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COMMITTEE ON WAYS AND MEANS  
U.S. HOUSE OF REPRESENTATIVES

ESTATE AND GIFT TAX HEARINGS

STATEMENT OF ADMINISTRATION WITNESS  
(APPEARING MARCH 22, 1976)

AND

STATEMENTS PRESENTED IN PANEL DISCUSSIONS  
BY INVITED WITNESSES  
(MARCH 23, 1976)

ON THE SUBJECTS OF

EXEMPTIONS AND RATES UNDER THE ESTATE AND GIFT  
TAXES, THE TREATMENT OF NONLIQUID ESTATES, AND  
THE TREATMENT OF UNREALIZED APPRECIATION AT  
TIME OF DEATH UNDER THE INCOME TAX

AND

UNIFICATION OF ESTATE AND GIFT TAXES, TREATMENT  
OF GENERATION SKIPPING TRUSTS, AND TREATMENT OF  
THE MARITAL DEDUCTION



MARCH 23, 1976

Printed for the use of the Committee on Ways and Means

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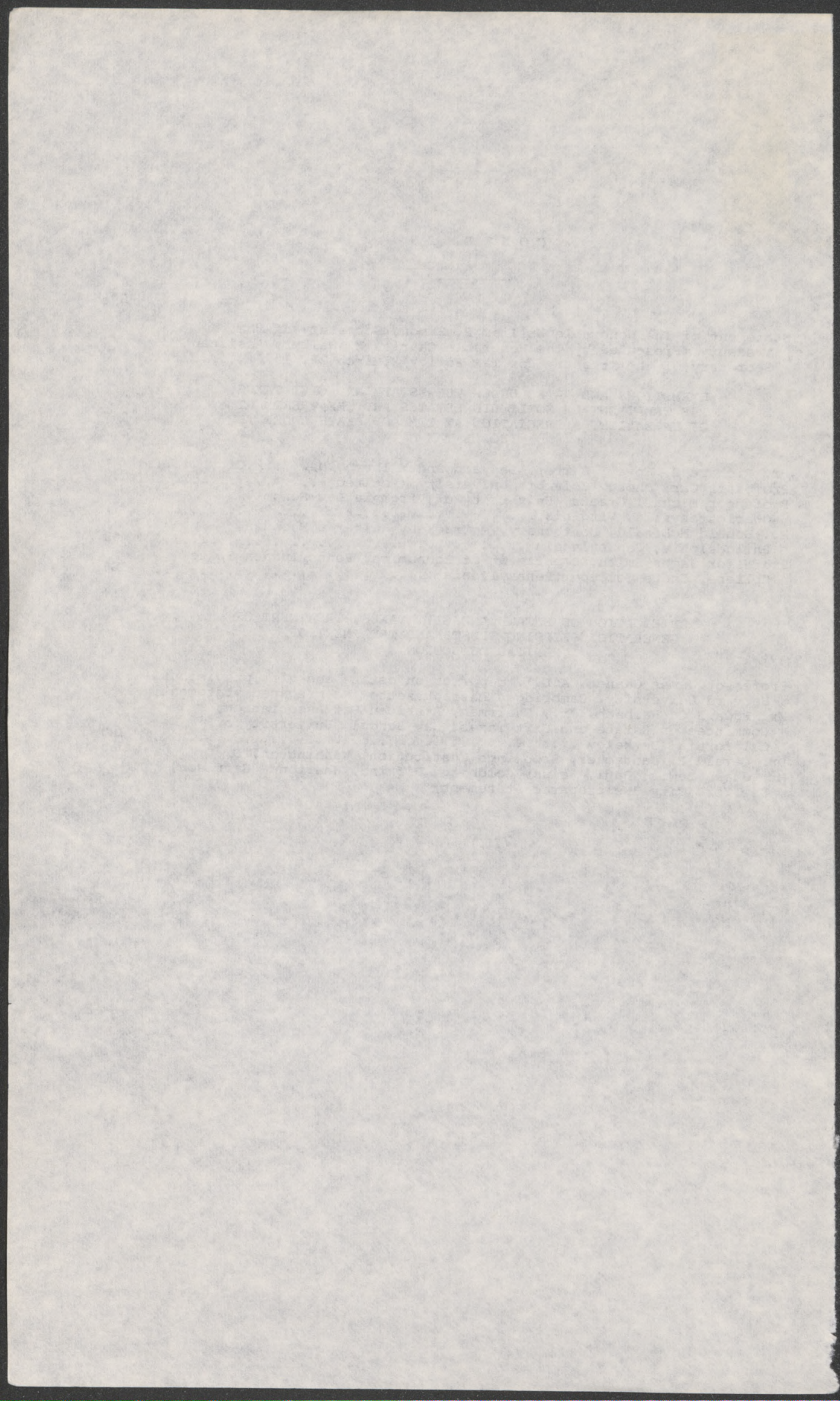
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STATEMENT OF THE HONORABLE WILLIAM E. SIMON  
SECRETARY OF THE TREASURY  
BEFORE THE HOUSE WAYS AND MEANS COMMITTEE  
MONDAY, MARCH 22, 1976 at 9:30 a.m.

Mr. Chairman and Members of the Committee:

I am pleased to be here today to present to you the Administration's position on the major issues of estate and gift tax revision you will be addressing during the coming weeks.

Except for the introduction of the marital deduction in 1948, the basic structure of the estate and gift taxes has remained fundamentally unchanged since 1932. The present estate and gift tax rates were adopted in 1941, and the estate and gift tax exemptions were last changed in 1942. A complete reexamination of the estate and gift taxes is, thus, long overdue, and we look forward to cooperating with you in this undertaking.

Objectives of estate and gift taxation.

Before discussing specific issues, I would like to set forth some general considerations underlying the estate and gift taxes.

Historically, the estate and gift taxes were prompted primarily by a desire to raise revenue. They were raised in wartime or periods of economic depression, when governmental needs for revenue were most intense. Once the immediate emergency was past, estate and gift taxes were lowered again or were eliminated. And even the maximum rates were relatively low by present standards; the top estate tax rate during the 1920's was 25 percent (a 40 percent top rate was enacted in 1924 but was retroactively repealed in 1926).

But the emphasis of estate and gift taxation gradually shifted during the 20's and 30's amid increasing social concern over unreasonable accumulations of wealth. This development culminated in 1941, with the enactment of the present estate tax rate structure that rises from three percent on the first \$5,000 of taxable estate to 77 percent

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on taxable estate in excess of \$10,000,000. Since then, a major effect of the estate and gift taxes has been to prevent or moderate the unreasonable accumulation of wealth and its transmission from generation to generation. At the same time, the importance of estate and gift taxes to Federal revenues has progressively diminished, so that these taxes now produce less than 2 percent of Federal revenues.

Until recent years, the estate and gift taxes did not affect a large segment of taxpayers. The limited impact of the taxes was consistent with their role as devices to restrain the undue accumulation of wealth. Thus, the annual number of estate tax returns filed during the period 1923-1945 never exceeded 18,000. 1938 was the peak year, with 17,642 returns; and 1932 was the low point, with 8,507 returns. This meant that the percentage of estates filing estate tax returns during the period varied between approximately two thirds of one percent and one and one quarter percent (0.65-1.25%).

During the thirty years since 1945, the situation has changed dramatically. In 1975, approximately 216,000 estates, or 11.2 percent of all estates, filed estate tax returns. Approximately 150,000 estates, or 7.7 percent of estates, paid estate tax. This development is summarized in the following table:

| Year | Deaths in<br>Preceding<br>Year | Estate Tax<br>Returns<br>Filed | Percentage<br>of Estates<br>Filing | Taxable<br>Returns | Percentage<br>of Estates<br>Taxable |
|------|--------------------------------|--------------------------------|------------------------------------|--------------------|-------------------------------------|
| 1945 | 1,411,338                      | 16,550                         | 1.2                                | 14,521             | 1.0                                 |
| 1950 | 1,443,607                      | 27,144                         | 1.9                                | 18,697             | 1.3                                 |
| 1955 | 1,481,091                      | 36,595                         | 2.5                                | 25,143             | 1.7                                 |
| 1959 | 1,647,886                      | 55,685                         | 3.4                                | 38,515             | 2.3                                 |
| 1963 | 1,756,720                      | 78,393                         | 4.5                                | 55,207             | 3.1                                 |
| 1966 | 1,828,136                      | 97,339                         | 5.3                                | 67,404             | 3.7                                 |
| 1970 | 1,922,000                      | 133,944                        | 7.0                                | 93,424             | 4.9                                 |
| 1973 | 1,964,000                      | 174,899                        | 8.9                                | 120,761            | 6.1                                 |
| 1975 | 1,936,000                      | 215,918                        | 11.2                               | 150,000**          | 7.7                                 |

\* Fiscal year ending June 30, 1975.

