PREVIOUSLY TAXED PROPERTY CREDIT AND THE 2035(B) GROSS UP

Kelly A. Moore*

The Tax Act of 1976 ushered in an era of unification of the gift and estate tax systems. The drive for aligning the taxes led to features in the transfer tax system such as the use of the same rate tables and the allowance of the same 100% deduction for outright or appropriately formed transfers between spouses. The unification of the systems evinced the policy that the taxes are imposed on cumulative lifetime gratuitous transfers over time and those occasioned by death through the application of a single, progressive rate structure, with a unified credit bolstering the goal of only taxing large estates. Despite the larger effort toward unification, certain differences persisted in the gift tax and estate tax systems: namely, for the purposes of this article, the different methods of calculating the taxes and the possible availability of a tax credit based only on the value of previously paid estate tax.

In 2001, the drive toward unification of the two transfer taxes came to a screeching halt with the enactment of the Economic Growth and Tax Relief and Reconciliation Act (EGTRRA). EGTRRA provided for a staged disconnect of the two taxes over 8 years and a repeal of the estate tax in 2010, leaving the gift tax in place. Due to Senate budgeting rules, the estate tax was slated to return in 2011, at the rates that had applied in 2001. This staged approach to a one-year repeal fostered complexity in the near-term and attendant uncertainty regarding the long-term status of the estate tax system, specifically, and the transfer tax system, generally. With the election of Barack Obama as President in 2008, the fog of uncertainty began clearing, as he is a supporter of the transfer taxes.[1] The exact scope of the future estate tax, however, is still up for debate. This article discusses an incremental change that can be made to reduce a disunity currently stemming from the application

---

* Kelly A. Moore, Assistant Professor, University of Toledo College of Law (former Director of Graduate Tax Program and Lecturer in Law, Washington University in St. Louis School of Law).
Editing and research assistance provided by Jacob Hills, 2009 JD, St. Louis University School of Law and Michael Foley, 2011 JD/MBA Candidate, Washington University in St. Louis School of Law.

1. The status of the estate tax has been in flux for most of the last decade. *See* Edward J. McCaffery & Linda R. Cohen, *Shakedown at Gucci Gulch: The New Logic of Collective Action,* 84 N.C. L. Rev. 1159, 1207–09 (2006). Currently, the estate tax remains slated for year long repeal in 2010, with automatic reinstatement in 2011, at 2001 levels. *Id.* at 1208–09. With the election of Barack Obama and the 111th Congress, the continuation of the estate tax regime seems likely. Jeanne Sahadi, *Where Taxes are Headed*, CNNMoney.com, Apr. 3, 2009, http://money.cnn.com/2009/04/03/pf/taxes/potential_tax_changes/index.htm.

of section 2035(b), (which grosses up the value of a decedent's gross estate by the amount of gift taxes paid on decedent's gifts within three years of death) in situations where section 2013 may become applicable.

Soon after the enactment of the initial iteration of the modern estate tax in 1916, Congress determined that some level of accommodation was necessary when property or interests therein were subjected to the estate tax in two estates in quick succession.[2] The House Ways and Means Committee noted the severe burden that could be placed on a family when a person dies, leaving their estate to a beneficiary who dies shortly thereafter, resulting in the property being taxed a second time.[3] This concern is currently addressed in section 2013, providing the credit for Tax on Prior Transfers, commonly referred to as the TPT credit.[4] Section 2013 provides that a credit may be available to offset the estate tax liability of a decedent who has received property from a transferor who died within the ten years before the decedent or within the two years after decedent.[5] The amount of the credit will be based, in part, on the estate tax paid by the transferor's estate in relation to the percentage of the transferor's gross estate the decedent received.[6] No such credit is available to estates of decedents who have received taxable gifts, unless the subject of the gift is brought back into the transferor's gross estate via a string provision.[7]

