REPORT OF THE AMERICAN COLLEGE

OF TRUST AND ESTATE COUNSEL

ON PROPOSED IRC SECTION 6166A

Recommendation to Amend Internal Revenue Code to Allow Deferral Treatment for Generation-Skipping Transfer Tax Arising From Taxable Terminations Resulting From Death in Similar Manner to Estate Tax Deferral Currently Allowed Pursuant to Section 6166

I. INTRODUCTION

The American College of Trust and Estate Counsel ("ACTEC") is a non-profit professional association of approximately 2,600 lawyers selected on the basis of professional reputation and ability in the field of trusts and estates. ACTEC does not take positions on matters of tax policy and politics. From time to time, based on the extensive experience that ACTEC members have with estate, gift and generation-skipping transfer taxes, we offer recommendations to improve existing tax laws to more clearly, simply, and fairly implement the policies those laws are intended to serve. This report (the "Report") describes a proposal to enact a new section of the Internal Revenue Code (section 6166A) which would provide deferral treatment for generation-skipping transfer taxes arising from taxable terminations resulting from death similar to that provided for estate taxes under section 6166.[1] The Report has been prepared by members of ACTEC'S Transfer Tax Study Committee and has also been discussed and approved by that Committee.

II. LEGISLATIVE HISTORY--SECTIONS 6166 AND 6166A

The legislative history of section 6166 and former section 6166A is somewhat convoluted. Section 6166 was originally enacted as part of the Small Business Tax Revision Act of 1958 and was part of an amendment to the Internal Revenue Code of 1954.[2] The first section 6166 (the "First 6166") provided for ten years of installment payments, but did not provide for an initial five years of deferral. In 1976, the First 6166 was redesignated as section 6166A and a new section 6166 was enacted (the "Second 6166"). The Second 6166 introduced an initial five-year deferral period, allowing total deferral for up to fourteen years instead of the nine years possible under the First 6166. Although deferral was longer, eligibility under the Second 6166 was more difficult. For example, the Second 6166 required that the closely held business interest (for all versions of the statute, hereinafter the "Interest") exceed 65% of the adjusted gross estate whereas the First 6166 only required

[1] All section references are to the Internal Revenue Code of 1986, as amended, unless otherwise stated.

[2] The provision was effective with respect to the estates of decedents dying in 1958 and after that time, with section 6166(i) applying to the estates of decedents dying after the date of the 1954 Act but whose returns were due before the date of the 1958 Act. Surprisingly, there seems to be confusion in some of the sources as to whether the original statute was designated as section 6166 or section 6166A.

that the Interest exceed 35% of the gross estate.[3] In 1981, section 6166 and former section 6166A were combined into a new section 6166 (the "Third 6166") and former section 6166A was repealed.[4] Eligibility for the Third 6166 required that the Interest exceed 35% of the adjusted gross estate. A key element of all versions of section 6166 is the definition of a closely held business, which has consistently meant a sole proprietorship, a partnership, or a corporation which is carrying on a trade or business.[5] Although important changes were made to the Third 6166 in 1984 and in 1997, the last major revision to the code section occurred in 1981.[6]

Of greater significance to this Report than some of the more technical, historical details of these two code sections is the underlying legislative history. In House Report No. 2198 (the "1958 House Report"), which was prepared in connection with the passage of the original legislation in 1958, the purpose of providing deferral is explained:[7]

> This provision is primarily designed to make it possible to keep together a business enterprise where the death of one of the larger owners of the business results in the imposition of a relatively heavy estate tax. Where the decedent had a substantial proportion of his estate invested in the business enterprise, under existing law this may confront the heirs with the necessity of either breaking up the business or of selling it to some larger business enterprise, in order to obtain funds to pay the federal estate tax. Your committee believes that this result has an especially unfortunate result in the case of small businesses. Therefore, although not removing any Federal estate tax in these cases, your committee hopes that by spreading out the period over which the estate tax may be paid, it will be possible for the estate

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[3] As originally enacted, the First 6166 required that the value of the Interest must exceed either 35% of the gross estate or 50% of the taxable estate.

