

Part I

Section 2201.-- Combat zone-related deaths of members of the Armed Forces and deaths of victims of certain terrorist attacks.

26 CFR 20.2201-1: Members of the Armed Forces dying during an induction period. (Also §§ 692, 2001, 2010, 2011, 2058, 6018; 20.2001-1, 20.2011-1.)

Rev. Rul. 2002-86

ISSUE

How does the estate of a “qualified decedent,” as defined in § 2201(b) of the Internal Revenue Code, compute the federal estate tax under § 2201, as amended by the Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, § 103, 115 Stat. 2427 (2002)?

FACTS

D, a resident of state X, is a qualified decedent. During D's lifetime, D did not make any adjusted taxable gifts (defined in § 2001(b)). In filing Form 706, the United States Estate (and Generation-Skipping Transfer) Tax Return, D's executor does not elect out of the application of § 2201(a). D's estate pays the applicable state death tax imposed by state X.

Situation 1. D died in 2001, a year in which state X imposed a state death tax equal to the state death tax credit allowable under § 2011(a). The amount of D's taxable estate is \$2,936,818.

Situation 2. The facts are the same as in Situation 1, except that the amount of D's taxable estate is \$8,762,500.

Situation 3. D dies in 2005, a year in which state X imposes a state death tax equal to the state death tax credit that would have been allowable under § 2011(a) as it existed prior to the passage of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), Pub. L. No. 107-16, 115 Stat. 38 (2001). The amount of D's taxable estate before the deduction for state death taxes is \$5,953,939.

LAW AND ANALYSIS

Section 2001(a) imposes an estate tax on the transfer of the taxable estate of every decedent who is a U.S. citizen or resident. The estate tax is computed using the rate schedule contained in § 2001(c).

Section 2201(a) provides that for purposes of computing the federal estate tax of the estate of a qualified decedent, the rate schedule set forth in § 2201(c) shall be used instead of the rate schedule contained in § 2001(c), unless the executor of the estate elects not to have § 2201 apply.

Under § 2201(b), a qualified decedent is: (1) any citizen or resident of the United States dying while in active service of the Armed Forces of the United States, if the decedent (a) was killed in action while serving in a combat zone, or (b) died as a result of wounds, disease, or injury suffered, while serving in a combat zone, and while in the

line of duty, by reason of a hazard to which the decedent was subjected as an incident of the service; and (2) any specified terrorist victim, as defined by § 692(d)(4).

Under § 692(d)(4), a “specified terrorist victim” is any decedent who dies as a result of wounds or injury incurred as a result of the terrorist attacks against the United States on April 19, 1995, or September 11, 2001, or who dies as a result of illness incurred as a result of an attack involving anthrax occurring on or after September 11, 2001, and before January 1, 2002. Any individual identified by the Attorney General to have been a participant or conspirator in any such attack or a representative of either is not a specified terrorist victim.

If § 2201 applies, the estate tax (including the aggregate amount of gift tax payable on any adjusted taxable gifts under § 2001(b)(2)) is computed in the same manner as provided in § 2001(b), except that the rate schedule provided in § 2201(c) is used to compute the tax instead of the rate schedule in § 2001(c). The rate schedule contained in § 2001(c) continues to be used to determine the applicable credit amount (the unified credit) available to the estate under § 2010(c).

Section 2011(f), added by EGTRRA § 532(a) as § 2011(g) and redesignated as § 2011(f) by the Victims of Terrorism Tax Relief Act of 2001 § 103(b)(1), provides that the state death tax credit under § 2011 will not be allowable to the estates of decedents dying after December 31, 2004. Instead, the estates of decedents dying after that date will be allowed a deduction under § 2058(a) for estate and inheritance taxes actually paid to any state or the District of Columbia in respect of any property included in the gross estate. Thus, beginning in 2005, no state death taxes will be owed by a

decedent's estate to a jurisdiction that imposes a death tax only equal to the allowable federal credit for state death taxes.