---

2. H.R. REP. NO. 65–767 (1918), *reprinted in* 1939-1 C.B. 86, 102.
3. *Id*. The concern was particularly acute in the early years of the estate tax, as there was no deduction for transfers to a surviving spouse, leaving the possibility that a child could receive an inheritance reduced by the payment of the estate tax from both his father's estate and his mother's estate, in succession. If the policy behind the credit, initially, was so narrow that the true concern only dealt with successive taxation of taxable estates as it passed from one spouse to another, and then to the offspring of that union, the continuing justification for the TPT credit in the era of the 100% marital deduction is doubtful. If there is no estate tax liability in outright or appropriately formed transfers between spouses, the children of the union will receive the estate after only one transfer: the transfer from the second spouse to die to the children. If the concern is over the broader possibility of imposition of the estate tax in quick succession, regardless of the parties involved in the transfer, the justification for the credit persists. The credit was not specifically tailored to spousal transfers and is currently available regardless of the relationship of the parties involved. This is inconsistent with the general approach of the income tax provisions, which deem as gross income non-gratuitous receipts, even if the payor is paying with an item which was recently deemed gross income to the payor.
4. I.R.C. § 2013 (2006).
5. *Id.*
6. *Id.*
7. A decedent's gross estate may include property which had either partially or entirely been the subject of a taxable gift during decedent's life. The 'string provisions' bring such gifts into a decedent's gross estate because of some retained interest which, although it may not have prevented the gift from being complete for gift tax purposes, is deemed to be tantamount to continued ownership of the property at death. *See* I.R.C. § 2036 (retained income interest or power over beneficial interests in the trust); I.R.C. § 2037 (retention of a reversionary interest); I.R.C. § 2038 (retention of a power to

As discussed below, the availability of the credit based on the payment of estate tax and not based on the payment of gift tax may generally be justified by the different calculation approaches of the estate and gift taxes. In a sense, this justification equates to a rough justice, allowing one disconnect between the systems–the methods of calculation (between the estate and gift tax systems to justify another disparity) allowing a taxes-paid-credit only for prior estate taxes.[8] This justification may not explain, however, the unavailability of the credit in a third situation: where the donor of a taxable gift who incurs a gift tax liability dies within the three years following the gift.

Gift tax paid within three years of the transferor's death is included in the value of the transferor's gross estate under section 2035(b).[9] In addition, as with the value of any adjusted lifetime taxable gift, the value of the taxable gift is included in determining the donor's estate tax liability.[10] As a result of the inclusion in the gross estate of gift tax paid within three years and the addition of the value of lifetime gifts into the estate tax calculation, the estate tax treatment of the gift is aligned with the treatment of other items included in the gross estate.[11] Although aligned with the treatment of other portions of the donor's gross estate, the estate tax resulting from these calculation requirements is not allowed as a credit to the recipient of the lifetime gift at

---

alter, amend, revoke, and terminate); and I.R.C. § 2035a (addressing attempts to relinquish string powers within three years of death). For example, if a decedent was the grantor of an irrevocable trust which paid him the income derived from the trust until he died, section 2036(a)(1) would bring the entire trust corpus back into the decedent's estate, even though the decedent may have already paid a gift tax at the time of the creation of the trust on the value of the trust remainder interest.

8. My use of the "rough justice" logic is the same as saying that two wrongs make a right. The purpose of this article, however, is to address a disunity between the taxes. Accepting differing calculation approaches of the taxes is a necessary component to the discussion. It has been proposed that the differences resulting from the different calculation approaches should be addressed by further unifying the taxes in that regard. Barring that broader solution, this paper proceeds to a more discrete topic on the assumption the difference in calculation methods will persist.

9. I.R.C. § 2035(b).

10. *Id*. § 2001(b). The cumulative value of lifetime taxable gifts is added into the estate tax calculation to further the transfer tax system's goal of taxing the cumulative transfers of an individual over life and at death with one unified progressive rate structure. Tax Reform Act of 1976, Pub. L. No. 94–455 (1976), 90 Stat. 1520 (codified as amended in scattered sections of 26 U.S.C.). The total value of lifetime taxable gifts is adjusted by removing the value of any such gifts which have been ignored through the application of a string provision and included in the transferor's gross estate at death. I.R.C. § 2001(b).