[4] The Senate Report at that time explained the reason for combining: "Under present law, though both §6166 and 6166A permit deferred tax payments for illiquid estates, there are unnecessary differences between the two sections. The definition of an interest in a closely held business, the percentage of estate assets required to be represented by such interest, the length and conditions of the deferral, the appropriate interest rate and the conditions for acceleration, vary between the sections. In addition, §303, which permits an estate consisting largely of interests in a closely held business to redeem stock to pay estate taxes, funeral expenses, and administration expenses contains a third threshold minimum value test and different aggregation rules. The committee believes that these provisions should be simplified and coordinated to provide a single set of rules to govern the estate tax treatment and qualified stock redemption of interests in a closely held business." S. Rep. No. 144, 97th Cong., 2d Sess. (1981).

[5] Another requirement that has been consistent throughout the history of section 6166 is that either the decedent must own at least 20% of the Interest or the entity must not have more than a certain number of owners. However, the permitted number of owners has increased from 10 under the First 6166, to 15 under the Second, and to 45 under the Third. The business aggregation requirement for purposes of determining eligibility has also been modified over time. Under the First 6166, aggregation was permitted if more than 50% of the value of two businesses was owned by the decedent. However, under the Second and Third, aggregation is permitted if at least 20% of each business is included in the estate.

[6] Two significant changes made in 1984 were the addition of special rules excluding passive assets from eligibility for deferral and treating the stock of a holding company as stock of a business company.

[7] There was no Senate Report prepared at this time.

tax in most cases to be paid for out of earnings of the business, or at least that it will provide the heirs with time to obtain funds to pay the Federal estate tax without upsetting the operation of the business. Your committee believes that this provision is particularly important in preventing corporate mergers and in maintaining the free enterprise system.

There is also a House Report in connection with the passage of the Second 6166 in 1976 (the "1976 House Report"), which states:

> The present provisions have proved inadequate to deal with the liquidity problems experienced by estates in which a substantial portion of the assets consist of a closely held business or other illiquid assets. In many cases, the executor is forced to sell a decedent's interest in a farm or other closely held business in order to pay the estate tax. This may occur even when the estate qualifies for the 10-year extension provided for closely held businesses. In these cases, it may take several years before a business can regain sufficient financial strength to generate enough cash to pay estate taxes after the loss of one of its principal owners. Moreover, some businesses are not so profitable that they yield enough to pay both the estate tax and interest especially if the interest rate is high. On the other hand, your committee believes that the relatively low percentage thresholds for qualification for the 10-year extension are, for the most part, unnecessary.[8]

In addition, a Senate Committee on Finance Report prepared in connection with the 1997 changes to section 6166 (the "1997 Senate Report") states:

> The Committee believes that the installment payment provisions need to be expanded in order to better address the liquidity problems of estates holding farms and closely held businesses, to prevent the liquidation of such businesses in order to pay estate taxes. The Committee further believes that the protection of closely held businesses will preserve jobs and strengthen the communities in which such businesses are located.[9]

Finally, in 2001, a report from the Senate Finance Committee (the "2001 Senate Report") states:

> The Committee finds that the present-law installment payment of estate tax provisions are 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 and modify availability of the provision to enable more estates of decedents

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[8] H.R. Rep. No. 1380, 94th Cong., 2d Sess. (1976).

