# WILL THE APPLICABLE EXCLUSION AMOUNT TAME SECTION 2057, AGAIN?

*by Kelly A. Moore*[*]



## I. INTRODUCTION

In 1998, Congress enacted section 2057 of the Internal Revenue Code, providing certain owners of qualified family-owned business interests with a tailored estate tax deduction.[1] The section 2057 deduction replaced the similarly focused 2033A exclusion, which had been added to the Code by the Taxpayer Relief Act of 1997 (TRA).[2] The section 2033A exclusion was criticized as too complex and suffering from structural flaws.[3] Section 2057 not only replaced the section 2033A exclusion with a deduction, but it better defined the limits of the deduction as compared to the exclusion—including the computational relationship of the deduction with the applicable exclusion amount.[4]

At the time of enactment, the maximum potential benefit to an estate from a section 2057 deduction resulted in $675,000 of a decedent's gross estate passing free of federal estate taxes, regardless of the applicable exclusion amount otherwise available to the estate under the estate tax.[5] In 1998, if an estate could use the full section 2057 deduction and the applicable exclusion amount of $625,000, the estate shielded $1.3 million

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1. I.R.C. § 2057(e) (West 1998); Internal Revenue Service Restructuring and Reform Act of 1998, H.R. 2676, 105th Cong. (2nd Sess. 1998).

2. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 788 (1997).

3. *See* Neil E. Harl, *The Family Owned Business Deduction: Still in Need of Repairs*, 4 DRAKE J. AGRIC. L. 59, 60 (1999) (stating that "the family-owned business exclusion was a model badly in need of an overhaul.").

4. Shannon E. O'Brien, *Estate Tax Treatment of Family-Owned Businesses: The Evolution of Internal Revenue Code Section 2057*, 67 UMKC L. REV. 495, 513 (Spring 1999).

5. I.R.C. §§ 2057, 2010(c) (West 2002). The applicable exclusion is the amount of a taxable estate exempt from federal taxes under the unified credit.

from the estate tax.[6] The combined total benefit provided was possibly reduced by the interplay of the deduction limit and a special applicable exclusion amount calculation provided in section 2057.[7] As a result of this interplay, the utility of the deduction diminished as the applicable exclusion amount available—absent a claim of a section 2057 deduction—increased.[8]

In order for an estate to avail itself of this deduction, a very complex set of rules has to be satisfied.[9] The resulting complexity placed in the Code led some to assert that the benefit of the deduction—especially as the benefit decreased with the anticipated increase in the applicable exclusion amount—did not justify the attendant planning efforts.[10]

As part of the staged dismantling of the federal transfer-tax system put in motion by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), the applicable exclusion amount was set at $1.5 million as of January 1, 2004.[11] The EGTRRA set the exclusion amount at a level in excess of the total combined benefit available to an estate under section 2057.[12] With the utility of section 2057 thus reduced, the EGTRRA also repealed section 2057 for decedents dying after December 31, 2003.[13]

The scope of the EGTRRA was broader than just the repeal of section 2057 and the increase in the applicable exclusion amount. The EGTRRA eventually triggered a one-year complete repeal of the estate tax in calendar year 2010.[14] This one-year "death tax" holiday was preceded by a staggered increase in the applicable exclusion amount, providing a staged increase in the value of property allowed to be bequeathed exempt from the tax between 2001 and 2009.[15] This was accompanied by a staggered decrease in the maximum rate applied to the value of the taxable estate over that same period.[16] The EGTRRA also repealed the generation-skipping

6. *See* Martin A. Goldberg & Robert E. Wnek, *Estate Planning for Future Reinstatement of I.R.C. § 2057*, 18 QUINNIPIAC. PROB. L. J. 128, 128–29 (2004) (discussing continuing need to plan for section 2057 considerations, even during the temporary repeal of section 2057, ending 2011).