11. A key difference, of course, is that the addition of taxable gifts into the estate tax calculation includes the gifts at their date of gift values, allowing any post gift appreciation to escape transfer taxation. The impact of the String provisions, where applicable, is that the value on the date of gifting is removed from the calculation and the date of death value is included in the gross estate.

any time.[12] This article explores whether, and in what situations, the credit for prior estate taxes paid should be extended to cover this third type of scenario.[13]

Section I of this paper briefly illustrates and compares the tax exclusive calculation approach of the gift tax with the tax inclusive nature of the estate tax, including the impact of section 2035(b) on the estate tax calculation. Section II of this paper discusses section 2013, which provides the credit for prior taxes paid. Section III discusses section 2035(b). Section IV proposes extending section 2013 to provide a credit to estates of decedents who have received taxable gifts, the resulting gift tax of which was included in the transferor's gross estate under section 2035(b). Section V concludes that extension is appropriate given the change from an exclusive to an inclusive calculation occasioned by section 2035(b).

I. TAX EXCLUSIVE GIFT TAX V. TAX INCLUSIVE ESTATE TAX

Although the gift and estate tax are complementary taxes, unified in many regards[14] and functioning in conjunction with the Generation Skipping Transfer Tax to impose a tax on the cumulative and total transfers of wealth during a taxpayer's life and at death,[15] some differences remain.[16] Significant among the differences is the manner in which the two taxes are calculated. The gift tax is imposed on a taxpayer's annual taxable gifts and the tax is calculated exclusive of the attendant tax liability. Any gift tax liability is paid from assets not the subject of the taxable gift. The recipient's taxable gift is undiminished by any gift tax liability.[17] The estate tax is calculated using the

12. *See supra* note 11. Any attendant increase in the donor's estate tax liability stemming from the section 2035(b) gross up may increase the potential credit under section 2013 available to recipients of property included in donor's gross estate but, unless the recipient of the *inter vivos* taxable gift is also a beneficiary of a gross estate item, this credit offers no relief to the *inter vivos* recipient.

13. In a recent report, the Task Force on Federal Wealth Transfer Taxes suggested that the prior taxes paid credit should be extended to gift taxes paid, cautioning that any such extension should be sensitive to the impact of section 2035(b). TASK FORCE ON FEDERAL WEALTH TRANSFER TAXES, *Report on Reform of Federal Wealth Transfer Taxes*, *reprinted in* 58 TAX LAW 93 (2004). This report posits that, so long as the gift and estate taxes have different calculation models, the general unavailability of a credit based on prior gift taxes may be justified. *See id.*

14. *See, e.g.*, I.R.C. §§ 2001(c), 2502 (2006) (unified rate schedule); I.R.C. §§ 2010, 2505 (2006) (unified credit structure).

15. *See* BORIS I. BITTKER ET AL., FEDERAL ESTATE AND GIFT TAXATION 26 (9th ed. 2005).

16. For instance, section 2503(b) provides an annual exclusion for certain *inter vivos* transfers from the definition of taxable gifts, for which the estate tax offers no corollary. I.R.C. § 2503(b) (2006). For an article proposing the adoption of limited exclusion provisions in the estate tax, see Kelly A. Moore, *Proposal to Create Exclusion Provisions in the Estate Tax*, 35 OHIO N.U. L. REV. 37 (2009).