[9] Interestingly, the Senate Report also states that "The bill extends the period for which Federal estate tax installments may be made under section 6166 to a maximum period of 24 years. If the election is made, the estate pays only interest for the first four years, followed by up to 20 annual installments of principal and interest." However, this provision never became part of the law. There is also a Conference Report from 1984 that is not helpful to this analysis other than to emphasize that deferral is available for assets actively used in a trade or business, but not for other assets. See Conf. Rep. No. 861, 98th Cong., 2d Sess. (1984).

with an interest in a closely held business to claim the benefits of installment payment of estate tax.[10]

The legislative history cited above makes clear that for almost sixty years, Congress has been consistently concerned with the ability of active trades or businesses to maintain their viability in the face of substantial estate taxes for which the trade or business may be the only source of funds. As explained in the 1958 House Report, in the absence of a deferral provision such as section 6166, heirs are confronted with the choice of "either breaking up the business or of selling it to some larger business enterprise," which the House felt was "an especially unfortunate result in the case of small businesses." The 1976 House Report also makes the point that not only does the death of a significant owner trigger the estate tax, it may also impact the business's financial strength and hamper its ability to pay. In contrast, deferral under section 6166 may allow for the payment of the estate tax out of earnings "without upsetting the operation of the business." In fact, the House Committee was not simply concerned with the particular businesses subject to the estate tax, but with much broader societal concerns: "Your committee believes that this provision is particularly important in preventing corporate mergers and in maintaining the free enterprise system." Such broad societal concerns are also reflected in the 1997 Senate Report: "The Committee further believes that the protection of closely held businesses will preserve jobs and strengthen the communities in which such businesses are located." Finally, the 2001 Senate Report demonstrates a desire to "expand and modify availability of the provision to enable more estates of decedents . . . to claim the benefits of installment payment of estate tax."

III. PURPOSE OF THE GENERATION-SKIPPING TRANSFER TAX

The current generation-skipping transfer tax laws were enacted as part of the Tax Reform Act of 1986, which also retroactively repealed the original generation-skipping laws from 1976. In enacting the new law, a general explanation prepared by the staff of the Joint Committee of Taxation (the "Joint Committee Report") states the following:

> ***Reasons for Change***
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> The Congress believed, as it stated when the generation-skipping transfer tax originally was enacted in 1976, that the purpose of the three transfer taxes (gift, estate, and generation-skipping) was not only to raise revenue, but also to do so in a manner that has as nearly as possible a uniform effect. This policy is best served when transfer tax consequences do not vary widely depending on whether property is transferred outright to immediately succeeding generations or is transferred in ways that skip generations. The Congress determined that the present generation-skipping transfer tax was unduly complicated. Therefore, the Congress determined that this tax should be replaced with a simplified tax, determined at a flat rate. The Act accomplishes Congress' goal of simplified administration while ensuring that transfers having a similar substantial effect will be subject to tax in a similar manner.

[10] S. Prt. 107-30, at 83–84 (2001).

The Joint Committee Report also states:

> ***Coordination with other provisions***
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> The Act also includes several provisions coordinating the generation-skipping transfer tax with the gift and estate taxes. The Code provisions governing administration of the gift and estate taxes also apply to the amended generation-skipping transfer tax. Estate tax rules apply to generation-skipping transfers occurring as a result of death, and gift tax rules apply in other cases.
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> In addition to any adjustment to basis received under the gift or estate tax basis provisions, the basis of property subject to the amended generation-skipping transfer tax generally is increased by the amount of that tax attributable to the excess of the property's value over the transferor's basis. <u>In the case of taxable terminations occurring as a result of death, a step-up in basis like that provided under the estate tax (sec. 1014) is provided</u>.
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> . . .
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> <u>The special rules under which estate tax attributable to interests in certain closely held businesses may be paid in installments also apply to direct skips occurring as a result of death</u>. The provision permitting tax-free redemptions of stock to pay estate tax is amended to permit those redemptions to pay generation-skipping transfer tax in the case of such transfers occurring as a result of death. (Emphasis added)

IV. <u>REASONS FOR CHANGE</u>

As indicated in the Joint Committee Report, it is the stated goal of Congress that "transfers having a similar substantial effect will be subject to tax in a similar manner." This corresponds to the stated purpose that transfer taxes should have "as nearly as possible a uniform effect." Furthermore, this "policy is best served when transfer tax consequences do not vary widely depending on whether property is transferred outright to immediately succeeding generations or is transferred in ways that skip generations." Significantly, with respect to taxable terminations occurring as a result of death, "a step-up in basis like that provided under the estate tax (sec. 1014) is provided."