7. I.R.C. § 2057 (West 1998).

8. S. Rep. No. 105-174 (1998) (explaining examples of section 2057*); see also* CCH INCORPORATED, 1998 TAX LEGISLATION: IRS RESTRUCTURING AND REFORM: LAW, EXPLANATION AND ANALYSIS 23 (1998).

9. I.R.C. § 2057; *see* R. Lee Grant, *Analysis of the Recapture Tax for Qualified Family-Owned Business Interest Deductions*, 26 OHIO N.U. L. REV. 289, 291 (2000) (stating that "[a] positive side is that estate planners and attorneys are guaranteed a job with the passage of complex code sections like section 2057.").

10. Grant, *supra* note 9, at 289.

11. I.R.C. § 2010(c) (West 2010); Economic Growth and Tax Relief Reconciliation Act (EGTRRA), Pub. L. No. 107-16, 115 Stat. 38 (codified as amended in scattered sections of I.R.C.).

12. *Id.*

13. I.R.C. § 2057(j).

14. I.R.C. § 2210 (providing the repeal of estate tax on "estates of decedents dying after December 31, 2009"); EGTRRA § 901(a)(2) (2001) (sunset provision reinstating the estate tax in 2011).

15. I.R.C. § 2010(c); *see* Daniel W. Matthews, *A Fight to the Death: Slaying the Estate Tax Repeal Hydra*, 28 WHITTIER L. REV. 663, 671–74 (2006) (discussing the adoption and manipulation of the term "death tax" by the proponents of repeal to sway public opinion against the estate tax).

16. EGTRRA § 511; I.R.C. § 2001(c).

transfer tax for 2010 with an accompanying increase in exemptions similar to those in the estate tax for the years prior to 2010.[17] The gift tax was left in place as the sole transfer-tax system survivor to act as a supplement to the federal income tax.[18]

For relatively obscure parliamentary reasons, the EGTRRA's dismantling of the federal transfer-tax system was temporary.[19] The estate tax and generation-skipping transfer tax will be reinstated at their 2001 rate levels in 2011.[20] With the resurrection of these two taxes, the federal transfer-tax system springs back to life.[21] Barring congressional action, the transfer-tax system will catch gratuitous conveyances from January 1, 2011 and on as though the EGTRRA never existed.[22] The applicable exclusion amount will be reset at $1 million as of January 1, 2011, and section 2057 will again offer a limited deduction to appropriate estates.[23]

Section 2057 is a complex provision, but the provision's repeal in 2004 pursuant to the EGTRRA only superficially removed a level of complexity from the Code. Although absent from the Code for seven years, the provision's scheduled return in 2011 preserves the need for estate planners to plan for the deduction during the years of the provision's repeal.[24] This residual complexity was inherent in the EGTRRA. Due to the compliance difficulties in the staged and temporary change and repeal of the estate tax provided for in the EGTRRA, the EGTRRA added complexity to the transfer-tax system.[25]

The EGTRRA foisted a "tentative and uncertain" transfer-tax system on taxpayers.[26] Many assumed Congress would either make the repeal permanent or modify and perpetuate the estate tax before the 2010 repeal of

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17. EGTRRA §§ 501(b), 521(c) (2001); I.R.C. §§ 2631, 2664.

18. *See* I.R.C. § 2210 (West 2001) (demonstrating no provision for repeal of gift tax). The gift tax is not left completely unaffected by the EGTRRA; for example, the EGTRRA increased the amount of property that can be gratuitously transferred *inter vivos* and provided for a general reduction in its rate scales. EGTRRA §§ 511, 521(b) (2001); I.R.C. §§ 2001(c), 2505(a)(1). *See generally* Mitchell M. Gans & Jay A. Soled, *Reforming the Gift Tax and Making it Enforceable*, 87 B.U. L. REV. 759 (2007) (discussing whether the gift tax effectively buttresses the income tax as intended).