\*\* Estimated.



In brief, the past 30 years have seen a ten-fold increase in the impact of the estate tax in terms of the percentage of estates affected. No longer does the tax impact principally on the relatively larger estates. Rather the estate tax has shifted to a more broadly-based tax on the private capital accumulations of more moderate estates. It is, thus, time to reexamine whether the existing estate tax structure is harmonious with the basic objectives of the estate tax.

It should be emphasized that the question is not whether the wealthy should pay taxes. Obviously, an individual should surely count himself fortunate to be among the 8 or 10 percent most wealthy. And such individuals are rightly held accountable by our progressive tax system for defraying a greater share of the costs of government.

Rather, the question is what combination of income taxes and estate and gift taxes is most appropriate for ensuring the desired degree of progressivity in our tax system. From this standpoint, I would urge the Committee to emphasize that the estate tax has the limited function of restraining the undue accumulation of wealth. It should not be viewed as a device to raise revenue nor to achieve progressivity in the tax system, per se. Rather we should rely primarily on the progressive income tax for the orderly collection of revenues from the income stream as it is generated. It is inappropriate, therefore, to continue down the present path to a broad-based estate tax that imposes heavy burdens on moderate estates at a time when financial demands on the widow and children of a decedent may be most heavy and when the chief revenue producer has been lost to the family.

#### Estate and Gift Tax Exemptions and Rates

As should be evident from the preceding discussion, the most pressing single issue of estate and gift taxation today is whether, and how much, to increase the estate tax exemption.

The estate tax has reached out to more and more estates in part because of an increase in average real family wealth. But the widening impact of the estate tax is also attributable in large part to inflation. Adjusting the \$60,000 estate



tax exemption for inflation since 1942 would require an estate tax exemption of \$210,000. While a person with a \$60,000 estate in 1942 could leave it to his family without tax, today an individual must have an estate of \$260,000, on which an estate tax of \$50,700 will be levied, in order to leave the equivalent amount, \$210,000, to his family.

We believe that an increase in the estate tax exemption is clearly warranted. Indeed, such an increase is essential if the estate tax is to be returned to its historic role as an excise on the transfer of relatively larger wealth accumulations. At the same time we cannot ignore the significant revenue consequences that would result from increasing the estate tax exemption. Thus, we recommend that the estate tax exemption be increased to \$150,000 over a 5-year transition period and that the lower bracket estate tax rates on the first \$90,000 of taxable estate be eliminated. Limiting the increase to \$150,000 (with the proposed rate changes) will permit the revenue loss to be held to an acceptable amount, which can be absorbed gradually during the phase in period.

We are not recommending any change in the gift tax exemption or rates. In general, it is only those persons with relatively large estates who make substantial lifetime gifts. Individuals with an estate of \$250,000 to \$500,000 are unlikely to exceed the present \$30,000 lifetime exemption and there is less pressing need for an increased gift tax exemption than for an increased estate tax exemption.

While the proposal to eliminate the lower estate tax rate brackets is prompted in part by revenue considerations, it will also achieve a needed simplification and restructuring of the present estate tax rates, which are set out in Table I below.



TABLE I  
Estate Tax Rates

|   | Present<br>Estate Tax Rates<br>(percent) |
|---|--|
| Taxable net estate<br>(or taxable gifts): |  |
| 0 to \$5,000.....                         | 3  |
| \$5,000 to \$10,000.....                  | 7  |
| \$10,000 to \$20,000.....                 | 11                                       |
| \$20,000 to \$30,000.....                 | 14                                       |
| \$30,000 to \$40,000.....                 | 18                                       |
| \$40,000 to \$50,000.....                 | 22                                       |
| \$50,000 to \$60,000.....                 | 25                                       |
| \$60,000 to \$100,000.....                | 28                                       |
| \$100,000 to \$250,000.....               | 30                                       |
| \$250,000 to \$500,000.....               | 32                                       |
| \$500,000 to \$750,000.....               | 35                                       |
| \$750,000 to \$1,000,000.....             | 37                                       |
| \$1,000,000 to \$1,250,000.....           | 39                                       |
| \$1,250,000 to \$1,500,000.....           | 42                                       |
| \$1,500,000 to \$2,000,000.....           | 45                                       |
| \$2,000,000 to \$2,500,000.....           | 49                                       |
| \$2,500,000 to \$3,000,000.....           | 53                                       |
| \$3,000,000 to \$3,500,000.....           | 56                                       |
| \$3,500,000 to \$4,000,000.....           | 59                                       |
| \$4,000,000 to \$5,000,000.....           | 63                                       |
| \$5,000,000 to \$6,000,000.....           | 67                                       |
| \$6,000,000 to \$7,000,000.....           | 70                                       |
| \$7,000,000 to \$8,000,000.....           | 73                                       |
| \$8,000,000 to \$10,000,000.....          | 76                                       |
| \$10,000,000 and over.....                | 77                                       |

As can readily be observed, the lower estate tax rates are in a sense illusory. Thus, the beginning rate is 3 percent for the first \$5,000 of taxable estate, but the lower rate brackets are so narrow that the marginal rate quickly reaches 25 percent at \$50-\$60,000 of taxable estate.



Thereafter, the rate progression slows dramatically. Once an adequate exemption is provided, the lower rate brackets should simply be eliminated. This will mean a higher initial rate but a smoother rate progression. The proposed estate tax rates are set out in Table II below. Table III illustrates the effect of the exemption and rate changes on estates of varying sizes.

TABLE II

Proposed  
Estate Tax Rates  
(percent)

|                             |    |
|-----------------------------|----|
| \$0 to \$100,000            | 30 |
| \$100,000 to \$250,000      | 32 |
| \$250,000 to \$500,000      | 34 |
| \$500,000 to \$750,000      | 36 |
| \$750,000 to \$1,000,000    | 38 |
| \$1,000,000 to \$1,250,000  | 41 |
| \$1,250,000 to \$1,500,000  | 44 |
| \$1,500,000 to \$2,000,000  | 47 |
| \$2,000,000 to \$2,500,000  | 50 |
| \$2,500,000 to \$3,000,000  | 54 |
| \$3,000,000 to \$3,500,000  | 57 |
| \$3,500,000 to \$4,000,000  | 60 |
| \$4,000,000 to \$5,000,000  | 64 |
| \$5,000,000 to \$6,000,000  | 67 |
| \$6,000,000 to \$7,000,000  | 70 |
| \$7,000,000 to \$8,000,000  | 73 |
| \$8,000,000 to \$10,000,000 | 76 |
| \$10,000,000 & over         | 77 |