It is noteworthy that the Joint Committee Report specifically refers to installment treatment for generation-skipping taxes solely in the context of direct skips, which is the only form of generation-skipping transfer covered in section 6166 (see section 6166(i)). There are at least three possible explanations for singling out direct skips in the context of section 6166. First, Congress did not intend for taxable terminations of any type to receive installment treatment. Second, Congress forgot to include taxable terminations resulting from death or simply did not recognize the problem. Third, section 6166 is so closely connected to the estate tax that there was no simple fix that could be made to cover taxable terminations resulting from death under that statute as there could be in the case of direct skips.

In considering these possibilities, the sentence in the Joint Committee Report which immediately follows the reference to installment treatment for direct skips is very important: "The provision permitting tax-free redemptions of stock to pay estate tax is amended to permit those redemptions to pay generation-skipping transfer tax in the case of such <u>transfers occurring as a result of death</u>" (emphasis added). Section 303(d) provides for this treatment in cases "where stock in a corporation is the subject of a generation-skipping transfer (within the meaning of section 2611(a)) occurring at the same time as and as a result of the death of an individual." Section 2611(a) states that "the term 'generation-skipping transfer' means—(1) a taxable distribution, (2) a taxable termination, and (3) a direct skip." Thus, taxable terminations resulting from death were specifically included in this redemption treatment which was part of an effort to coordinate the transfer tax laws and to provide for a uniform result to the extent reasonably possible. Based on this analysis, it seems most likely that Congress did not address the availability of installment treatment for taxable terminations resulting from death because to do so would have required the drafting of a completely new code section, which was beyond the scope of its effort to coordinate at that time. At least, there is nothing in the legislative history that would suggest that Congress did not wish taxable terminations to receive similar treatment to other transfers occurring because of death.

The analysis in Private Letter Ruling 200939003 is consistent with the foregoing conclusion:

> Under these provisions, the estate's eligibility for the deferral, as well as the amount of tax that may be deferred, is dependent on the inclusion of the property in the gross estate, and the size of the adjusted gross estate, which in turn is dependent on the amount of estate administration expenses, claims, etc. In contrast, the amount of the GST tax is dependent on the "taxable amount", i.e., the value of the property subject to the taxable termination less the deductions allowed as provided in section 2622. The elements involved in this calculation are different from those used under section 6166 to determine the eligibility for section 6166, i.e., the gross estate and the adjusted gross estate. In view of the statutory requirements contained in section 6166, that section would not otherwise be applicable to, or consistent with, the provisions of the GST tax imposed upon a taxable termination. Section 2661(2), therefore, does not provide a basis for making a section 6166 election in connection with a taxable termination.

Section 2661 states: "Insofar as applicable and not inconsistent with the provisions of this chapter— . . . (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)." Section 6166 is part of subtitle F. Nevertheless, although other interpretations would have been possible, the Private Letter Ruling takes the position that the structure of section 6166 is inconsistent with the application of the generation-skipping transfer tax, and therefore section 6166 is not applicable. However, there is nothing in the Ruling that suggests any other basis for precluding the application of installment treatment to taxable terminations resulting from death.

Based on the foregoing, Congress has demonstrated its intent to provide similar tax consequences to the various forms of transferring assets, whether those transfers are made at death or during life, and whether or not generation-skipping transfers are involved. In addition, Congress has indicated a clear intent not to cause the destruction of closely held businesses for the purpose of paying transfer taxes relating to death. Generation-skipping transfer taxes which arise from taxable terminations resulting from death may cause the same types of liquidity issues with respect to closely-held businesses that arise with respect to the payment of estate taxes. However, at the time the First 6166 was enacted, there was no generation-skipping transfer tax, and that statute was not drafted with such taxes in mind.