17. BITTKER, *supra* note 15, at 22. A gift can be made net of the taxes, in which case the recipient of the gift agrees to bear the burden of the taxes. In 'net gift' situations, the tax exclusive nature of the calculation is preserved by treating the amount of gift taxes paid as consideration for the transfer,

gross estate as the starting point,[18] with any tax liability imposed reducing the ultimate amount of property to be distributed from an estate.[19] In this manner, the estate tax base is inclusive of the ultimate tax liability, if any.[20] For example, assuming a flat fifty percent transfer tax rate, no exclusions involved in determining taxable gifts, no deductions, and no credits, compare the following two examples:

Example One

During life, individual *A* has a total worth of $2,000,000, and decides to make a gift to *B* of $1,000,000. Due to the flat fifty percent transfer tax rate and the other assumptions, *A* has a transfer tax liability of $500,000 ($1,000,000 gift x 50% tax rate). After paying the tax liability, *A* has a remaining total worth of $500,000 ($2,000,000 initial worth – ($1,000,000 gift + $500,000 tax liability payment)). *A* then dies, leaving his remaining property to *B*. The total value of *A*'s worth at death is $500,000, constituting his gross estate for tax purposes. Avoiding the technicalities of the estate tax calculation formula, as a practical matter it can be determined that the remaining gross estate will be subjected to the 50% estate tax rate, resulting in a $250,000 estate tax liability ($500,000 gross estate x 50% estate tax rate). The estate pays the $250,000 estate tax liability and transfers the remaining property, $250,000, to *B*. In this scenario, the total transfer tax burden for the taxpayer during life and at death was $750,000 ($500,000 gift tax and $250,000 estate tax) and *B* received transfers totaling $1,250,000 ($1,000,000 gift + $250,000 transfer at *A*'s death).

Example Two

During life, *A* has a total worth of $2,000,000, but makes no lifetime gifts, obviously triggering no lifetime transfer tax liability. At *A*'s death, *A*'s gross estate is again $2,000,000, and his estate plan provides that his entire estate passes to *B*. The estate tax liability for this estate is $1,000,000

---

lowering the ultimate tax liability. *Id.* at 116.

18. *See* I.R.C. § 2051 (defining the taxable estate as the gross estate less deductions).

19. *See* BITTKER, *supra* note 15, at 22.

20. I.R.C. § 2031(a) (gross estate defined). Reforming the gift tax to be computed on a tax-inclusive basis has previously been proposed without success. *E.g.*, 2 TREASURY DEP'T, TAX REFORM FOR FAIRNESS, SIMPLICITY, AND ECONOMIC GROWTH: THE TREASURY DEPARTMENT REPORT TO THE PRESIDENT 376–77 (1984) *available at* http://www.ustreas.gov/offices/tax-policy/library/tax-reform/tres84v2All.pdf. *See also* Theodore S. Sims, *Timing Under a Unified Wealth Transfer Tax*, 51 U. CHI. L. REV. 34, 36 (1984).

($2,000,000 x 50% tax rate). After paying the estate tax liability, the remaining property in the estate, $1,000,000 is transferred to *B*. In this scenario, the total transfer tax liability was $1,000,000 and *B* received property transfers totaling $1,000,000.

In Example One, *B* received $250,000 more in property as a result of *A*'s gratuitous transfers than in Example Two. The different result stems from *A*'s decision to incur lifetime transfer tax liability. The gift tax is calculated on the total value of gifts made, exclusive of the amount of the any tax liability payment. As a result, the payment of the gift tax liability reduced the total value of property available to transfer without triggering any transfer tax liability. By contrast, the estate tax is calculated inclusive of the property which may ultimately be used to satisfy any attendant estate tax liability. The tax rate is applied against the total value of property owned[21] or controlled[22] by the decedent or insufficiently given away[23] by the donor as of the time of his death, thus taking into account for tax calculation purposes the value of the property which may ultimately be transferred to the government in satisfaction of the estate tax liability. The differing calculation approaches lead many estate planners to counsel clients to incur lifetime gift tax liability as a way of reducing the total transfer tax liability the taxpayer may incur,[24] as this simplified comparison demonstrates.