Table III

## ESTATE TAX BURDENS

(Exemption Only; No Credits Or Deductions From Adjusted Gross Estate)

| Adjusted Gross Estate | Current Law    |            | Proposed Law   |            | Percentage           |                      |
|-----------------------|----------------|------------|----------------|------------|----------------------|----------------------|
|                       | Taxable Estate | Tax Burden | Taxable Estate | Tax Burden | Change in Tax Burden | Change in Tax Burden |
| \$                    | \$             | \$         | \$             | \$         | \$                   | %                    |
| 60,000.               | 0.             | 0.         | 0.             | 0.         | 0                    | -100.0               |
| 100,000.              | 40,000.        | 4,800.     | 0.             | 0.         | 4,800                | -37.1                |
| 250,000.              | 190,000.       | 47,700.    | 100,000.       | 30,000.    | 17,700               | -11.5                |
| 500,000.              | 440,000.       | 126,500.   | 350,000.       | 112,000.   | 14,500               | -6.2                 |
| 750,000.              | 690,000.       | 212,200.   | 600,000.       | 199,000.   | 13,200               | -4.1                 |
| 1,000,000.            | 940,000.       | 303,500.   | 850,000.       | 291,000.   | 12,500               | -2.7                 |
| 1,250,000.            | 1,190,000.     | 399,800.   | 1,100,000.     | 389,000.   | 10,800               | -1.7                 |
| 1,500,000.            | 1,440,000.     | 503,000.   | 1,350,000.     | 494,500.   | 8,500                | -0.2                 |
| 2,000,000.            | 1,940,000.     | 726,200.   | 1,850,000.     | 725,000.   | 1,200                | +0.2                 |
| 2,500,000.            | 2,440,000.     | 968,800.   | 2,350,000.     | 970,500.   | 1,700                | +0.3                 |
| 3,000,000.            | 2,940,000.     | 1,231,400. | 2,850,000.     | 1,234,500. | 3,100                | +0.4                 |
| 3,500,000.            | 3,440,000.     | 1,509,600. | 3,350,000.     | 1,515,000. | 5,400                | +0.4                 |
| 4,000,000.            | 3,940,000.     | 1,802,800. | 3,850,000.     | 1,810,500. | 7,700                | +0.6                 |
| 5,000,000.            | 4,940,000.     | 2,430,400. | 4,850,000.     | 2,444,500. | 14,100               | +0.4                 |
| 6,000,000.            | 5,940,000.     | 3,098,000. | 5,850,000.     | 3,110,000. | 12,000               | +0.2                 |
| 7,000,000.            | 6,940,000.     | 3,796,200. | 6,850,000.     | 3,805,500. | 9,300                | +0.1                 |
| 8,000,000.            | 7,940,000.     | 4,524,400. | 7,850,000.     | 4,531,000. | 6,600                | +0.1                 |
| 10,000,000.           | 9,940,000.     | 6,042,600. | 9,850,000.     | 6,046,500. | 3,900                | +0.1                 |

Office of the Secretary of the Treasury  
Office of Tax Analysis

March 16, 1976



### Liberalized Payment Provisions For Family Farms And Businesses.

An issue on which attention has increasingly focused concerns the provisions for installment payment of estate taxes.

Inflation has had a particularly serious impact upon the family farm or business. Property values have risen dramatically with the result that owners have been faced with higher estate taxes. This has created a greater need for liquidity than is faced by many other taxpayers, because family farms or businesses generally tend to represent a significant portion of the owners' estates in terms of dollar values. Therefore, many families have found it necessary to sell the family farm or business to obtain cash to pay Federal estate taxes.

These liquidity problems will be alleviated by the adoption of the proposed increase in the estate tax exemption, but they will still exist for estates over \$150,000.

To meet the specific liquidity problems of family farms and small businesses, the Administration has proposed a change in the present provisions for 10-year installment payments of estate tax to make it easier to continue the family ownership of a small farm or business following a substantial owner's death. In summary fashion, the details are as follows:

- At the estate's option, a 5-year moratorium will apply to payment of that portion of the tax liability attributable to an ownership interest in a family farm or other closely-held business qualifying for 10-year installment payments under present section 6166 of the Internal Revenue Code. No interest will accrue during the 5-year moratorium period and no principal or interest payments will be required during that period.
- At the end of the 5-year period, the deferred tax will, at the estate's option, be payable in equal annual installments over the next 20 years.
- Interest on the installments will be reduced to 4 percent per annum from the 7 percent rate generally applicable to deferred tax payments.



- The 5-year moratorium and 20-year extended payment provisions will apply only to the estate tax liability attributable to the first \$300,000 in value of the family farm or business. Between \$300,000 and \$600,000 there will be a dollar-for-dollar reduction in the value of the farm or business qualifying for the moratorium and extended payment provisions. That portion of the tax not qualifying will continue to be subject to 10-year installment payments with the 7 percent interest rate.

We believe that enactment of the Administration's proposals would be a positive and essential step toward ensuring the survival of small farms and businesses for future generations.

#### Marital Deduction

Let me turn now to the question of liberalizing the estate and gift tax marital deduction provisions.

The marital deduction was introduced in 1948 to equalize the estate and gift tax treatment of couples in common law property States with that of couples in community property States. The property of community property couples is, in general, split 50-50 between the spouses by operation of law without imposition of estate or gift taxes; and the objective of the marital deduction provisions was to provide equivalent tax treatment for common law property couples.

Under the gift tax, a marital deduction may be claimed for one-half the amount transferred to a spouse. Under the estate tax, a marital deduction may be claimed for up to one-half of the adjusted gross estate (gross estate less administrative expenses of the estate, debts of the decedent, and the value of any community property included in the estate). Under both the estate tax and the gift tax, transfers of certain "terminable interests" are nondeductible; the deduction is generally limited to gifts of outright ownership and gifts that will result in the transferred property being included in the estate of the surviving spouse.



The present marital deduction provisions are subject to criticism on several grounds.

First, under the existing provisions it is still not possible for couples in common law property States to obtain a tax-free division of their property in all cases. Whereas the community property laws operate automatically to split the spouses' property between two estates, the estate tax marital deduction may be utilized to split a family's wealth accumulation only in the event the wealthier spouse dies first. And the division of property may not be accomplished free of tax during life, since the gift tax marital deduction equals only one-half of the property transferred.

Secondly, many families rightfully regard their property as being generated by their combined efforts and, thus, "ours" rather than "his" and "hers" (this is likely to be particularly true of checking and savings accounts, stocks registered in joint names, and the family residence). As a result, they often transfer property from separate ownership, to joint ownership or community ownership without paying much attention to the legal change in ownership. There is a serious question whether it is appropriate to tax such transfers that are basically just incidents in the common management of the family's pooled resources.

Finally, the present 50 percent deduction has created complicated administrative problems for many estates. In some estates, tax savings may be achieved through use of a marital gift provision precisely limited to exactly 50 percent of the adjusted gross estate. Since the exact amount of the adjusted gross estate cannot be predicted when a will is drawn, will draftsmen have resorted to formula provisions which have increased the administrative problems of executors and have required fiduciary accounting which is a mystery to widows and children.

We recommend the adoption of a free interspousal transfer rule, or unlimited marital deduction, under which all transfers between spouses would be completely excluded from the estate and gift taxes. Such a rule best comports with the way most couples manage their property and would substantailly simplify the estate tax law and the administration of estates.



We estimate that this unlimited marital deduction, when fully effective, will reduce Federal estate and gift tax revenues by \$500 million annually, if adopted in combination with the proposed \$150,000 estate tax exemption, and \$700 million annually if combined with the present \$60,000 estate tax exemption. This is obviously a major sum in terms of the total Federal budget, and the loss ought ideally to be phased-in gradually over a period of years. In practice, however, such a phase-in is not feasible because the initial steps in liberalizing the deduction produce the greatest portion of the total revenue loss. For example, a minimum marital deduction of \$100,000 plus one-half of the adjusted gross estate in excess of \$100,000 would reduce revenues about \$350 million if adopted together with the \$78,000 exemption proposed for the first year under the 5-year phase-in period for the proposed \$150,000 exemption. Moreover, a phase-in of the increased marital deduction would create a veritable nightmare for will draftsmen who would have to consider contingent provisions to match each increase in the allowable deduction. We are accordingly recommending that the effective date for the unlimited marital deduction be postponed, so that it would be effective for estates of persons dying after December 31, 1976. The first estate tax returns to which the provision would apply would, thus, not be due until October 1, 1977; and there would be no significant revenue impact until fiscal year 1978.

#### Tax on Unrealized Appreciation

Another major issue before your Committee concerns the treatment of unrealized appreciation in property transferred at death. Under present law, the heirs receive a new fair market basis in such property, so that any unrealized gain or loss permanently escapes income tax. This rule is sometimes called the stepped-up basis rule. In contrast, if appreciated property is given away during life, the donor's tax basis is carried over to the recipients and any unrealized gain will be taxed on their later sale of the property.