V. POSSIBLE METHODS FOR EXPANDING DEFERRAL ELECTION

If a decision is made to extend section 6166 deferral treatment to taxable terminations resulting from death, there are a number of possible methods that could be used. First, the IRS could use a Revenue Ruling or a Notice to advise that it will not follow the position taken in Private Letter Ruling 200939003 and to set forth a new position. However, a Revenue Ruling is normally focused on a specific set of facts and is not the place for a broad pronouncement of generally applicable propositions of law. Furthermore, in litigation, a Revenue Ruling is not binding upon a court and does not carry the full force and effect of law.[11] Although Notices may be used to provide substantive guidance, they are subject to the same limitations as Revenue Rulings in terms of authoritative weight, and a simple administrative statement that a section 6166 election can be made with respect to generation-skipping transfer taxes arising from taxable terminations resulting from death will not resolve the many issues addressed in this Report. Both a Revenue Ruling and a Notice would also create some degree of uncertainty because either one could be revoked, modified, or superseded by the IRS at any time.

Second, the Treasury Department could promulgate new Regulations. If those Regulations were legislative in nature, they would carry the force of law. Also, legislative Regulations would require public notice and a comment period, which would allow for a more comprehensive and considered approach to resolving the issues. However, the issuance of legislative Regulations would require a specific grant of authority from Congress, which does not appear to exist in this case. Although it might be argued that section 2661 provides an implied grant of legislative regulatory authority to apply "all provisions of subtitle F" to taxable terminations arising at death, that grant is limited by the requirement that those provisions be "applicable" (a circular test) and "not inconsistent." Consistency in this case may be a matter of opinion, with the Private Letter Ruling taking the position that it does not exist, but at the least it can be acknowledged that section 6166 and the generation-skipping transfer tax are a very complex set of tax laws, and the integration of the two requires a substantial amount of effort and decision-making in order to reconcile all of the inherent inconsistencies (as demonstrated below in the next section).

In contrast, interpretive Regulations can be issued under the general authority of section 7805(a), and are intended to interpret and clarify the law, but do not necessarily carry the force of law. Furthermore, interpretive Regulations implement Congressional intent but do not make new law. On the other hand, "*Chevron* deference" may be

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[11] Although a Revenue Ruling is generally not binding upon a court, the IRS may be bound by its own published Revenue Rulings and in a judicial proceeding may be considered to have made a "concession" with respect to the position previously taken in such a ruling. See <u>Rauenhorst v. Comm'r.,</u> 119 T.C. 157 (2002); see also <u>McLendon v. Commissioner of Internal Revenue</u>, 135 F.3d 1017, 1025 (5th Cir. 1998). This may be especially true in cases in which the IRS has issued guidance which is friendly to taxpayers as opposed to being pro-IRS. Accordingly, if the IRS were to issue a Revenue Ruling to the effect that a taxable termination resulting from death qualified for installment treatment under section 6166, the IRS would very likely be bound by such a ruling in a judicial proceeding involving that specific issue. However, as noted below, the IRS would presumably be otherwise free to modify or revoke such a ruling.

appropriate when Congress has delegated authority to an agency to make rules carrying the force of law, and the agency has issued an interpretation claiming such deference.[12] In this case, the fact that Congress amended section 6166 to specifically allow deferral treatment for direct skips but not for taxable terminations makes it difficult to argue that either delegation or mere statutory interpretation is involved. In addition, the fact that in 1986, Congress chose to amend section 303 to provide special rules for generation-skipping transfers "occurring at the same time as and as a result of the death of an individual" reinforces this point.[13]

Notwithstanding the foregoing, the very last section of chapter 13 is section 2663, which authorizes "such regulations as may be necessary or appropriate to carry out the purposes of this chapter," and mentions three specific areas to be covered.[14] However, none of the three areas listed suggests looking for a statutory purpose outside the scope of chapter 13.[15] The narrow question becomes whether allowing tax deferral under section 6166 could be considered one of the purposes of chapter 13. Although applying certain portions of subtitle F could be considered such a statutory purpose, this first requires that there be no inconsistency, and applying subtitle F therefore seems to be an insufficient justification for the reasons discussed above. In summary, there does not appear to be clear regulatory authority for allowing deferral in this case.