Section 2035(b) of the estate tax code provides that gift tax paid as a result of transfers within three years of death is added back into a decedent's gross estate, effectively removing the benefit of the tax exclusive nature of the gift tax for taxable gifts made within three years of death.[25] Consider Example One above. If the gift at issue in Example 1 had been made within three years of death, *A*'s gross estate at death would have been $1,000,000 ($500,000 property owned at death + $500,000 gross up based on value of gift tax paid within three years of death). With the gross estate grossed up to $1,000,000, the estate tax liability would be $500,000 ($1,000,000 gross estate x 50% tax rate). The total amount transferred to *B* in the scenario would be $1,000,000 (the value of the gift). The total amount of transfer taxes would be $1,000,000 ($500,000 gift tax + $500,000 estate tax). This result is economically identical

---

21. I.R.C. § 2033.

22. *Id*. § 2041 (inclusion into gross estate of general powers of appointment); I.R.C. § 2042 (2006) (inclusion into gross estate of life insurance policies over which the decedent controlled sufficient incidents of ownership at death).

23. As determined pursuant to a 'string provision,' *see supra* note 7.

24. *See, e.g.*, Lawrence P. Katzenstein, *Numbers Matters: The Mathematics of Estate Planning*, *in* COURSE OF STUDY ON ADVANCED ESTATE PLANNING TECHNIQUES 89(A.L.I., A.B.A. Feb. 19–21, 2009) *available at* http://www.ali-aba.org/doc/frontmatter/cp037_fm.pdf.

25. IRC § 2035(b).

to the result in Example Two above. Thus, for gifts made within three years of death, the result of the calculation does not differ from a scenario where the gift was not made during life, but instead made at death in the first instance.[26]

II. THE SECTION 2013 CREDIT

Section 2013(a) provides:

> 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.[27]

The predecessor to section 2013 was section 812, which provided a deduction from a decedent's gross estate for the value of any property received from a taxable estate or via taxable gift within five years of death.[28] In the Internal Revenue Code of 1954, section 2013 replaced section 812, converting the deduction to a credit, but evincing the same objective of eliminating the imposition of two transfer taxes in a short period of time.[29] As section 812 operated, if any of the previously taxed property resulted in gift or estate tax liability to the donor/decedent, it was exempt from the estate tax of the later decedent.[30]

Beyond changing the deduction to a credit, section 2013 altered the scope of section 812 in two other significant ways. First, the credit was limited to prior estate taxes paid only, whereas the former deduction encompassed property that had been the subject of a prior gift tax. Section 812's inclusion of gift tax paid was strongly criticized because the gift tax is voluntarily incurred and because taxable gifts are often made for transfer tax avoidance

---

26. *See* examples *supra* pp. 279-81.
27. I.R.C. § 2013.
28. Revenue Act of 1939, ch. 247, 53 Stat. 862 (1939).
29. *See, e.g.*, Estate of Sparling v. Comm'r, 552 F.2d 1340 (9th Cir. 1977); Roth v. Welch, 183 F. Supp. 559 (S.D. Ohio 1960).
30. Revenue Act of 1939, ch. 247, 53 Stat. 862 (1939).

purposes.[31] Second, whereas the deduction allowed 100% of the value of property received from a taxable estate or as a taxable gift to be deducted for a five year period from date of receipt, section 2013 implemented a ten year period during which the credit will be available, reducing the amount of the credit by 20% with the passage of each two year increment.[32]

Section 2013 permits a decedent's estate to take a credit for a portion of the estate tax paid by the transferor's estate, the amount of which depends on the amount of time that lapsed between deaths. A credit can be applied against the decedent's estate tax if there was a transfer of property to the decedent from a prior estate within the preceding ten years. A credit is also possible if the transferor of the property dies within two years after the decedent, if the subject taxable gift is brought back into the transferor's gross estate pursuant to a string provision.[33]

The base amount of the credit (prior to any adjustments for length of time) is the lesser of either the federal estate tax attributable to the transferred property in the transferor's estate ("The First Limitation", as the regulations describe it) or the amount of the federal estate tax attributable to the transferred property in the decedent's estate ("The Second Limitation").[34] The First Limitation requires that the property received from the transferor must have triggered an initial estate tax.[35] If the transferor did not have a taxable estate, the whole equation unwinds and the value of the First Limitation is zero, resulting in no credit for the decedent.