The fact that present law does not tax unrealized appreciation in property transferred at death is said by some critics of the system to create an inequity between taxpayers who accumulate wealth mainly from previously taxed income (e.g., wages and realized appreciation) and those



whose accumulated wealth consists largely of unrealized appreciation in the value of their property. Both groups are subject to the estate and gift taxes, but it is argued that the latter group escapes payment of its fair share of income taxes because the unrealized appreciation had not been taxed before death. Moreover, present law is thought to create a "lock-in" effect--a tendency of taxpayers (particularly older taxpayers) to retain highly appreciated property so that they may avoid payment of capital gains tax and pass on a larger estate to their families.

These concerns have led to recurrent, serious proposals to change the rules. The main alternatives that have been suggested at various times are: (1) to impose a capital gains tax on unrealized appreciation in an estate; (2) to extend to property transferred at death the carryover basis provision now applicable to gifts; and (3) an additional estate tax on the amount of unrealized appreciation in an estate.

1. Capital gains tax. Proposals to impose a capital gains tax on unrealized appreciation in an estate would, in effect, treat the estate as if it had been sold at death. If the property in the estate had in fact been sold immediately before death, tax would have been paid by the executor with the decedent's final income tax return, and that tax would have been deductible from the gross estate subject to estate tax. Accordingly, proposals to impose a capital gains tax similarly provide for the deduction of such tax from the gross estate.

The basic assumption of the capital gains tax, which treats the estate as if it was all sold at death, is obviously unrealistic. The concept of a capital gains tax has been to tax realized gains. The event of death hardly qualifies as a tax realization transaction. During his lifetime, a taxpayer has a choice of realizing gain on sale of an asset, paying the tax, and keeping the net proceeds, or of retaining the asset and not realizing a gain on it. The occurrence of his death is hardly a voluntarily chosen event upon which to base the realization of gain. Moreover, the tax will really fall on the heirs in any event. We cannot tax a dead man for a sale he did not make no matter how hard we try. Proposals to impose a capital gains tax at death can, thus, be viewed as proposals to tax some individuals who inherit property differently from others who



also inherit property solely because of the decedent's investment decisions during his lifetime. It is by no means self-evident that such a system would be more equitable than present law.

Moreover, because of the deductibility of the capital gains tax against the gross estate, the net effect of a capital gains tax would be more severe for smaller estates than for larger estates. As an example, consider two estates that both have \$1,000 of appreciation taxed at a 25 percent capital gains rate but with marginal estate tax rates of 30 percent and 70 percent. For both estates the initial capital gains tax would be \$250. But the reduction in estate taxes resulting from the deductibility of that \$250 would be \$75 for the smaller estate with the 30 percent marginal rate and \$175 for the larger estate with the 70 percent marginal rate. The net tax on appreciation would be 17.5 percent for the smaller estate and 7.5 percent for the larger estate. Certainly many people would instinctively question the justice of a proposal that would tax small estates more heavily than large ones.

2. Carryover basis. The second approach that has sometimes been suggested as an alternative to present law is the carryover basis approach, under which the decedent's basis in property transferred at death would be carried over to his heirs. The unrealized appreciation would be taxed when and if the property is sold by the heirs. Your Committee tentatively approved the carryover basis provisions in 1963 but deleted that provision from the bill reported to the House.

The carryover basis approach is consistent with the tax treatment that would have resulted had the decedent not died but had continued to retain the property. However, the carryover basis approach suffers from a number of major disadvantages.

The first is administrative complexity for both taxpayers and the Internal Revenue Service in determining the decedent's basis in the property, particularly for property that passes to several successive generations. In many cases, records concerning the original basis of the property will have been lost by the time the property is sold. Many of us have undoubtedly had the experience of selling stock or a house and then, at tax return time, having to search through various files, receipts, and check stubs to determine the original cost of the property and the amount of any



required adjustments to basis. Often the key to reconstructing the tax basis of property is one's personal recollection of the transactions in question. The carryover basis approach, and to a lesser degree any tax on appreciation transferred at death, will put an even greater premium on careful records, and a greater penalty for carelessness, than normally exists.

Further administrative complexity would be created by carryover basis adjustments. Thus, most carryover basis proposals, such as your Committee's tentative decision in 1963 and section 106 of H.R. 1040 (introduced by Mr. Corman), provide for increasing the decedent's basis by the amount of State and Federal death taxes attributable to the unrealized appreciation in an estate. Such a basis adjustment tends to equalize the treatment of estates of persons who realize their gains during life and estates of persons with large unrealized gains. When property is sold and tax paid on the gain, the tax is deductible from that person's estate (or if not formally deducted, is excluded as a practical matter from the estate); and the estate tax is thereby reduced. The basis adjustment for death taxes allocable to unrealized appreciation in an estate has the effect of deducting such taxes from the gain that ultimately will be subject to income tax, with a consequent reduction in income tax liability. While never exactly equivalent, the income tax reduction provided by the basis adjustment for estates with unrealized appreciation roughly corresponds to the estate tax reduction provided to estates with taxed appreciation.

Allowance of an increase in the carryover basis for a portion of death taxes means that the exact amount of gain realized on sales made during administration of the estate can not be computed until final determination of State inheritance and Federal estate tax liability, including the final calculation of the total value of the estate and the amount of unrealized appreciation. As a result, income tax returns filed prior to such final determination of death tax liability may have to be reopened and the tax recomputed.

Under the carryover basis approach, there would also be a number of thorny questions regarding the allocation among specific assets of the total appreciation in the estate and the increase in basis for a portion of death taxes. For example, the tax basis of property transferred to a charity is ordinarily of little moment, since the charity will be exempt from tax on any gain it realizes upon disposition of the property. Thus, taxes could be minimized by directing



highly appreciated property to charity and less highly appreciated property to others. In your Committee's 1963 tentative decision, this problem was resolved by requiring a pro rata allocation of the total unrealized appreciation in an estate among all the assets in the estate, obviously a complicating provision. Similarly, questions will be raised concerning whether the increased basis on account of death taxes should be allocated ratably among all estate assets (by value or by amount of unrealized appreciation) or only among assets included in the taxable estate (excluding, that is, deductible marital and charitable transfers). Or it might be questioned whether the basis increase should be allocated to those persons who, because of a specific direction in the will or because of State law, are actually held liable to pay the tax.

Finally, the carryover basis approach does little to eliminate the lock-in of investment resulting from the present law stepped-up basis rule. Rather, it perpetuates that lock-in effect even after a property owner's death.

3. Additional estate tax. The American Bankers Association has developed a third approach, which it calls an Additional Estate Tax, or AET. This would be a flat rate tax, the ABA suggests a 14 percent rate, on the unrealized appreciation in an estate. Unlike a capital gains tax, it would not be deductible from the estate tax base--hence the name Additional Estate Tax.

The rationale for imposition of a flat rate, nondeductible tax is the phenomenon I discussed earlier, that a capital gains tax falls more heavily on small estates than on large ones. That phenomenon, which is asserted to demonstrate that the capital gains approach is "regressive," is simply a natural consequence of the deductibility of income taxes against the estate. It is equally true of all income taxes paid during life, a fact that can most clearly be observed with respect to the income taxes paid on the decedent's final return. For example, suppose two individuals pay income tax at an average rate of 40 percent in their final returns and that the marginal estate bracket for one is 30 percent and for the other is 70 percent. Allowing for the reduced estate tax due to the deductibility of income taxes, the net tax on the income of the first individual with the smaller estate will be 28 percent and the net tax for the



second individual with the larger estate will be 12 percent. This obviously does not mean that either the income tax or the estate tax is regressive. Nor does it mean that we should deny the estate tax deduction; the funds used to pay the decedent's income taxes are not available for transfer to his heirs and should not be subjected to estate tax.

Nevertheless, the AET proposal is far simpler than either of the other two approaches. Moreover, when viewed in isolation as most changes are viewed by taxpayers, it will not increase effective taxes more for small estates than for large ones. Also, it is a direct excise tax on transfer of unrealized appreciation in an estate and is not an attempt to use income tax concepts in an inappropriate setting. To that extent, therefore, it does not answer the objective of some critics of the present system, namely redressing the income tax inequity alleged to be created by the stepped-up basis rule.