Third, the issue could be resolved statutorily, either through revisions to existing section 6166 or through the enactment of a new code section. Although it would be possible to amend section 6166 so that it covers taxable terminations resulting from death, Private Letter Ruling 200939003 suggests that the existing framework of section 6166 is not compatible with the methodology of imposing this type of generation-skipping transfer tax. In fact, a careful review of the statute indicates that it would have to be substantially reworked in order to make it applicable to generation-skipping transfer taxes arising from taxable terminations. In contrast, enacting a new code section would combine all of the specialized provisions necessary for the deferral of a unique transfer tax into one place in a consistent and coherent manner.

VI. RECOMMENDATION AND PROPOSED CHANGES

Based on the foregoing, ACTEC believes that allowing a deferral election similar to section 6166 with respect to taxable terminations resulting from death can be best accomplished by enacting a new section in the Internal Revenue Code. Given the historical relationship between sections 6166 and 6166A, drafting a new section 6166A for this

[12] See Mayo Found. for Medical Education and Research v. U.S., 562 U.S. 44, 57 (2011).
[13] It should be noted that prior to the 1986 amendment, section 303(d) provided similar provisions for generation-skipping transfers occurring "at or after the death of the deemed transferor," but also stated that these rules were to be implemented "[u]nder regulations prescribed by the Secretary." This former provision is evidence that Congress knows how to authorize regulations in a generation-skipping context arising outside of chapter 13 when it needs to.
[14] There are also numerous authorizations to issue Regulations scattered throughout chapter 13. See, e.g., sections 2632, 2642, 2651, 2653, and 2662.
[15] Two of the three areas listed in section 2663 are the application of the valuation rules of section 2032A (specifically mentioned in section 2624(b)) and adjustments for arrangements to be treated as trusts under section 2652(b). The third area mentioned is the application of chapter 13 to nonresident aliens.

purpose seems like the most logical choice.[16] The proposed section 6166A attached to this Report closely follows current section 6166, with essentially the only changes being those that are necessary to reflect the differences that exist between the estate tax and the generation-skipping transfer tax. In addition to proposed section 6166A, a redline document showing the differences between current section 6166 and proposed section 6166A is attached to this Report.

An obvious change that occurs twice in proposed section 6166A(a) is the reference to the generation-skipping tax imposed by section 2601 instead of the estate tax imposed by section 2001. Also, the phrase "the taxable amount of the taxable termination" is derived from section 2622(a) and is the equivalent of the special definition of "adjusted gross estate" found in current section 6166(b)(6). Although that special definition allows for deductions under sections 2053 and 2054, section 2622(b) already allows for deductions similar to what is provided under section 2053, and it appears that chapter 13 does not specifically provide for the deduction of losses during administration similar to what is provided under section 2054. As a result, no special definition is required with respect to taxable terminations and no parallel to section 6166(b)(6) is included in the proposed statute.

Furthermore, the phrase "the value of all property with respect to which the taxable termination has occurred" is taken verbatim from section 2622(a)(1) and is the equivalent of the term "gross estate of the decedent" found in section 2031. This new phrase is incorporated into the definition of a closely held business in section 6166A(b)(1). The 35% test found in the general rule of section 6166A(a)(1) uses a similar phrase but modifies the words "taxable termination" to require that the termination be one which is "directly resulting from the death of a non-skip person." As noted above, the legislative history makes clear that Congress intended to provide similar transfer tax treatment for different forms of transfers occurring at death, so this provision is consistent with that history.