31. Harry J. Rudick, *The Estate Tax Deduction for Property Previously Taxed*, 53 COLUM. L. REV. 761 (1953).
32. I.R.C. § 2013(b) (2006).
33. *Id*. § 2013(a).
34. Treas. Reg. § 20.2013–1(b) (2008).
35. *Id.* § 20.2013–2(a).

III. SECTION 2035(b)

Section 2035(b) provides:

> (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.[36]

Section 2035(b)[37] requires the inclusion in a decedent's gross estate of the value of any gift tax paid on taxable gifts made within three years of death.[38] This requirement stems from Congress's desire to prevent deathbed gifts from incurring gift tax liability over estate tax liability.[39] The three year look back rule was enacted for administrative convenience, as delving into whether a gift was motivated by tax avoidance was cumbersome.[40]

The disunity in the calculation of the two taxes creates a potentially effective method of removing value from an estate through lifetime transfers to reduce overall transfer tax liability. Recall the simplified scenarios from section I. In example one, *A*, having a total worth of $2,000,000, transferred half of his estate via lifetime transfers with the remaining half passing upon *A*'s death. The result was a total transfer tax burden during life and at death of $750,000 ($500,000 gift tax and $250,000 estate tax) for an effective tax rate of 37.5% ($750,000/$2,000,000). In example two, *A* did not make any lifetime transfers and thus his entire gross estate was subject to the estate tax upon death, resulting in a total transfer tax burden of $1,000,000 at the hypothetical 50% rate. As the examples show, because gift taxes are paid with property that would otherwise be included in the decedent's gross estate and would thus generate additional estate tax, making a lifetime gift (that would otherwise occur at death) and paying the concomitant gift tax can reduce a

---

36. I.R.C. § 2035.
37. Section 2035(b) is a companion to section 2035(a), which buttresses the objective of the string provisions and secction 2042 in preventing estate tax avoidance by relinquishing previously retained powers over or interests in putative *inter vivos* transfers within three years of death. The sections work independently of each other, and a discussion of section 2035(a) is beyond the scope of this article.
38. I.R.C. § 2035(b).
39. BITTKER, *supra* note 15, at 220.
40. *Id.* at 221.

taxpayer's overall tax liability. Clearly, with these results there is a strong incentive for lifetime transfers to reduce overall tax liability.[41]

Section 2035(b), however, removes this incentive, to a limited extent, by requiring gift taxes paid on taxable gifts made within three years of death to be included in the decedent's gross estate and thus subject to the estate tax.[42] The legislative history further explains:

> Since the gift tax paid on a lifetime transfer which is included in a decedent's gross estate is taken into account both as a credit against the estate tax and also as a reduction in the estate tax base, substantial tax savings can be derived under present law by making so-called 'deathbed gifts' even though the transfer is subject to both taxes. To eliminate this tax avoidance technique, the committee believes that the gift tax paid on transfers made within 3 years of death should in all cases be included in the decedent's gross estate. This 'gross-up' rule will eliminate any incentive to make deathbed transfers to remove an amount equal to the gift taxes from the transfer tax base.[43]

The effect of the gross-up rule is that the estate tax liability for a decedent who made lifetime taxable gifts within three years of death is the same as if the decedent had never transferred the property during life.[44]

Recall example one above. If the gift at issue in example one had been made within three years of death, *A*'s gross estate at death would have been $1,000,000 ($500,000 property owned at death + $500,000 gross up based on value of gift tax paid within three years of death). With the gross estate grossed up to $1,000,000, the estate tax liability would be $500,000