19. *See* ROBERT KEITH, CONG. RESEARCH SERV., CRS REPORT FOR CONGRESS, THE BUDGET RECONCILIATION PROCESS: THE SENATE'S "BYRD RULE" 14-15 (2005), *available at* http://www.rules.house.gov/Archives/RL30862.pdf (describing the effect of the Byrd Rule in encouraging the addition of sunset provisions to bills so that only a simple majority of affirmative votes is necessary for the bill to pass).

20. EGTRRA § 901(a)(1) (2001).

21. *Id.*

22. Kelly A. Moore, *Proposal for Estate Tax Exclusion Provisions*, 35 OHIO N.U. L. REV. 37, 39 (2009).

23. EGTRRA § 901(a)(1) (2001).

24. *See* Martin A. Goldberg & Robert E. Wnek, *Estate Planning for the Future*, 18 QUINNIPIAC PROB. L. J. 128, 128 (2004).

25. *See Federal Estate Tax: Uncertainty in Planning Under the Current Law: Hearing Before the Subcomm. on Fin.*, 110th Cong. 13–16 (2007).

26. Michael J. Graetz, *100 Million Unnecessary Returns: A Fresh Start for the U.S. Tax System*, 112 YALE L.J. 261, 262 (2002).

the estate tax provided by the EGTRRA.[27] It turns out the old saying is correct: It is not safe to assume. Because Congress did not resolve the existential issue of the estate tax prior to 2010, it will revert back to 2001 rates after 2011.[28] As the glittering ball descended in Times Square at midnight December 31, 2009, a metaphorical wrecking ball also descended, smashing the estate plans of many Americans and ushering in the year of estate tax repeal.

Amid the calls for a retroactive reinstatement of the estate tax at 2009 levels for calendar year 2010 and arguments that repeal be permanent, the former estate tax, circa 2001, waits for the dawn of 2011 to regain its effectiveness.[29] In the meantime, the debate rages between two arguments: retroactive reinstatement of the estate tax for the calendar year or permanent repeal of the estate tax.[30] The existential debate over transfer tax reform pre-dates and is deeply embedded in the EGTRRA, but the EGTRRA's provisions left the issue completely unresolved.[31] Instead, the EGTRRA represented a tenuous, temporary compromise between those urging repeal of transfer taxes and those urging their persistence.[32]

As with any compromise, neither side of the debate over repealing the estate tax was pleased with the EGTRRA.[33] The compromise resulted in an increase in the estate tax applicable exclusion amount.[34] This compromise ensured the tax impacted only the wealthiest taxpayers (thereby impacting fewer taxpayers) and worked towards the repeal camp's ultimate goal, but it failed to free all taxpayers from the grips of the tax.[35] A one-year only repeal also did not accomplish the ultimate goal.[36] Those urging continuation of the estate tax for social and other policy grounds kept the tax in place, living to fight for its perpetuation another day.[37]

The Estate Tax Bar advocated for certainty in the transfer tax system.[38] The Bar has told Congress that a continuation of the rollercoaster like changes to the transfer tax unacceptably leaves too many people in estate

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27. *See* Dustin Stamper, *GOP Hoping for Resurrection of Estate Tax Reform in 2006*, 2005 TAX NOTES TODAY 220–22, Nov. 16, 2005.

28. EGTRRA § 901(a)(1).

29. *See generally* J. COMM. ON TAXATION, 111th Cong., (describing revenue provisions contained in the President's Fiscal Year 2011 Budget Proposal 68 n88 and cataloguing continued policy attacks against the estate tax).

30. *Id.*

31. *Id.*

32. Moore, *supra* note 22.

33. *Id.*

34. EGTRRA § 521; I.R.C. § 2010(c).

35. Reginald Mombrun, *Let's Protect Our Economy and Democracy from Paris Hilton: The Case for Keeping the Estate Tax*, 33 OHIO N.U. L. REV. 61, 61–62 (2007).

36. *See* EGTRRA § 901(a)(2).

