A. Introduction

1. The Tax Reform Act of 1976 (the “1976 Act”) established a unified rate schedule and a unified credit which applies both to transfers during life and transfers at death. The Economic Recovery Tax Act of 1981 (“ERTA”) increased the unified credit and the Taxpayer Relief Act of 1997 (the “1997 Act”) further increased the credit. The Economic Growth and Tax Relief Reconciliation Act of 2001 (the “2001 Act”) increased the unified credit beginning in 2002 and created in 2004 a different credit for transfers during life and transfers at death.

2. Although one single rate structure applied until 2004 both to lifetime gifts and to transfers at death, the fundamental questions of what constitutes a taxable gift and what assets are includable in a decedent’s gross estate are (subject to a few special statutory modifications) basically unchanged.

3. Although the rate structure was unified until 2004, no attempt has been made to unify the gift tax and estate tax in any philosophical sense.

   a. Thus, some transfers will still be treated as completed gifts for tax purposes but will still be subject to full inclusion in the gross estate.

   b. The most common example of a transfer subject both to gift tax and estate tax is a gift with a retained life estate.
4. Following the gradual increases in the unified credit beginning in 2002 and the generation skipping tax beginning in 2004, the 2001 Act repeals the estate tax and the generation skipping tax for persons who die in 2010, but the 2001 Act provides for the reinstatement of the estate tax and generation skipping tax in its form prior to the 2001 Act for persons dying after 2010. The gift tax is not repealed.

5. In late 2010, President Obama signed the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (the “2010 Act”) which drastically changed the provisions of the 2001 Act that would have been applicable in 2010 and thereafter.

   a. There is a retroactive restoration of the estate tax for 2010, a $5 million applicable exclusion amount for the gift tax and estate tax and a 35 percent maximum rate for the gift tax and estate tax.

   b. Estates of decedents who died in 2010 could opt out of the estate tax and allocate up to $1,300,000 of appreciation to increase the adjusted bases of the decedent’s assets and up to $3 million of appreciation to increase the bases of property left outright to a spouse or left in a trust from which such spouse receives all of the income (at least annually) for life. Internal Revenue Code (“Code”) §1022 (b) and (c). Note that section 1022 was repealed by the 2010 Act, applicable to estates of decedents dying and transfers made after December 31, 2009.

      i. Property left to the spouse which qualifies for the up to $3 million increase is not included in the estate of the surviving spouse and on spouse’s death does not receive a stepped up basis.

   c. The $5 million exclusion amount for the estate and gift tax is indexed for inflation beginning in 2011.

   d. There is portability of the exclusion amount not utilized by the first spouse to die, i.e., the surviving spouse may utilize the unused exclusion amount of the first spouse to die.

   e. The provisions of the 2001 Act that would have been applicable to 2011 are applicable in 2013 in the absence of legislation by 2013 to the contrary.

B. The Federal Estate Tax: The Gross Estate

1. The starting point in computing the federal estate tax is the “gross estate,” which consists of the following:


      i. This includes essentially the items found in the decedent’s probate estate.

      ii. However, foreign real estate is included.
b. Joint Tenancy (and other forms of joint ownership with right of survivorship, such as tenancy by entirety in states where it exists). Code §2040.

i. The general rule is that the gross estate includes property with respect to which the decedent was a joint tenant, except to the extent that the surviving joint tenant or tenants can show contribution (which never came from the decedent by way of gift) to the acquisition of the property.

ii. ERTA adopted the simple rule that if an interest in property is held by decedent and his spouse as tenants by the entireties or as joint tenants with right of survivorship (provided the decedent and the spouse are the only joint tenants), one-half of the value of the jointly owned interest will be included in the estate of the decedent regardless of which spouse furnished the original consideration. Code §2040(b)(2).

iii. In addition, ERTA repealed the material participation rule, the rules concerning retroactivity of the fractional interest rule and the gift tax provisions governing the creation of spouses’ joint interests.

iv. Since present interest gifts to a spouse now qualify for the unlimited gift tax marital deduction and are exempt from gift tax, it no longer matters, for gift tax purposes, whether the creation of a joint interest in property between spouses constitutes a gift.

v. The joint tenancy rules do not apply to tenancy in common property, the decedent’s interest in which is included under section 2033 of the Code.


i. Definition: A general power of appointment is one exercisable by the decedent in favor of herself or himself, his or her estate, his or her creditors, or the creditors of the estate. All others are special powers of appointment.

ii. Major exceptions:

   (1) Power limited by an ascertainable standard relating to health, education, support or maintenance is not a general power. Code §2041(b)(1)(A).