---

41. The incentive still exists as long as section 2035(b) can be avoided. *But see, e.g.,* Brown v. United States, 329 F.3d 664, 674–75 (9th Cir. 2003), *cert. denied*, 540 U.S. 878 (2003) (applying the step transaction doctrine to prevent an "end-run" around section 2035(b) to include gift taxes paid by a spouse in the decedent taxpayer's gross estate when taxpayer was the true source of funds and the spouse was a mere conduit); *see also* Estate of Sachs v. Comm'r, 856 F.2d 1158, 1163–64 (8th Cir. 1988) (holding that even in the case of net gifts, where the donee is required to pay the gift tax incurred by the donor, section 2035(b) applies to such tax paid if the donor dies within the three year period).
42. Section 2035(b) was originally enacted as section 2035(c) in 1976. Tax Reform Act of 1976, Pub. L. No. 94–455, 90 Stat. 1520, § 2001(a)(5) (1976) (current version at I.R.C. § 2035(b) (2006)). It was redesignated as section 2035(b) without substantive change in 1997. Taxpayer Relief Act of 1997, Pub. L. 105–34, 111 Stat. 788, § 1310(a) (1997).
43. H.R. REP. NO. 94–1380, at 3366 (1976), *reprinted in* 1976–3 C.B. 738. *See also* STAFF OF JOINT COMM. ON TAXATION, 94TH CONG., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1976 529 (Comm. Print 1976).
44. *See, e.g., Brown*, 329 F.3d at 667–68 (explaining that section 2035(b) "presumes that gifts made within three years of death are made with tax-avoidance motives and eliminates the tax advantage for those death bed transactions").

($1,000,000 gross estate x 50% tax rate). The total amount transferred to *B* would be $1,000,000, the value of the lifetime gift, and the total amount of transfer taxes would be $1,000,000 ($500,000 gift tax + $500,000 estate tax). This result is economically identical to the result in example two above. Thus, for gifts made within three years of death, the result of the calculation does not differ from a scenario where the gift was not made during life and instead made at death in the first instance.

As the preceding discussion makes clear, section 2035(b) further unifies the estate and gift tax (at least with respect to transfers presumed to be made in contemplation of death) by removing the potential disparity in total tax liability caused by the different methods of calculating the two transfer taxes. However, unification in this respect creates disparity with respect to the credit for prior estate taxes paid under section 2013, discussed in the previous section. The next section suggests a further unification.

IV. PROPOSED SECTION 2013 MODIFICATION

Section 2013 could be modified to allow a credit for any additional estate tax incurred as a result of section 2035(b)'s triggering of a gift tax liability within three years of death with transfers of property directly out of a gross estate. Unlike an individual who received a gift subject only to a tax exclusive calculation, the property in recipient's estate bore a tax inclusive burden, no different from the burden section 2013 is designed to alleviate. The doctrine of horizontal equity provides that similarly situated taxpayers should be treated, generally, in the same manner under the tax code. As a result of the 2035(b) gross up, the recipient of a taxable gift, which generated a gift tax liability for the donor within three years of death, is aligned with a recipient of a transfer occasioned by the death of the donor. Though similarly treated in the donor's estate tax calculation, the estate of the recipient of a taxable gift is treated unlike the estate of a recipient of a transfer occasioned by death. The estate comprised of property received from a prior estate is granted a tax credit that is unavailable to the estate comprised of property received as a taxable gift.

If the credit is extended to cover situations in which section 2035(b) is involved, certain administrative issues need to be addressed. Among them is the phase out period for a credit attributable to section 2035(b) transactions. The current phase out is ten years, with a 20% reduction of the credit available every two years. Should the phase out here begin counting the ten year requirement at the time of the gift, accounting for the time the recipient had to enjoy the property? Or, should the phase out countdown begin when the estate tax calculation actually imposes the tax inclusive burden?