37. Mombrum, *supra* note 35, at 62.

38. Task Force on Federal Wealth Transfer Taxes, *Report on Reform of Federal Wealth Transfer Taxes*, 58 TAX LAW. at 96–98 (2004).

planning limbo.[39] Among the compromises offered to reach a consensus on the existence and structure of the estate tax post-repeal, some have proposed allowing the estate tax to reemerge in 2011, but with an applicable exclusion amount of $3.5 million.[40] If this is the bargain struck, it not only provides certainty but also allows continued repeal of section 2057. This will finally eliminate the complexity added and the possible horizontal inequity triggered by the provision.[41]

Congress previously used an increase in the amount of property that can be transferred without imposition of the estate tax as an occasion to strip the Code of complexity.[42] Assuming a compromise regarding the future of the estate tax is reached that provides an applicable exclusion amount of $3.5 million, this essay posits that a secondary benefit of such compromise is the permanent elimination of section 2057. First, this essay will provide an overview of the mechanics and underlying policies of section 2057. Next, the essay will briefly outline other provisions of the Code providing targeted relief to estates comprised of such assets. Then, the essay considers whether or not it is still necessary to endure the complexity added to the Code by section 2057. Given the assumed increase in the applicable exclusion amount and other provisions protecting estates comprised of such assets, the essay concludes that section 2057 is not necessary and Congress should repeal it, again.

## II. I.R.C. § 2057: MECHANICS

Congress intended for section 2057 to provide relief to estates, the value of which included a significant percentage of a "qualified family-owned business interest" (QFOBI); QFOBI consists of certain business interests included in determining the value of a decedent's gross estate that are passed to a qualified heir.[43] An estate could only take this deduction if (1) the decedent was a citizen or resident of the United States, an appropriate election was made, and the QFOBI's value in decedent's gross

39. *See Federal Estate Tax: Uncertainty in Planning Under the Current Law: Hearing Before the Subcomm. on Finance.*, 110th Cong. 13–16 (2007) (statement of Conrad Teitell, Principal, Cummings & Lockwood, LLC) (comparing the approach of the EGTRRA to a roller coaster ride of increasing exemptions followed by a precipitous fall in the year of repeal and a return in the next year to the pre-EGTRRA system).

40. *See* J. COMM. ON TAXATION, *supra* note 29.

41. Although not the focus of this essay, offering a benefit to an estate based on the composition of its assets, while not offering such a benefit to an estate with a similarly valued gross estate consisting of a different form of assets, may violate the principle of horizontal equity. *See* Richard J. Wood, *Supreme Court Jurisprudence of Tax Fairness*, 36 SETON HALL L. REV. 421, 435 (2006) (defining horizontal equity as a policy of treating similarly situated taxpayers in the same manner under the Code).

42. *See* Joseph M. Dodge, *A Feminist Perspective on the QTIP Trust and the Unlimited Marital Deduction*, 76 N.C. L. REV. 1729, 1746 n.84 (1998) (referring to the repeal in 1981 of an estate tax exclusion related to a decedent's orphaned children under twenty-one years old).

43. I.R.C. § 2057(b)(1)(C) (1998); I.R.C. § 2057(b)(2)(A) (2010); I.R.C. 2057(b)(2)(B) (2010).

estate, when added to the value of gifts in the interest made to decedent's family exceeded 50% of decedent's gross estate, and (2) the decedent satisfied requirements related to duration of ownership before death.[44]

Adding to the complexity of section 2057 were the recapture provisions, providing that the heirs receiving the QFOBI were required to file an agreement to pay any recapture taxes that might apply.[45] Recapture taxes applied if, within ten years after the date of the decedent's death, (1) the decedent's family had failed to satisfy certain material participation requirements pertaining to the QFOBI, (2) the qualified heir had disposed of the QFOBI, (3) the qualified heir had lost United States citizenship without having transferred the QFOBI to a specifically defined domestic trust, or (4) the QFOBI's principal place of business ceased to be in the United States.[46] If recapture applied, an additional estate tax was levied based on the now-lost tax benefit of the section 2057 deduction, plus interest.[47]