In short, when the rhetoric is cut away, the AET proposal gives credence to what many of us have long suspected: proposals to tax capital gains at death are not fundamentally grounded in income tax concerns but are essentially an effort to increase death tax burdens.

That being the case, the threshold question is whether those burdens should be increased. In our view they should not be increased. Indeed, the extent of the present burden has become so severe that the Administration has recommended measures to alleviate the burden by increasing the exemption and providing for a deferral of payment of tax in certain situations.

4. Exemptions. Under all three approaches for taxing unrealized appreciation in an estate, there would be a number of difficult questions respecting the allowance of exemptions and exclusions. For example, most proposals for changing the present stepped-up basis rule would exempt estates that are not required to file an estate tax return (estates of \$60,000 or less under present law). We quite agree that such an exemption would be a requisite of any such change. It would be inappropriate to impose on those smaller estates a substantial tax burden (under the capital gains or AET approaches) or the great complexity inherent in the carryover basis approach.



Many proposals to impose a capital gains tax at death would also exempt marital deduction and charitable deduction transfers. Such an attempt to harmonize the principle of taxing unrealized gains with the estate tax policies underlying the estate tax marital and charitable deductions is quite understandable, but it would combine the disadvantages of the capital gains and carryover basis approaches, and would cause the greatest of complexity for the tax system and family estate planning.

5. Administration recommendation. We oppose these proposals to change the present tax treatment of unrealized appreciation in property transferred at death. We are unable to discern any consistent rationale underlying such proposals other than a desire to increase death taxes; and we believe that decisions regarding the proper level of death taxes should be made through a review of estate and gift tax rates and exemptions, rather than through the device of a tax on appreciation in an estate. Moreover, the pressing need today is for estate tax relief rather than an increase in death tax burdens. It would be wholly inappropriate to hold forth the promise of such relief through an increased estate tax exemption and then to make that promise illusory through a tax on unrealized appreciation that will fall particularly heavily on the owners of farms and small businesses.

#### Miscellaneous Changes

In my testimony, I have addressed only the major issues of estate and gift tax reform. There are a number of other issues your Committee may want to examine. If so, and if time permits, I will be glad to discuss them with you. I would, however, like to mention one problem in particular because remedial action concerning it could significantly simplify the administration and application of the present gift tax law.

In the Excise, Estate, and Gift Tax Adjustment Act of 1970, Congress accelerated the collection of estate and gift taxes by requiring earlier filing of returns. The principal objective of the legislation was to accelerate the collection of estate taxes. Because the timing of gifts, unlike deathtime transfers, is subject to the volition of the donor, shortening the return period for gifts would not necessarily accelerate collections. Nevertheless, the most



recent statistics (1966 returns for 1965 gifts) indicate that \$100 million (or more than one-quarter of total gift tax collections in 1966) was collected from 10 donors who each made more than \$10 million in gifts. In the expectation that shortening the return period would accelerate collections from such large donors, it was decided to require earlier filing of returns for both gift and estate taxes.

The annual filing system for gift tax returns was therefore changed to a quarterly filing system (under which a return is required for the first calendar quarter in which total gifts for the year exceed \$3,000, and for each succeeding calendar quarter of the year).

Two problems have arisen under the quarterly gift tax return provisions. First, although Congress did not intend any changes in the rules regarding the computation of the gift tax, because of the structure of the gift tax provisions a taxpayer may now lose a portion of the gift tax marital deduction. It is clear that this effect of the 1970 changes was unintended. Second, the number of gift tax returns filed annually has increased dramatically, imposing additional administrative burdens on taxpayers and the Internal Revenue Service. During Fiscal Years 1968-70, the number of gift tax returns filed annually ranged from 139,000 to 151,000; in Fiscal 1974, 260,000 gift tax returns were filed.

We recommend that the quarterly gift tax return requirement be amended by adding a \$100,000 threshold, so that a quarterly return would be required only when, by the end of a calendar quarter, total gifts for the year exceed \$100,000. In other cases, an annual return would be filed, as under prior law. The suggested change would remedy the technical difficulty created under the marital deduction provisions by the 1970 changes, and also would eliminate the quarterly return requirement for most taxpayers, while retaining the intended effect of the 1970 changes of putting donors of very large gifts on a more current basis respecting payment of gift tax.

Thank you for this opportunity to address your Committee on these very important estate and gift tax issues.



STATEMENT OF RICHARD B. COVEY  
BEFORE THE  
COMMITTEE ON WAYS AND MEANS  
UNITED STATES HOUSE OF REPRESENTATIVES  
ON ESTATE AND GIFT TAX REVISION

March 23, 1976

SUMMARY

This Committee should determine the appropriate amount of revenue to be produced by the estate and gift tax laws, or by a change in the treatment of net appreciation included in a decedent's estate, without taking account of immediate budgetary considerations.

My approach to the specific areas assigned to this panel is:

1. Substitute an estate tax credit of \$20,700, the estate tax now payable on a taxable estate of \$100,000, for the exemption of \$60,000.
2. Retain the current gift tax exemption of \$30,000 and the gift tax annual exclusion at \$3,000.
3. Leave the present estate tax rates intact through 70% and eliminate the rates above that percentage.
4. Have the estate tax rates apply to gift transfers, except that the rate would be 20% on all taxable gift transfers under \$100,000.
5. Do not subject unrealized appreciation at death to another tax unless you are prepared to tax appreciation which passes to a surviving spouse and qualifies for the marital deduction. If you do change the law, reduce the estate tax rates.
6. Reinstate the 4% interest rate on estate tax deferred under section 6166. Be skeptical of granting any further relief to farms and closely held businesses pending a study of the liquidity problem, but if further relief is to be granted do so directly by partial forgiveness of the estate tax.



STATEMENT OF RICHARD B. COVEY  
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March 23, 1976

I. Introduction

During the past 35 years the estate and gift tax laws have remained essentially the same. The only major change has been the enactment of the marital deduction in 1948, which permits a decedent to give up to one-half of his estate to a surviving spouse free from estate tax. The estate and gift tax exemptions (\$60,000 and \$30,000 respectively) and rates have not changed. Today about one out of every ten decedents is required to file an estate tax return and one out of every thirteen decedents pays some estate tax. Judged by the past, the figures should be close to 20% and 14% in another ten years if current law is continued regarding the exemption.

This is the third time hearings have been held on estate and gift tax laws and a change in the basis rule since 1969. On the surface, the issues involved do not appear to be particularly troublesome, but as one gets into the subjects they become quite difficult and interrelated. Also, the taxation of property at death is a highly charged emotional issue, which cuts across normal party lines, as the 1972 Democratic presidential candidate discovered when



he proposed to increase substantially the tax on inheritances to a person to the point where the rate on more than \$500,000 would be 100%.

I agree with former Secretary of the Treasury Schultz when he said before this Committee on April 30, 1973 that

"Most of the controversy involving estate and gift taxes turns on matters of personal philosophy. There is no key to truth in this area and even individuals of the same political persuasion feel differently and deeply. The permutations and combinations are myriad. Differences in view must be compromised for they cannot be reconciled, and Congress is the best place to do it."

Differences in view among people of the same "political persuasion" are evidenced by the statements of the former Chairman of this Committee, Representative Mills, in a speech before the House on May 30, 1973 and the present Chairman in an interview with Tax Notes, which was published in the issue of October 6, 1975. The former Chairman said:

"We need tax provisions which assure every individual that his savings efforts will be amply rewarded, not frustrated by taxation. We are not going to wind up with a tax system that meets the purist standards of academicians but shuts off the wellsprings of economic progress - personal and business savings. We are going to simplify our estate and gift taxes and close the escape hatches that allow huge amounts of property to pass tax free from one generation to another. But we are not going to have the Government confiscate half or more of the estates people manage to build for their families. We are seeking in every aspect of taxation improvements to make the system fairer, simpler, and less repressive of saving, enterprise, and growth."



Chairman Ullman stated:

"The net effect of estate and gift tax revision will have to be a substantial revenue gain"

I cannot reconcile these two statements.