Another question stems from this example: donor gives recipient a taxable gift in year one, incurring a gift tax liability. Also, in year one, Recipient dies, incurring an estate tax liability, in part, due to the inclusion of the gift of property in his gross estate. If donor dies within three years, he will be required to add the related gift tax into his gross estate under section 2035(b) and the value of the related taxable gift to his estate tax calculation base as an adjusted taxable gift. By so calculating, part of donor's estate tax liability will be generated by the gift to the predeceased recipient. Should recipient's estate be able to seek a refund based on this payment of estate tax? Section 2013 currently provides for a refund possibility in a similar scenario: where a taxable gift has been made and respected by the gift tax code, but is ignored for estate tax calculation purposes.

For instance, if an individual makes a gift to an irrevocable trust in year one, retaining the income interest for life but effectively giving the remainder interest in the trust to an unrelated third party, the actuarial value of the remainder is deemed a gift on the date of the trust funding. This taxable gift may result in the payment of a gift tax liability. Upon the death of the grantor, the trust will be included in grantor's gross estate under section 2036(a)(1). The inclusion of the date of death value of the trust in grantor's gross estate will lead to a possible section 2013 credit for tax on prior transfers. If the remainderman had died within the two years prior to the grantor, he may be able to seek a refund of his estate tax liability based upon the credit calculations stemming from the grantor's gross estate.[45] This model could be used to allow a refund in a section 2035(b) situation, but would have to be modified to account for the three year look back period of the section 2035(b) inclusion rule. In addition, section 2013's focus on date of death value would have to be modified to address the date of gift value of the subject property included under section 2001(b).

V. CONCLUSION

The historical trend of estate and gift tax legislation has been a move toward unification.[46] Whereas the taxes had separate rate structures, for

45. *See* I.R.C. § 2013(a) (2006) (recipient allowed a credit if transferor " . . . died within 10 years before, or within 2 years after, . . . " recipient. The 2 year look back limit is for administrative convenience.); S. REP. NO. 83–1622, at 121–22 (1954), *reprinted in* 1954 U.S.C.C.A.N. 4621, 4755–56.

46. *See, e.g.,* The Tax Reform Act of 1976, Pub. L. No. 94–455, 90 Stat. 1520 (1976); BITTKER, *supra* note 15, at 19–23. The Economic Growth and Tax Relief Reconciliation Act of 2001 ('EGTRRA') fractured this unity, providing for its ultimate demise with a repeal of the estate tax in 2010. *See* Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107–16, 115 Stat. 38 (codified in scattered sections of 26 U.S.C.). This Article is written on the assumption that the repeal

example, the systems now are designed to promote a unified tax, using the same rate tables.[47] The move toward unification, however, has not yet fostered removing the difference in the tax calculation approaches.[48] In situations where lifetime gift tax payments result in a reduction of an individual's overall transfer tax liability, the unavailability of the section 2013 credit may be justified. Section 2035(b) removes this impact for gift taxes paid in the last three years of life. Despite bringing such gifts into conformity with the estate tax calculation, however, a prior taxes-paid-credit is denied. The goal of unifying the two systems will be furthered by allowing a credit for lifetime gifts, the resulting gift tax from which is brought back into the donor's gross estate pursuant to section 2035(b).

Gift tax payments within three years of death may have been motivated by tax minimization objectives, but that is no reason to deny the section 2013 credit where the timing is appropriate. Section 2035(b) is Congress's response to any such tax minimization estate planning gambits. Section 2013 manifests Congress's desire to address perceived excessive imposition of transfer taxes on property or property interests in two estates in quick succession. If section 2035(b) has removed the advantage of the tax exclusive nature of the gift tax calculation, aligning the transfers with transfers made from a transferor's gross estate, the availability of the section 2013 credit should be similarly aligned.

---

feature of EGTRRA will not be allowed to take effect and that the transfer tax system will persist, with some modifications. Even if the year of repeal is allowed, the transfer tax is currently slated for return in 2011, at 2001 levels.

47. BITTKER, *supra* note 15, at 19.

48. BITTKER, *supra* note 15, at 22.