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*28 JOINT RESOLUTION ON THE UNIFIED CREDIT

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In February 1994 the Young Lawyers Division Assembly of the ABA House of Delegates adopted a resolution proposing an increase in the unified credit's exemption equivalent from $600,000 to $1 million.

A joint committee comprised of members of the Probate and Trust Law Committee and the Tax Law Committee of the Young Lawyers Division (Committee) proposed the resolution. This article introduces the justifications for the resolution and the policy arguments supporting an increase in the unified credit.

Contentious Issue

Altering the unified credit has been a highly contested national issue. Since November 1991 at least eight bills have been proposed in Congress to modify the unified credit. The changes proposed by these bills are nearly evenly divided between increasing and decreasing the unified credit. The American Association of Retired Persons and groups representing small businesses and farmers have joined together to lobby against any proposed decrease in the unified credit. Considering the amount of public attention aimed toward this issue and the significance of the public policy arguments relating to the unified credit, the Committee set out to create a resolution proposing an increase in the unified credit. The resolution begins with a discussion of the history of the estate and gift tax system and its unified credit and the generation-skipping transfer (GST) tax and its exemption. After reviewing recent proposals in Congress to alter the unified credit, the resolution presents the following justifications for raising the unified credit equivalency to $1 million (an increase in the credit from $192,800 to $345,800).

Tax Equity and Fairness Arguments

The purpose of the unified estate and gift tax credit is to reduce or eliminate the estate and gift tax liability of small and medium-sized estates. Because those estates often consist of family businesses, family farms, family homes or moderate amounts of accumulated wealth, public policy favored the passage of such wealth from one generation to the next. The unified estate and gift tax is a graduated tax that has been justified as a means to minimize the passage of vast amounts of accumulated wealth.

The public policy in favor of protecting small to moderate-sized estates from the transfer tax system has been an important public policy issue for farming and small business communities in the United States. Protecting the interests of small businesses is vital to the country's economic prosperity. Most recent growth in private sector employment has occurred among businesses with 20 or fewer employees. During the period of economic growth from 1983 to 1990, Fortune 500 companies actually decreased their total number of jobs, while net job growth in the small business sector flourished, creating millions of jobs. Family-owned businesses accounted for the highest growth. Family-owned businesses also produce about 50% of actual wages and almost 50% of the gross national product in the United States. Disincentives to forming family businesses and passing family businesses to future generations pose grave problems for the nation's economy, while incentives to small businesses should spur economic growth.

The resolution reflects expressed public policy and provides five sound arguments for increasing the unified credit.

• The resolution urges an increase in the credit to $1 million to protect a wider economic community from the imposition of transfer taxes. If protecting estates of $600,000 is valuable to the national economy, the same protection for estates of $1 million should be even more valuable. If small family businesses and farms are not protected from the estate and gift tax, many may not survive the transition to a second generation. The majority of small businesses fail to survive the first generation; the unified tax credit protects the surviving businesses from the immediate need to raise cash to pay estate taxes. Without such protection, development of small businesses and job creation will be affected adversely.

***29** • Inflation over the past two decades has changed what constitutes wealth. An individual who bought a home in the 1960s and has a retirement plan, a life insurance policy and a moderate amount of savings may easily have an estate that surpasses the current $600,000 level of the unified credit. Failure to increase the unified credit might discourage home ownership and savings.

• The unified credit is not indexed to reflect the cost of living and the effects of inflation. Although the unified credit has not increased since 1986, $600,000 buys less today than it did in 1987. Because the estate and gift tax unified credit has not been indexed for inflation, the resolution urges an increase in the unified credit to ameliorate the ravages of inflation.

• Because the unified credit imposes a zero effective rate of tax for smaller estates, its increase would result in greater tax neutrality for more taxpayers. Tax neutrality eliminates the resulting distortions in investment decisions by taxpayers who may dispose of or retain assets in reaction to taxes. A reduction in the unified credit, by contrast, would reduce tax neutrality and might adversely affect the investment decisions of many taxpayers.

• The Revenue Reconciliation Act of 1993 (RRA '93) retroactively reinstated the top two estate and gift tax rates that had expired on December 31, 1992. See RRA '93, § 13208(a). With the reinstatement of the top estate and gift tax rates, the increased revenue from these increases should offset the lost revenue generated from an increase in the unified credit. Moreover, the inequity in the retroactively reinstated higher estate and gift tax rates may be relieved by an increase in the unified credit.

Simplified Administration of the Transfer Tax System

Increasing the unified credit to $1 million would simplify the administration of the transfer tax system as a whole and might result in a better allocation of resources (including IRS resources) for purposes of planning for and enforcing the estate, gift and GST taxes. Raising the unified credit equivalent to $1 million would unify the estate and gift tax unified credit with the GST tax exemption and thereby create a "truly unified credit." Unifying all three transfer tax exemptions would make individual estate plans and estates of decedents more efficient to implement and administer. Moreover, by avoiding the need for "reverse QTIP" trusts and for legal proceedings to split trusts to qualify for reverse QTIP treatment, some inefficiencies and legal expenses of estate administration will be eliminated. Unification of the three transfer tax exemptions would make the systems more comprehensible to individual citizens who might otherwise be unfamiliar with the three transfer tax systems.

If the unified credit is raised, many estates that currently must file estate tax returns (Form 706) may be relieved of this requirement. This increased efficiency for estate administration would lower the cost to the IRS of processing estate tax returns that estates under $1 million must now file. Many of those returns actually generate little or no tax to the federal government as a result of the various credits (including the state death tax credit) and deductions afforded estates. The costs of administering the returns of these "small" estates may be inefficient when compared to the amount of tax generated. The number of estate tax returns filed between 1986 and 1991 increased 24.4% for estates between $650,000 and $1 million ($650,000 is the figure used to provide a constant dollar analysis). Increasing the unified credit would greatly decrease the volume of returns processed.

Revenue Loss

Forces that oppose the proposed increase in the unified credit argue that the increase will cause a huge decrease in federal revenue. Increasing the unified credit would actually have a minimal effect on total revenue. The amount of revenue generated from estates between $600,000 and $1 million represents only 5% of the total revenue received from estate and gift taxes and totals only . 03% of total revenues of the federal government.

The lost revenue also would be offset in part by efficiencies created for the IRS. An increase in the unified credit would yield a decrease in the number of returns that the IRS must process. A cost/benefit analysis of the time spent reviewing, auditing and litigating estates under $1 million indicates that the amount of revenue generated thereby does not offset the effort required. Increasing the unified credit would allow the government to focus on larger estates that should yield greater tax benefits and limit the effects of revenue lost from the increased unified credit.

Conclusion

Public policy supports the unified credit and its goal to shelter small to medium-sized estates from transfer taxes. Unfortunately, the effects of time and inflation have resulted in protection for a lower percentage of estates and individuals--about 24.4% less than was the case a mere seven years ago. The resolution that proposes to increase the unified credit maintains the public policy justifications for the unified credit and unifies the estate and gift tax credit with the GST exemption. Finally, the resolution proposes to create a "truly unified credit" that will promote a significantly more efficient transfer tax system, thereby enhancing estate planning, estate and trust administration and tax administration.

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