Another important change in the proposed statute reflects the fact that the person who is liable to pay the tax under section 2603(a)(2) is the trustee rather than the executor. The trustee is also the person who files Form 706GS(T) in order to report taxable terminations to the IRS. Because the only credit applicable to the federal generation-skipping transfer tax was the now repealed credit for certain state generation-skipping transfer taxes under section 2604, in the phrase "reduced by the credits against such tax," the word "the" has been changed to "any" in the proposed statute. Also, because direct skips occurring upon the death of an individual are already covered by section 6166, there is no need to have a provision similar to section 6166(i) in the proposed statute (and a direct skip at death is more closely related to a transfer subject to the estate tax in any event).

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[16] Although adding a new section 6166A would add to the already convoluted legislative history of these two code sections, this may have little relevance except to the drafters of reports such as this. On the other hand, because of this confusing background, it is already important to carefully consider which version of these sections is involved when they are cited in case law or IRS rulings. Furthermore, at some point, the original IRS Regulations under section 6166 were re-designated as being under former section 6166A. This continues to be the case even though there is not a section 6166A at the present time. If proposed section 6166A is enacted, that would be even more reason for the IRS Regulations pertaining to section 6166 to be re-designated back to the proper Code section.

In considering these changes, a significant amount of discussion took place in the Transfer Tax Study Committee with respect to the need for aggregation of trusts for which there is a common grantor and a common non-skip person whose death triggers the generation-skipping transfer tax. The Committee felt that in order to prevent taxpayers from manipulating the opportunity for tax deferral under proposed section 6166A, there should be aggregation rules for combining generation-skipping trusts for purposes of qualification under such circumstances. Although section 6166A(b) provides a number of definitions and special rules, the aggregation provision has been placed in section 6166A(a) because of its relationship to the 35% test of (a)(1). Furthermore, although paragraph (b)(2) provides certain aggregation and attribution rules, the purpose of those rules is to determine whether the 45 or fewer partners and shareholders tests have been met under (b)(1), which defines the term "interest in a closely held business," and subsection (a) is therefore a more appropriate place for a trust aggregation rule.

Along the same lines, current section 6166(b)(2)(D) provides an attribution rule which treats the decedent as owning any stock or partnership interests owned by the decedent's family. In other words, this attribution rule helps the decedent's estate qualify for the deferral election because there are fewer shareholders or partners when it is applied, thereby making it easier to qualify under the 45 or fewer partners or shareholders limitation. However, because a trust subject to a taxable termination does not have a family, this beneficial rule does not apply in the context of section 6166A. Therefore, to place the two taxpayers (i.e., under sections 6166 and 6166A) on a somewhat equal footing, for purposes of section 6166A, any trusts that would be aggregated under paragraph (a)(4) are also aggregated under subparagraph (b)(2)(D) for purposes of the 45 person limitation.

In contrast, the effect of the attribution rule of current section 6166(b)(2)(C) is to make estate beneficiaries and certain trust beneficiaries owners for purposes of the 45 person limitation, thereby increasing the number of owners and making it harder to qualify. However, this attribution rule does not apply to the decedent's estate because subparagraph (b)(2)(A) provides that the time for testing is "immediately before the decedent's death," meaning that the decedent's estate does not yet exist and therefore no one will be treated as indirectly owning the decedent's interests. Therefore, to again place the two taxpayers on a more equal footing, the trust subject to the taxable termination is carved out from the attribution rule applying to trusts.

Although there would not be attribution *from* the trust subject to the taxable termination, there may be attribution *to* such a trust under (b)(2)(C) (e.g., if the trust is a shareholder, partner, or beneficiary). In the event that a business interest is attributed to the trust under (b)(2), the trustee may make an election under paragraph (b)(6) to have the business interest treated as owned by the trust for purposes of the 20% test of (b)(1)(B) or (C) (presumably the business interest would not qualify as closely held without this election). However, it should be noted that this election does not cause the attributed property to be subject to the taxable termination. In the event of such an election, the initial five-year deferral period is eliminated and the special interest rate is not available. This election is the equivalent of the election that currently exists under 6166(b)(7). Like the current election, the election under proposed 6166A(b)(6) also applies to the aggregation rule of subsection (c), which allows interests in different businesses that each equal at least 20% of the value of all property with respect to the taxable termination to be joined together for purposes of the 35% requirement of (a)(1).