Disagreement on the other side of the aisle is shown by former Secretary Shultz' statement that

"\*\*we urge that whatever changes are made in estate and gift tax laws be balanced in a way which does not change the overall revenues from these taxes"

and the position of the current Administration which appears to be that a substantial tax reduction in these areas is desired.

I sense that a shift in approach to change has taken place since 1973. Times change. Inflation continues, up 29% from January 1, 1973 through December 31, 1975, if judged by the Consumer Price Index, and farm values have spiraled. A farmer driving a 1969 car may now have an estate tax problem. The impact of the estate tax on farms and closely held businesses has received a great deal of attention, particularly during the last year since the Senate Select Committee on Small Business under the chairmanship of Senator Nelson commenced hearings around the country on this subject. The Administration has proposed tax relief in this area as well as a substantial increase in the estate tax exemption to \$150,000. With the emphasis on tax relief, the basis issue which would involve a tax increase



seems to be taking a back seat in importance. In support of this statement, I note that the 1976 tax policy statement just issued by the Democratic members of the Joint Economic Committee does not mention changing the basis rule but does state "Provision should be made in the estate tax to avoid tax-enforced liquidations of small business". Contrast this with the 1973 tax policy statement recommending that capital gains tax at death be enacted. Rumor has it that farms and closely held businesses prevented a change in the basis rule in 1963. They now appear to be impacting the estate tax itself.

Clearly, an appealing case for estate tax relief is presented in the farm and closely held business area. There is something un-American about throwing a family off the farm or making them get out of the family business. On the other hand, giving a particular asset special tax treatment presents an obvious problem of equity for owners of other assets with an equal value.

The change in mood is also indicated by the virtual flood of relief bills introduced in Congress, particularly in the Senate. Senators who in the early seventies were supporting a substantial decrease in the exemption and increase in the estate tax rates are now supporting a substantial increase in the exemption and other relief.



## II. Fact Sheet

During fiscal 1975 the estate tax produced \$4.2 billion and the gift tax \$400 million. The percentage of total tax revenues produced by these taxes has in recent years remained fairly constant at under 2%. The estate tax has had an increasing impact on estates which judged by today's standards are not large. See Appendix A. It continues to be a highly progressive tax when viewed in terms of the estates which pay some tax. Based upon estate tax returns filed in 1973, almost 60% of the aggregate amount of estate tax payable (before allowance for credits) was attributable to taxable estates of \$500,000 or more which comprised only 4.5% of all decedents paying some estate tax. A table contained in Appendix B points up the progression by comparing estates in various ranges of value.

Some people have referred to the estate tax as a seive which catches only a small part of the total value of property transferred. Looking at the statistics compiled from estate tax returns filed during 1973, the total gross figure was \$38.9 billion of which \$33.3 billion was attributable to returns shown some tax due. The deduction totals were as follows:

|                                     | <u>Billions</u> |
|-------------------------------------|-----------------|
| Funeral and administration expenses | 1.7             |



|                      |            |
|----------------------|------------|
| Claims               | 2.2        |
| Marital deduction    | 7.5        |
| Charitable deduction | 2.0        |
| Exemption            | <u>9.6</u> |
| Total                | 23.0       |

While the deductions and the exemption total about 60% of the total gross estate figure, the reasons for them are clear and I do not know of much activity to restrict them. The current activity seems rather to extend them.

Is there considerable wealth which is not included within the total gross estate figure, but should be? There is some, but the amount is difficult to determine. The generation-skipping trust is the prime candidate for inclusion in the gross estate base which is now outside of that base. Mr. Mills' statement quoted on page 2 above refers to "huge amounts of property" passing "tax free from one generation to another", obviously referring to the generation-skipping problem. In its testimony on the opening day of these hearings the Public Citizens' Tax Reform Research Group said "By some estimates this might increase estate tax revenues by 10% or more in the long run". I know of no reliable estimates and have some reservations about the 10% figure, but certainly do agree with the "long run" part of the statement. It would be a



very long time - a generation or more - before any significant revenue is produced from a change in this area unless this Committee is prepared to enact legislation which would apply to pre-existing transfers - a most unusual step. A solution to the generation-skipping problem should be proposed by this Committee, but please don't factor in some ephemeral revenue gain from this area to assert that you have produced a balanced program in terms of revenue if this is your decision.

The other areas for broadening the estate tax base are quite limited in terms of revenue. The section 2039(c) exclusion could be repealed. The tax savings from deliberate transfers in contemplation of death should be eliminated and the ability to get group term life insurance out of the gross estate at no transfer tax "cost" could be changed.

### III. Approach

#### 1. In General

Ideally, the revenue gain or loss from any change in the estate and gift tax laws or the basis rule should not be considered. The ratio of decedents' wealth to total income in our country is too low for these taxes to play a significant role in financing the national government. Rather, transfer taxes are mainly instruments of



social policy which influence the economic and social structure of the country. They are the primary way in which a free society, after taking account of the need that exists for private capital and making a decision as to how much property it is "fair" to take, limits the extent to which its citizens can confer on their families unearned advantages which others do not possess. I hope this Committee will confront the problem squarely and not let revenue considerations be paramount. When you consider such an important matter only once in 35 years it should not be affected by budgetary considerations. Both the rich and the poor are entitled to this. Such an approach may result in either an increase or decrease in the revenues from the transfer taxes.

The Administration has not put revenue considerations aside in proposing a phase-in of its recommended increase in the estate tax exemption to \$150,000. I can understand the reason for wanting to get estates below this figure off the estate tax rolls. But if the policy is correct, then put it into effect immediately. Why should a person dying on December 31st of one year pay a higher estate tax than a person dying one day later?

## 2. Comparison to Income Tax

The advocates of increasing the "cost of dying"



(which could include a change in the basis rule) often assert that the estate tax does not contribute its "fair share" when compared with the income tax. The premises upon which this conclusion is based are not entirely clear to me, and do, I submit, involve value judgments upon which reasonable people may differ. The comparison between the two taxes, one of which is an annual tax and the other a "once in a lifetime tax" is helpful to me only in terms of setting the lowest and the highest income tax and estate and gift tax rates. I would have the lowest estate tax rate and the lowest gift tax rate higher than the lowest income tax rate and the highest rate for each tax the same. Thus, since the highest income tax rate is 70%, I would reduce the highest estate tax rate to 70%.

The current estate tax rates are in my judgment criticized more frequently by estate owners subject to this tax, and particularly those with estates of \$1 million or less, than are the income tax rates applicable to them. The criticism is not logical, and some would say it is irrational, but it is a fact. Perhaps it is based upon a differentiation between what is income and what is principal. Persons understand the need for having an income tax satisfy current needs of the government. They have more difficulty, however, understanding why principal (capital) should be taken by the government to support current needs.



#### IV. Exemptions and Rates

##### 1. Estate Tax

During these hearings much testimony has supported an increase in the exemption. A figure up to \$200,000 has been frequently suggested. Estimates indicate that such an increase would result in a revenue loss of over \$2 billion. Advocates of a substantial increase in the exemption justify the need for an increase by stating that inflation has reduced the purchasing power of the dollar from what it was when the \$60,000 was established in 1942. This assumes that the relationship established in 1942 between the \$60,000 exemption and the purchasing power of the dollar was correct and continues to be essentially correct. One can, of course, argue with this assumption.

The Administration has proposed increasing the exemption to \$150,000, but would commence the estate tax rates at 30%. As a result of starting the rates at this figure the revenue loss is less than it would be if the exemption were increased to this figure without any change in rates. The Administration proposal would remove about 70% of the estates paying some estate tax from the estate tax rolls and thus take a giant step towards returning the estate tax to its 1942 status. If this Committee determines that a revenue loss of such magnitude cannot



be tolerated, the loss can, in my judgment, only be recouped by changing the basis rule. Mr. Conable, in his questioning of the first panel on March 15th, seemed to make this point.

a. Substitution of a Credit for the \$60,000 Exemption

In my view the purpose of an exemption in the estate tax law should be to set the floor under which no tax will be imposed. Today the exemption does more and acts as a deduction against the tax at the estate's highest estate tax rate, thus saving more tax for the larger estate than for the smaller estate. I favor changing the exemption to a credit against the estate tax which would be the same for all estates.