Even if an estate satisfied these requirements and an heir was willing to satisfy the recapture provision requirements, the deduction was limited in amount and by its relation to the applicable exclusion amount.[48] Section 2057(a) provided:

> **(a) General rule.**
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> **(1) Allowance of 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).
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> **(2) Maximum deduction.**—The deduction allowed by this section shall not exceed $675,000.
>
> **(3) Coordination with the 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

44. I.R.C. § 2057(b)(1)(A)–(C).
45. I.R.C. § 2057(b)(1)(B).
46. I.R.C. § 2057(f)(1)(A)–(D); I.R.C. § 2057(g)(2).
47. I.R.C. § 2057(f)(12).
48. *See generally* Martin A. Goldberg & Robert E. Wnek, *supra* note 24, at 128 (discussing requirements in more detail and related estate planning opportunities).

> applicable exclusion amount under section 2010 [26 USCS S.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.[49]

For example, with the deduction limited to a maximum of $675,000 and the provision of a special applicable exclusion calculation, an estate valued at $450,000 along with $850,000 in allowable exclusion amount willing to comply with the complexities of this system could effectively shield a total of $1.3 million from the imposition of the estate tax liability.[50] This $1.3 million total benefit was static at the time of enactment, but one of the component parts—the applicable exclusion amount—had been targeted for gradual increase by the TRA.[51] The TRA provided that the applicable exclusion amount would increase as follows:

| Year | Applicable Exclusion Amount |
|---|---|
| 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.[52] |

Based on the gradual increase of the applicable exclusion amount provided in the TRA, the following examples demonstrate the impact of the deduction limitation and the interplay with the applicable exclusion amount:

> Example (1): Decedent A dies in 2004 with a gross estate of $2 million. A's estate includes a qualified family-owned business interest worth $500,000. Her estate elects to take a section 2057 deduction of $500,000 and is also entitled to an applicable exclusion of $800,000 thus shielding $1,300,000 from estate tax.
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> Example (2): Decedent B dies in 2000 with a gross estate of $2 million and a qualified family-owned business worth $1 million. B's estate elects to take a section 2057

49. I.R.C. § 2057(a).

50. *See* Terrence M. O'Rourke, *Qualified Family-Owned Business Interest* (2008), http://cfc.royaloakbusinesses.com/QFOB.pdf.

51. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 788 (1997).

52. *See* I.R.C. § 2010(c) (West Supp. 1998).

> deduction of $675,000 and is entitled to an applicable exclusion amount of $625,000, thereby shielding $1.3 million from estate tax
>
> Example (3): Decedent C dies in 1999 with a gross estate of $2 million and a qualified family-owned business interest worth $350,000. C's estate elects a section 2057 deduction of $350,000 and is entitled to an applicable exclusion of $650,000, thereby shielding $1 million from estate tax.[53]

As these examples illustrate, the interrelated computation of the total benefit added to the complexity of section 2057. Further, the examples indicate that the benefit of enduring this complexity could never exceed $1.3 million. With the enactment of the EGTRRA, the applicable exclusion amount for the estate tax was set at $1.5 million as of January 1, 2004.[54] As a result, the EGTRRA repealed section 2057 as of December 31, 2003.[55]

## III. I.R.C. 2057 AND FRIENDS—UNDERLYING POLICY CONSIDERATIONS

While groups lobbied for Congress to repeal the estate tax, an effort that eventually led to the enactment of the EGTRRA, groups—sometimes including the same groups—lobbied for Congress to give some level of targeted estate tax relief to small businesses and family farms.[56] These groups argued that the imposition of the estate tax on estates comprised of such assets created liquidity problems, sometimes triggering a forced sale of the assets.[57]

The persuasions of these groups led Congress to enact section 2033A and then replace section 2033A with section 2057.[58] Arguments of this sort also influenced the drive to the EGTRRA and its mirage of repeal.[59] By