   (A) The Internal Revenue Service (the “Service”) has ruled that a non-general power may be held by an individual serving as sole trustee and income beneficiary, if the statutory language is strictly followed. Rev. Rul. 78-398, 1978-2 C.B. 237.

   (B) In Estate of Chancellor v. Comm’r., 102 T.C.M. (CCH) 70 (2011) the Tax Court held that the addition of “welfare” did not create a general power because under state law (Mississippi) a state court would construe the power narrowly.
(2) A power held jointly with a substantially adverse party or with the creator of the power is not a general power.

(3) A general power created before 1942 results in estate taxation only if exercised.

(4) Lapse of power to appoint the greater of $5,000 or five percent of trust corpus is not subject to normal rules applicable to lapses or releases. Code §2041(b)(2).

iii. Section 2044 of the Code provides that the value of a decedent’s gross estate shall include the value of any property in which the decedent had a qualifying income interest for life and for which a deduction was allowed with respect to the transfer of such property to the decedent. As will be noted subsequently, such inclusion is the price paid for the tax deferral granted by the unlimited marital deduction provisions.

d. Gifts Within Three Years of Death. Code §2035.

i. The long standing “three-year rule” which required that property given away by a decedent within three years before death be included in the gross estate was abolished for estates of decedents dying after 1981, except for limited purposes and subject to specified exceptions. Apart from these limited purposes and exceptions, no part of the value of property which a decedent has transferred by gift within three years of death will be included in the gross estate under the three-year rule.

(1) The effect of this change is to free from estate tax any appreciation in value of the property between the date of gift and the date of decedent’s death. This frees such post-gift appreciation from transfer taxes entirely, since that appreciation also escapes gift tax.

ii. This change removes the distinction made by the 1976 Act between gifts made within three years of a decedent’s death and gifts made more than three years before death. For estates of decedents dying after 1981, both types of gifts will be treated for estate tax purposes in the same manner. They will not be included in the decedent’s gross estate and will enter into the estate tax computation only to the extent that they constitute “adjusted taxable gifts.”

iii. Inclusion in the gross estate of the gift tax on gifts made within three years of death is referred to as “grossing up.”

e. Transfers with Retained Income, Possession or Enjoyment. Code §2036(a)(1).

i. The retained life estate need not be expressed. For example, it has been held that an outright gift, without any restrictions, of a house by an individual to a child followed by retained possession by the donor gives rise to an inference of an implied retention of a life estate. Rev. Rul. 78-409, 1978-2 C.B. 234. Contrast Rev. Rul. 70-155, 1970-1 C.B. 189 (a transfer of a home to a spouse with the transferor continuing to reside there until death resulted in no inclusion in grantor’s estate).
   i. The 1976 Act (as modified by the Revenue Act of 1978) expanded the definition of retained enjoyment under section 2036(a)(1) to include the retention of voting rights in transferred stock in a corporation in which the decedent (together with related persons and entities, using the attribution rules of section 318 of the Code) owned or had the right to vote at least 20 percent of the total combined voting power of all classes of stock.

   ii. The Service has concluded that section 2036(b) applies when the decedent was the general partner of a limited partnership and held the right to vote as a result of being the general partner. Tech. Adv. Mem. 99938005.

g. Anti-Freeze Provision. Code §2036(c).
   i. The Tax Reform Act of 1986 (the “1986 Act”) provided that certain “valuation freezes” (preferred stock recapitalizations, for example) which resulted in a transfer of a “disproportionately large share of the potential appreciation in such person’s interest” while the transferor retained an interest in “income” or “rights” would result in transferred property being included in the transferor’s gross estate.

   ii. The Revenue Reconciliation Act of 1990 (the “1990 Act”) removed section 2036(c) from the Code retroactive to its date of enactment and replaced it with a new provision, affecting the valuation of such transfers for gift tax purposes.

h. Transfers With Retained Powers to Affect Beneficial Enjoyment. Code §§2036(a)(2) and 2038.
   i. Although there is some difference in coverage between section 2038, which requires inclusion in the gross estate of property with respect to which the decedent retained or reacquired the power to alter, amend, revoke or terminate the enjoyment, and section 2036(a)(2), which requires inclusion of property with respect to which the decedent retained the right to designate the persons who shall possess or enjoy the property or its income, these two sections are largely overlapping. The principal kinds of transfers covered by these two very broad provisions are:

