift tax system in that year.

The potential for income tax avoidance will have to be addressed or Congress ultimately may be forced to rescind the promised repeal of the estate and gift tax. The Committee bill contains a provi-

sion requiring a Treasury study of the potential income tax avoidance. Until we see the results of that study, there is no assurance that the repeal ever will take effect.

CARRYOVER BASIS

Under current law, individuals inheriting property from a decedent receive a tax basis in that property equal to its fair market value at the time of the decedents death. That basis rule in effect eliminates liability for capital gains tax on the increase in the value of that property that occurred before death. This favorable tax treatment is called "step-up in basis." The Democratic substitute would make no change to those rules.

The Committee bill would impose a new carryover basis regime for property acquired at death. The new rules would limit the current law step up in basis, creating liability for capital gains tax on increases in value before death. The Committee bill attempts to exclude small and moderate sized estates from the new carryover basis rules through a $1.3 million exclusion ($4.3 million for transfers to a surviving spouse). The carryover basis rules contained in the Committee bill are similar in concept to rules that were enacted by the Congress in 1976 and repealed retroactively in 1978.

It is truly ironic that, while the Republicans led the charge for repeal of carryover taxes in 1978, they are quietly slipping the same provision back in to the Internal Revenue Code today. In the process, they are conveniently choosing to ignore their own words of 1978. At hearings on this issue, the ranking Republican on the Ways and Means Committee, Barber Connable, referred to "the kind of complex, make-work stuff we have here [in the Code]." Rep. Frenzel argued that if carryover basis was not repealed, there would be no immediate public outcry, but that "as soon as the effect of this law begins to be felt, then we are going to hear an outcry, but, by that time, all of us perpetrators will also have gone to our great reward."

It is difficult to comment in detail on the new carryover basis rules because of the short time that we have had to analyze the new rules. However, several conclusions are clear.

1. The Democratic substitute retains current law step up in basis rules. Therefore, families with net wealth of less than the exclusion ultimately provided in the Democratic substitute ($2.5 million for single individuals, $5 million for married couples) would receive tax benefits under the Democratic substitute that are the same or larger than those provided under the Committee bill. It is estimated that approximately 99.5% of all decedents will have net wealth of less than the exclusion contained in the Democratic substitute.

2. The Committee bill will be a tax increase on many families when compared to the benefits of the Democratic substitute. There also will be circumstances where the Committee bill will result in an actual tax increase compared to current law. In those circumstance, the potential capital gains tax liability resulting from the carryover basis regime would exceed the benefit from the estate tax repeal. Those circumstances include estates where all of the property of the decedent is transferred to a surviving spouse, and in the case of estates where there is debt-financed property, most often real estate. The potential tax increase on surviving spouses

is recognized in the Committee bill, and there is an attempt to mitigate it by providing a larger exemption from the carryover basis rules. However, we doubt that many Members of the Committee understand that there could be tax increases under the Committee bill where land or other real estate is encumbered by debt in excess of its tax basis. This could occur when a farmer incurs additional debt because of low farm prices or where depreciation reduces the adjusted basis of a building below outstanding mortgage debt. In those circumstances, the additional capital gains tax owed by reason of the carryover basis rules could exceed the tax reduction resulting from the estate tax repeal.

3. It will be very difficult for executors to administer estates under the new rules. They will have to allocate potential income tax liability among the heirs. The executors have a fiduciary responsibility to all of the heirs, but the Committee bill may create circumstances where actions of the executor will create benefits for one category of heirs with resulting tax increases on other categories of heirs.

4. All individuals, regardless of their current wealth, would have to retain records of purchases, sales, depreciation and other factors that may be necessary to comply with the carryover basis rules.

CONCLUSION

We believe that our Democratic substitute provides immediate relief to the compliance and liquidity burdens of the estate tax. Unlike the Committee-reported bill, it does not deny relief to small and moderate sized estates in order to build support for relief to the most wealthy in our society. The following table clearly shows the difference between our approach and the Committee bill. It shows the amount of wealth that a family would have to have before the tax reductions under the Republican bill exceed those under our substitute.

Family Wealth Below Which Democratic Plan Provides Greater Benefit

Year	*Millions of dollars*
2002	27.7
2003	22.3
2004	18.3
2005	15.9
2006	13.6
2007	12.3
2008	10.6
2009	10.0
2010	9.6

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JIM MCDERMOTT.
BEN CARDIN.
WILLIAM J. JEFFERSON.
KAREN L. THURMAN.
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