What should be the floor for the imposition of an estate tax? I have no pearl of wisdom to suggest. To me a net estate of \$100,000 seems reasonable. The credit necessary to do this would be the current tax on a taxable estate of \$100,000, or \$20,700. It would take approximately 45% of the estates which now pay an estate tax off the estate tax rolls. The revenue loss from shifting to a \$20,700 credit instead of the current \$60,000 exemption would be modest and no more than 5% of estate tax revenues.

The operation of estate tax credits of various sizes is both dramatic and quixotic to those accustomed to dealing with deductions. The tables attached as



Appendix C show the effect on estates of various sizes of eliminating the present \$60,000 exemption and replacing it with credits of \$17,900, \$20,700, and \$25,000, (representing respectively the tax on taxable estates of \$90,000, \$100,000, and \$114,333). The tables show two somewhat surprising things. First, the size of estates benefiting to some extent from substitution of the credit for the exemption increases dramatically with relatively modest increases in the credit. Second, the benefits of any given credit in percentage terms diminish rapidly as estates increase in size beyond the no-tax point.

Thus, a credit of \$17,900 is better than a \$60,000 exemption only for taxable estates (before the exemption) at or below \$155,000. The \$20,700 credit benefits estates at or below \$550,000, and the \$25,000 credit benefits estates at or below \$1,303,333. Increasing the credit by 40% in this range increases the size of estates benefiting by more than eightfold.

These benefits are, however, weighted toward the smaller estates and diminish rapidly. Thus, with the \$17,900 credit an estate of \$100,000 would pay 42% less tax than with a \$60,000 exemption. An estate of \$120,000 has its tax reduced by only 7%. With the \$25,000 credit, an estate of \$120,000 has its reduced by 82%, and an estate of \$160,000 by only 34%.



b. Rates

Assuming an estate tax credit in the range of \$20,000 is enacted in place of the current \$60,000 exemption, the effective estate tax rates would begin at 30%. Again, the starting rate and the highest rate and the progression in between are matters of personal preference. My feeling is that the current rate progression once you arrive at the 30% rate is reasonable, and I would not change it unless the Committee desires to significantly increase or decrease the estate tax collections. If this is the decision, the rates will obviously have to be changed. I would, however, as already mentioned, reduce the top rate to 70% for the reason which I have previously stated and because some of the other changes which I believe should be made and which are summarized at the end of this paper will increase the progressive effect of the application of the gift and estate tax laws.

Before leaving rates, I would like to make one final comment. A rate structure which commences at 3% is, in my opinion, ridiculous. The cost of preparing an estate tax return is more than the current estate tax of \$500, which is imposed on the first \$10,000 of taxable estate.

2. Gift Tax

I do not favor a change in the current gift tax exemption of \$30,000 or the amount of the annual exclusion



which is now \$3,000. In my judgment, the exemption and the exclusion are sufficient to handle most family needs and objectives and, at the same time, do not permit undue erosion of the estate tax base. On the other hand, I would have the gift and estate tax rates the same. If a person is in a fortunate enough position to be able to make substantial gifts to members of his family he should not expect or receive a lower rate of tax than that applicable to transfers at death. Under the credit approach which I have suggested above, there is no effective estate tax rate on taxable transfers of less than \$100,000. As previously indicated I do not believe the lowest gift tax rate should be less than the lowest income tax rate. I arrive at a 20% gift tax rate for gift transfers on the first \$100,000 by taking two-thirds of the lowest effective estate rate of 30%.

V. The Basis Issue - Appreciation at Death

1. Introduction

The basis issue has been around for a long while. Emotions run high concerning it. Now that percentage depletion has been changed, the failure of current law to subject unrealized appreciation at death to income tax



may well be the number one target of tax reformers. Dr. Gerard M. Brannon, a panelist before the Committee three years ago on estate and gift tax revision, has said that he would consider a legislative session a success in the tax sense if the only accomplishment were changing the basis rule. Estimates indicate that unrealized appreciation in all estates of decedents dying during a year is around \$16 billion and that perhaps \$10 billion would be in estates of \$60,000 or more after allowing for a minimum basis of \$60,000. Hopefully, my fellow panelist James Smith will be able to supply some helpful figures on this subject.

During the public hearing last week this Committee heard stirring defenses of current law. In considering a change in current law, this Committee must decide whether there is a better alternative. Three have been suggested - capital gains tax at death, carryover basis and an additional (appreciation) estate tax (AET). The first two are the old standbys. The AET is the new horse in the race, having been put before public view for the first time at the 1973 hearings. It is, as expected, now getting its dose of salts and being attacked from many directions. See, e.g., Background Materials 682-88.

The carryover basis approach would eliminate the favorable "stepped-up" basis at death and would treat the



basis of inherited assets similarly to the present treatment of lifetime gifts. The heirs would take the decedent's basis increased by estate tax paid which is attributable to the appreciation.

The capital gains tax at death in essence entails pretending that the decedent sold his assets immediately prior to death and duplicating the tax results of the sale. Thus, an income tax on appreciation at capital gains rates would be payable by the estate, and a deduction for that income tax would be allowed in computing the taxable estate under the estate tax, just as today income taxes paid prior to death reduce the gross estate, and those due at death are estate tax deductions. The basis of the heirs for estate assets would continue to be their estate tax values.

Simply stated, the AET subjects to a second tax the net appreciation included in a decedent's gross estate for estate tax purposes at a relatively low flat rate of tax which reflects the highest capital gains tax rate and estate tax rate.\* This would produce the same net effect as the capital gains tax at death proposal for

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\* To illustrate, if the highest estate tax rate were 60% and the highest capital gains tax rate were the current 35% the AET rate would be 14%,  $35\% \times 40\% (100 - 60)$ .



an estate in the highest estate and income tax brackets. In contrast to the capital gains tax at death proposal, no marital or charitable deduction would be allowed in computing the AET. Certain assets having special characteristics would be deemed to have a basis equal to their estate tax values and thus would not cause an AET liability. The basis of the heirs for estate assets would continue to be their estate tax values.

I had something to do with the birth of the AET. It is an illogical approach to the basis problem which attempts to compromise policy issues in a way which gives a little, but not too much, to everyone involved with a minimum amount of complexity. I believe the most useful function I can perform for this Committee is to explain why in my judgment the AET is preferable to capital gains tax at death and carryover.

## 2. Major Policy Issues

### a. Effect on Smaller Estates

An owner of an appreciated asset must pay an income tax on the appreciation (capital gains) when he sells it. This fact naturally enters into his decision to sell or not to sell, particularly when the rate of tax is substantial. Under current law, if the asset is not sold during life, it receives a new income tax basis at



death equal to its estate tax value. Thus, the appreciation is not subjected to income tax. It is, of course, subjected to estate tax. The basic issue is whether the appreciation should be subjected to two taxes.

If the appreciation is to be subjected to both income and estate taxes, some adjustments must be made in order to prevent a result which is more severe than a life-time sale. These adjustments create complexity and present difficult problems when two different taxes, with differing rules, are being integrated. We have had some of these problems on a small scale in dealing with section 691 income, income in respect of a decedent, which is subjected to both estate tax and income tax.

The capital gains tax at death proposal makes the adjustment by allowing an estate tax deduction for the income tax imposed on the net appreciation, with the result that there would be no estate tax on the income tax paid. The carryover basis approach solves this problem in reverse fashion by increasing the basis of the property by the estate tax attributable to the net appreciation, with the result that there would be no income tax on the estate tax paid. The AET contains no such adjustment and accepts "double taxation". How can this illogical result be justified? It is not simplicity, as my fellow panelist Mike Graetz seems



to suggest in his excellent article, "Taxation of Unrealized Gains at Death: An Evaluation of the Current Proposals" (59 Va. L. Rev. 830, at 835 (1973)), but rather its effect on smaller estates.