53. Shannon E. O'Brien, *Estate Tax Treatment of Family Owned Businesses: The Evolution of Internal Revenue Code Section 2057*, 67 UMKC L. REV. 495, 515 (1999). In Example 1, the $800,00 comes from the $625,000 plus the difference between $675,000 and $500,000, the amount of the section 2057 deduction taken. *Id.* at 514–15. The $800,000 exclusion amount is less than the amount otherwise available to decedent's estate, but the total amount of the benefit of the deduction and the amount remains at $1.3 million, a net advantage of $450,000 over estates ineligible for the section 2057 deduction. *Id.* at 515. Example 2 shows Decedent B is entitled to an exclusion amount of $625,000, not the exclusion otherwise provided by the TRA of $675,000. *Id.* The total benefit to the estate remains $1.3 million, so taking the deduction and the limited applicable exclusion is still the superior choice if the estate is willing to comply with the attendant complexities. *Id.* Decedent C in Example 3 is entitled to an exclusion of $650,000 because that was the maximum allowed for calendar year 1999. *See id.*

54. I.R.C. § 2010(c) (West 2010).

55. I.R.C. § 2057 (West 2010).

56. Grant, *supra* note 9, at 292–93.

57. *Id*. at 293.

58. *See* 143 CONG. REC. H4668, H4669-78 (1997) (statements of Rep. Dunn, Kasich, and Mendez).

59. *See* 147 CONG. REC. H2204, H2204-05 (2001) (statement of Rep. Frost).

design, section 2057 offers a benefit to estates comprised of business assets, and leaves the estate tax otherwise in full force for estates not comprised of such assets.[60] By shielding the estates from some level of estate tax, Congress strove to reduce or eliminate the liquidity concerns caused by the imposition of the estate tax on decedents' estates comprised of a significant level of a QFOBI.[61]

The Code contains, and presumably will contain again, other provisions offering some relief to estates holding either real property or other assets related to the conduct of a closely held business or farming operation. Examples of such provisions include section 2032A and section 6166.[62] These sections have slightly different focuses and provide benefits different in kind than section 2057, but they each offer targeted relief to estates possessing assets related in defined ways to the operation of a trade or business. Both sections are detailed, and section 2032A is particularly complex. A detailed discussion of either section is beyond the scope of this essay. The following summaries are designed to give a limited description and highlight the background of the two sections.

Section 2032A permits special valuation of certain items designated "qualified real property."[63] The scope of section 2032A was different from the scope of section 2057.[64] Whereas section 2057 focused on the value of all assets used in the QFOBI in determining the amount of and limitations imposed on the deduction, special use valuation applied only to real property being put to a qualified use in a business or farming operation.[65] The benefit was also different: section 2032A provided valuation relief whereas section 2057 provided a deduction.[66]

The general rule is that a decedent's gross estate is valued as of the time of the decedent's death.[67] The regulations provide that the value is set at the price a willing buyer would have paid a willing seller for the property, assuming each is aware of the relevant facts and free of compulsion.[68] Assuming its best possible use, this valuation approach could result in the value of a parcel of land being set at a higher price than if the parcel of land had been valued as part of an ongoing business

60. I.R.C. § 2057 (West 2010).

61. Grant, *supra* note 9.

62. *See* I.R.C. §§ 2032A, 6116.

63. I.R.C. § 2032A(b).

64. *Compare* I.R.C. § 2057, *with* I.R.C. § 2032A.

65. *See* I.R.C. § 2057(e) (West 1998); *see also* Neil E. Harl, *The Family-Owned Business Deduction: Still In Need of Repairs*, 4 DRAKE J. *AGRIC*. L. 59, 61 (1999) (discussing the valuation provisions as they interact with the section 2057 deduction); I.R.C. § 2032A(b)(1) ("'qualified real property' means real property located in the United States"); I.R.C. § 2032A(b)(2) ("'qualified use' means the devotion of property to . . . (A) use as a farm for farming purposes, or (B) use in a trade or business other than the trade of business of farming.").

66. I.R.C. §§ 2032A, 2057.

67. *Id.* § 2031(a).