Many states, however, impose state death taxes based on the state death tax credit computed under § 2011 as it existed prior to the passage of EGTRRA or on some other basis unrelated to the amount of any federal credit. Beginning in 2005, state death taxes paid to these jurisdictions will be deductible in computing a decedent's taxable estate, provided all the requirements of § 2058 are satisfied. These state death taxes will reduce an estate's federal estate tax liability but will increase the total death tax liability.

In Situation 1 and Situation 2, D died in 2001, a year in which a state death tax credit was allowable under § 2011 and state X imposed a state death tax equal to the allowable § 2011 credit. Accordingly, in Situation 1, D's estate will have no federal estate tax liability and no state death tax liability, as follows:

Taxable Estate	\$	2,936,818
Tentative Estate Tax Computed under Rate Schedule in § 2201(c)	\$	220,550
Less: Allowable Unified Credit under § 2010(a) and (c)	\$	<u>(220,550)</u>
Subtotal	\$	0
Less: State Death Tax Credit under § 2011 in Excess of Subtotal	\$	<u>(0)</u>
Federal Estate Tax	\$	0

In Situation 2, D's estate will have no federal estate tax liability but will have a state death tax liability of \$882,200, as follows:

Taxable Estate	\$	8,762,500
Tentative Estate Tax Computed Under Rate Schedule in § 2201(c)	\$	1,102,750
Less: Allowable Unified Credit under § 2010(a) and (c)	\$	<u>(220,550)</u>
Subtotal	\$	882,200
Less: State Death Tax Credit under § 2011	\$	<u>(882,200)</u>
Federal Estate Tax	\$	0

In Situation 3, D dies in 2005, a year in which state death taxes qualify for a deduction under § 2058, rather than a credit under § 2011. State X imposes a state death tax equal to the credit that would have been allowable under § 2011 prior to amendments by EGTRRA. Accordingly, D's estate will have no federal estate tax liability but will pay a state death tax of \$505,273, as follows:

Taxable Estate before application of the § 2058 deduction	\$	5,953,939
Deduction for State Death Taxes Paid under § 2058	\$	<u>(505,273)</u>
Taxable Estate	\$	5,448,666
Tentative Estate Tax Computed under Rate Schedule in § 2201(c)	\$	555,800
Less: Allowable Unified Credit under § 2010(a) and (c)	\$	<u>(555,800)</u>
Federal Estate Tax	\$	0

Under § 6018(a)(1), a Form 706 must be filed for the estate of a decedent who is a U.S. citizen or resident who dies in 2001 if the gross estate exceeds \$675,000 (the applicable credit amount). This amount increases to \$1,000,000 in years 2002 - 2003,

\$1,500,000 in years 2004 - 2005, \$2,000,000 in years 2006-2008, and \$3,500,000 in year 2009. (The applicable credit amount for non-resident non-citizens is lower than these amounts.) Accordingly, in Situations 1, 2, and 3, D's estate must file a Form 706 notwithstanding that no federal estate tax is due.

HOLDINGS

In Situations 1 and 2, no federal estate tax is due for a qualifying decedent who died in the year 2001 if the taxable estate is not more than \$8,762,500 and the state imposes a death tax that is at least equal to the state death tax credit under § 2011. If the taxable estate exceeds \$2,936,818, however, a state death tax will be due.

In Situation 3, under current law, no federal estate tax will be due for a qualifying decedent who dies in the year 2005 if the taxable estate before the deduction for state death taxes does not exceed \$5,953,939 and the state imposes a state death tax equal to the state death tax credit under § 2011 as it existed prior to EGTRRA. However, the state death tax will be due.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 78-361, 1978-2 C.B. 246, is modified and superseded.

DRAFTING INFORMATION

The principal author of this revenue ruling is Mayer Samuels of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Mr. Samuels at (202) 622-3090 (not a toll-free call).