A number of other relatively minor changes are found in proposed section 6166A. For example, proposed paragraph (b)(4), dealing with the value of the property subject to tax, refers to "chapter 13" instead of "chapter 11." Although an alternative would be to refer to section 2624, which deals specifically with valuation for purposes of chapter 13, referring to the chapter instead of to the individual code section more closely tracks the language of section 6166 and has the advantage of being broader than the reference to section 2624, which begins with the words "Except as otherwise provided in this chapter." Also, with respect to the acceleration of the deferred payments under subsection (g), the phrase "transferor in such transfer" used in subparagraph (D) has been changed to "person making such transfer" in order to avoid possible confusion with the term "transferor" as used in the generation-skipping transfer tax context. In that same subparagraph, the exception provided for a transfer of property to a person entitled to receive it "under the decedent's will, the applicable law of descent and distribution, or a trust created by the decedent" has been narrowed to simply receipt "under the terms of the trust." Finally, with respect to the treatment of undistributed income under the acceleration provision, subsection (g)(2)(B)(iii) refers to taxes imposed by both sections 2001 and 2601 because of the possibility that the trust subject to the taxable termination could also have assets subject to an existing section 6166 election.

In addition to the changes mentioned above, a certain non-change is noteworthy. Current section 6166 refers five different times to "the date prescribed by section 6151(a)," which is the date for paying the estate tax. Although section 2662 provides specific requirements for preparing and filing generation-skipping returns, it does not deal with the payment of the generation-skipping tax, which is instead covered by section 6151(a). Therefore, the references to that tax payment code provision are left unchanged in the proposed statute. This treatment is also consistent with the administrative provisions of section 2661, which generally apply the rules of subtitle F (including section 6151) to generation-skipping transfers.

Finally, a significant difference between the proposed code section and the existing code section is the inclusion of new subsection (i), dealing with the application of other code provisions that apply as written to the estate tax context. These code provisions include the special lien for estate taxes under section 6324A, the extensions for limitations periods under section 6503(d), the special interest rate under section 6601(j), and redemption treatment under section 303. Rather than revise these other code sections or add new ones applicable to the generation-skipping transfer tax context, the proposed statute provides that rules similar to those found in the other code provisions will apply. It should be noted that although section 303(d) already includes a special rule treating generation-skipping transfer taxes as estate taxes for purposes of that statute, the extended distribution period provided in section 303(b)(1)(C) is only applicable if a section 6166 election has been made. The extended period would not apply to an election under section 6166A without specific authorization in either section 303 or section 6166A.

VII. <u>CONCLUSION</u>

For the reasons stated above, ACTEC believes that the Internal Revenue Code should be amended to provide deferral treatment for generation-skipping transfer taxes arising from taxable terminations resulting from death similar to what currently exists for estate taxes under section 6166. ACTEC also believes that the proposed section 6166A attached to this Report would more accurately and efficiently implement what we understand to be the objectives and the intent of Congress than do the provisions of current law.

These recommendations were prepared by members of ACTEC's Transfer Tax Study Committee, including by David E. Sloan (801-237-0423) and Jonathan G. Blattmachr ( ), under the supervision of the most recent past Chair of that Committee, Barbara A. Sloan (212-448-6229), and the new Chair, Trent S. Kiziah (213-861-5028), and were reviewed and approved by Beth Shapiro Kaufman (202-862-5062) on behalf of ACTEC's Washington Affairs Committee. We appreciate the opportunity to provide these recommendations and would be pleased to offer additional comments if desired.