68. Treas. Reg. § 20.2031-1(b) (2010).

enterprise.[69] If this higher value is used, the heirs face the concern that the estate tax liability can increase and leave the heirs with no choice but to sell the property to pay the resulting tax liability. Section 2032A allows an alternative value to be set for such property, which properly reflects the value of the property based on its actual use rather than its most valuable potential use.[70] The objective is to reduce the value of the gross estate, thereby reducing the ultimate estate tax liability and relieving the liquidity pressures created by this possible scenario.

Section 2032A only applies to real property being used by the decedent or a member of decedent's family for a "qualified use."[71] A qualified use includes a devotion of the property for use in a trade or business.[72] Similar to section 2057, section 2032A requires (1) an election by the executor, (2) that the decedent or his family have materially participated in the business prior to decedent's death, (3) that the value of the asset comprise a significant percentage of the decedent's overall estate, (4) that the recipients be qualified heirs who commit to a continue use of the assets in the trade or business, and (5) the recipients must commit to pay any tax saved by use of the deduction if the property was not used for an appropriate period of time after decedent's death.[73] Additionally, section 2032A limited the benefit offered, setting it at $750,000 in 1998, and providing for an inflation adjustment for subsequent years.[74]

Section 6166 provided neither an exclusion nor a valuation alternative. Instead, section 6166 provided for an extension of time for payment of the estate tax if the decedent's estate consisted largely of an interest in a closely held business.[75] Specifically, if an interest in a closely held business that was included in a decedent's gross estate exceeded 35% of the adjusted gross estate, the executor could have elected to pay part or all of the estate tax liability in up to ten annual equal installments, with the first deferred payment being due no later than after a defined five-year period.[76] The amount of the tax liability that could have been paid via the installment method was limited to the ratio of the value of the closely held business and the total adjusted gross estate.[77] An interest in a qualified, closely held business could have included an interest in a trade or business as a proprietorship, a partnership interest, or a corporate interest.[78]

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69. *See* IRA BLOOM, FEDERAL TAXATION OF ESTATES, TRUST AND GIFTS: CASES, PROBLEMS AND MATERIALS, 77 (3d ed. 2003).

70. *See* I.R.C. § 2032A(a).

71. *Id.* § 2032A(b)(2).

72. *See id.* § 2032A(b)(2)(B) (describing trade or business).

73. *Id.* § 2032A(b)(1); *see also* § 2057(a).

74. I.R.C. §§ 2032A(a)(2)–(3).

75. *Id.* § 6166(a).

76. *Id.* §§ 6166(a)(1), (3).

77. *Id.* § 6166(a)(2).

78. *Id.* § 6166(b)(1).

The price of this deferral was an imposition of interest on the amount of any estate tax liability so deferred.[79] The benefit so purchased was intended to ease any liquidity concerns of the ongoing enterprise that might have arisen if the estate was required to pay the estate tax liability in a lump sum.[80]

## IV. DISCUSSION

Given the assumption that the estate tax will emerge on January 1, 2011 with an applicable exclusion amount of $3.5 million, one of two basic approaches to section 2057 will be possible: (1) tinker with the calculation of the benefit of section 2057 to account for an increased—possibly ever increasing—applicable exclusion amount, or (2) perpetuate the repeal of section 2057. Perhaps tinkering with the formula of section 2057 would have been appropriate before the EGTRRA, when tax professionals could not anticipate reaching an applicable exclusion amount of $3.5 million.[81] However, in a post-EGTRRA world, with a $3.5 million applicable exclusion, section 2057 may not be necessary. If, in addition to an increased applicable exclusion amount, the maximum estate tax rate is reduced, far fewer estates will be subjected to the estate tax and those that are will have a lower estate tax liability.[82]

There are indicators that, even before the EGTRRA, estates comprised of small business assets did not necessarily need relief from the estate tax to avoid dire liquidity concerns.[83] Based on returns from 2001, a study determined that estates claiming benefits under sections 2032A, 2057, or 6166 possessed nearly enough liquid assets to meet all debts against the estate.[84] Additionally, estate tax returns only involved a small percentage of decedents' estates overall, suggesting that the impact of the estate tax on small businesses may have been exaggerated.[85] Still, there is support for the position that the estate tax may hamper the ability of a subsequent generation to continue a family-owned business, which suggests that some sort of relief is required.[86]

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79. *Id.*

80. Eric D. Chason & Robert T. Danforth, *Toward a Practical Estate-Tax Exclusion for Family-Run Business: Analysis of Section 2033A and Proposal for Reform*, 32 REAL PROP. PROB. & TR. J. 571, 583 n.61 (1998).

81. *See generally* R. Lee Grant, *Analysis of the Recapture Tax for Qualified Family-Owned Business Interest Deductions*, 26 OHIO N.U. L. REV. 289, 309 (2000) (discussing the possible modification of § 2057 pre-EGTRRA).

82. *See generally* J. COMM. ON TAXATION, 111TH CONG., DESCRIPTION OF REVENUE PROVISIONS CONTAINED IN THE PRESIDENTS FISCAL YEAR 2011 BUDGET PROPOSAL 68 (Comm. Print 2010).

83. *See id.* at 68 n.88.

84. *Id.* at 68 n.89.

85. *Id.* at 64.

86. *Id.*

Section 2057 was, and is again, set to be a complex provision, as were its counterparts—section 2032A and section 6166.[87] Arguably, the assumed increase of the applicable exclusion amount at the dawn of a revival of the estate tax diminishes the need for all three sections.[88] This essay, however, focuses only on section 2057. Allowing section 2057 to remain repealed will keep some level of complexity from creeping back into the Code.[89] The pre-EGTRRA version of section 2057 manifested a determination that section 2057 was less necessary as the applicable exclusion amount increased. The provision of a $3.5 million applicable exclusion amount far exceeds the benefit section 2057 initially intended to bestow.[90]

This is not a new scenario for section 2057. In an earlier incarnation, section 2057 was subjected to the same fate—repeal—because of the same determination--that the hardship section 2057 alleviated had been otherwise addressed by an increase in the amount of property that could pass free of the estate tax.[91] The Tax Reform Act of 1976 enacted former Internal Revenue Code Section 2057.[92] The 1976 version of section 2057 provided, generally, for an orphan's exclusion from the estate tax, which was set at $5,000 a year for each surviving child under age twenty-one of a single decedent.[93] The provision was complicated and difficult to incorporate into estate plans.[94] In 1981, when the amount that could pass exempt from the estate tax was set to increase to $600,000, the orphan's exclusion was repealed.[95] Because more property was shielded from imposition of the estate tax, the complexity of the provision of targeted relief was removed from the Code.

## V. CONCLUSION

As we near the end of the estate tax holiday, the post-repeal structure of the estate tax is still unknown. Assuming that a compromise is struck, by raising the applicable exclusion amount to $3.5 million and lowering the highest rate imposed, the necessity of section 2057 is diminished. Eliminating section 2057 from the Code removes complexity. In addition,

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87. *See* I.R.C. § 2503(b)(1) (West 2010).
88. *See* O'Rourke, *supra* note 50.
89. *See id.*
90. *See id.*
91. Dodge, *infra* note 95.
92. Pub. L. No. 94-455, §§ 2057(a), (c) (1976).
93. I.R.C. § 2057, *repealed by* Economic Recovery Tax Act, Pub. L. No. 97-34 § 427(a), 95 Stat. 172 (1981).
94. Mark L. Ascher, *Curtailing Inherited Wealth*, 89 MICH. L. REV. 69, 127 (1990).
95. Joseph M. Dodge, *Comparing a Reformed Estate Tax with an Accessions Tax and an Income-Inclusion System, and Abandoning the Generation-Skipping Tax*, 56 SMU L. REV. 551, 564, n.59 (2003).

other sections of the Code, in conjunction with the assumed increase in the applicable exclusion amount, continue to address the concerns that motivated the enactment of section 2057.