The capital gains tax at death approach allows an estate tax deduction for the capital gains tax paid. The higher the estate tax bracket of the estate, the more this deduction is worth. Thus, the net effect of the capital gains tax at death is harsher on smaller estates, which will actually pay a higher rate of additional tax on each dollar of appreciation. My fellow panelist Carl S. Shoup points up this fact in Federal Estate and Gift Taxes at pages 71-72. For example, using a 35% capital gains tax rate, \$1 of appreciation will yield 10.5¢ in additional tax if the estate is in a 70% estate tax bracket, but 24.5¢ in additional tax if the estate is in a 30% estate tax bracket.\* In my judgment it is wrong to focus on duplicating lifetime sales when the result is to impact smaller estates more severely than larger estates. Such a "get even" approach without any estate tax rate reduction would mean that estates in the \$150,000 - \$500,000 range would be taxed at more than 50% on net appreciation included in the estate.

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\* The large estate pays 35¢ capital gains tax and has its estate tax reduced by  $70\% \times 35\text{¢} = 24.5\text{¢}$ , for a net additional tax of 10.5¢. The small estate also pays 35¢ capital gains tax but has its estate tax reduced by only  $30\% \times 35\text{¢} = 10.5\text{¢}$ , for a net additional tax of 24.5¢.



The same problem is presented by the carryover basis approach. The basis carried over is increased by estate tax attributable to appreciation. Large estates will have more estate tax per dollar of net appreciation because they are in higher estate tax brackets and pay a higher average tax rate. Thus, the partial "step-up" under the carryover basis approach benefits the heirs of large estates most. Also, when a sale of appreciated property is necessary to pay estate tax, carryover achieves the same result as to the time of imposition of the second tax as a capital gains tax at death to the extent of the property sold. Such cases would frequently occur.

Because the AET does not result in any deduction in computing the regular estate tax, it does not run afoul of this "reverse progression" problem. The effective rate of additional tax on each dollar of net appreciation will be the same for estates of all sizes.

In his article, Mike criticizes the "double tax" element of the AET and states that it should be eliminated by giving a basis increase in an amount equal to the estate tax on the net appreciation before computing the AET. He would then impose the AET at a substantially higher rate - 25% instead of 14%. The first draft of the AET did just this. It was discarded because of its effect on smaller



estates. The difference between the two approaches is shown in two examples contained in Appendix D.

Finally, I would emphasize that none of the three alternatives - capital gains tax at death, carryover or AET - is going to have a significant effect on the "lock-in" problem, the reluctance of the owner to sell during life and pay an income tax on the gain. The only way to attack this problem is to create a tax incentive to sell during life, such as a credit for the capital gains tax against the estate tax, or a tax penalty to holding at death, such as Dr. Brannon's 1973 suggestion to tax all appreciation at death as short term gain.

### 3. Proving Basis

One of the uncertainties connected with any change in the law is how much of a problem proof of basis would be. In large part this would depend upon how tough the Internal Revenue Service would be. If it should take the same approach it now does on valuation issues we would be in for trouble. The leverage which the Service has with smaller estates is considerable. The amount involved is usually not large enough to warrant taking the case through the Service's administrative processes and the courts.

A recent case I was involved in will emphasize the importance of this point. An estate tax return was



filed for a large estate having a substantial amount of one stock, which was valued on the return at \$30 per share. The auditing agent suggested approximately \$85 per share. Considerable time (and expense) was required to convince the agent that he was way off in his valuation. I would estimate the cost at somewhere between \$5,000 and \$10,000. The amount involved was large enough to warrant this cost. It probably would not be in a smaller estate. The agent agreed to a \$38 per share value.

My judgment is that proof of basis would prove troublesome for the smaller estates. The larger estates can afford the cost of protection - the creation of custodian accounts.

If basis cannot be proved, but there is in fact a basis, excessive taxation results. The effect of this unfortunate result is minimized by a relatively low flat rate of tax (the AET) when compared with a higher rate of tax under capital gains tax at death or carryover.

#### . 4. Transfers to Spouses and Charities

The AET differs from the estate tax and the capital gains tax at death proposal in that there are no deductions for transfers to surviving spouses qualifying for the marital deduction or to charities. This result has, as expected, been criticized. Regarding marital transfers, the impact of



the AET may be offset by increasing the marital deduction for estate tax purposes. The decision to tax marital transfers under the AET recognizes the desirability of simplicity. The creation of any deduction for a marital transfer, which frequently occurs, creates acknowledged complexity unless the bases for all assets is changed to their estate tax values.

Carryover also presents problems where a part of the estate qualifies for the marital deduction. The correct conceptual result is that the property qualifying for the deduction should not receive any basis increase for the estate tax on the appreciation because it does not cause any estate tax. This result is difficult to accomplish since assets are not divided into the marital and non-marital shares until sometime after death. When sales are made before the division, how is the basis for the stock sold to be determined? Most carryover proposals have avoided this problem by allocating the basis increase to all estate property, but this result "increases" the potential capital gains of the non-marital portion.

The most controversial part of the AET is its application to charitable transfers. Concessions have, however, been made to charities in several ways. For example, the estate tax charitable deduction is computed without reduction for any AET charged to the charitable



property. The tax benefit which should be available from a transfer of appreciated property to charity is a controversial subject, as the Filer Commission report, Giving in America, indicates. If desired, the AET may be revised to create a charitable deduction.

5. Simplicity of Operation and Ease of Administration

Clearly, any change in the basis rule is going to complicate the administration of affected estates. What is not so clear is what this "cost" would be. To me, it is indisputable that retention of current law giving a new basis at death, as would occur under the AET, is preferable to carryover in terms of ease of administration. Capital gains tax at death, with a marital deduction, is part carryover. The reallocation of basis under carryover will prove troublesome. Support for this conclusion is found in the difficulties lawyers and accountants now have in preparing accounts for estates where the decedent's residuary estate is divided into two or more shares and estate taxes are charged to less than all the shares.

I conclude that the AET would cause less disruption in the administration of estates than the capital gains tax at death, as proposed, or carryover. Further support for this conclusion may be found in Mike Graetz' article and in the detailed discussion of the AET at pages 482 through 505 of the Background Materials.



The best advice I can give this Committee as you consider whether to change the basis rule is don't do so unless you are prepared to tax appreciation passing to a surviving spouse.

VI. Farms and Other Closely Held Businesses - The Liquidity Problem

1. Introduction

In recent years rapidly increasing farm values have caused an increasing number of farm sales by estates in order to pay estate taxes. Farmers who do not consider themselves wealthy now have an estate tax problem. Owners of other closely held businesses have the same problem, which in my judgment is accentuated for them because of the often unrealistic positions the Internal Revenue Service takes in determining the value of the businesses. In the case of a farm, whose value people may believe is "inflated", comparable sales usually exist, thus assuring that a sale would produce its estate tax value. This is not necessarily so with stock of a closely held business.

Does the estate tax pose a serious problem to the continued operation of a farm or other closely held business by family members? In some cases, particularly with unplanned estates, it does. Would tax relief be helpful? Certainly. Should relief be enacted? This is not an easy question to



answer. Less than two years ago this Committee tightened the law in this area when, as a part of changing the interest rate on tax deficiencies, the special 4% interest rate on estate tax eligible for deferred payment under Section 6166 was eliminated.

In general, the suggestions for tax relief have been as follows:

1. Reinstating a lower interest rate for estate tax deferred under section 6166.
2. Increasing the estate tax exemption.
3. The Administration's proposal for a five year moratorium on payments eligible for deferral under section 6166 and a stretch-out of the deferred period from 10 years to 20 years after the end of the moratorium.
4. Providing a special valuation method which would produce a lower estate tax than under the current fair market value approach.
5. Partial or total forgiveness of the estate tax.

As noted, some of these proposals are keyed to section 6166. This provision was enacted as a part of The Small Business Tax Revision Act of 1958 and permits a decedent's estate to pay the estate tax attributable to an interest in a closely held business in as many as ten



equal annual installments provided the value of the interest is either 35% of the gross estate or 50% of the taxable estate. The legislative history states "that by spreading out the period over which the estate tax may be paid it will be possible for the estate tax in most cases to be paid out of the earnings of the business, or at least that it will provide the heirs with time to obtain funds to pay the Federal estate tax without upsetting the operation of the business." The Act also created a 4% interest rate under section 6601(b) for estate tax deferred pursuant to section 6166. This rate was two-thirds of the normal 6% rate on tax deficiencies.

When interest rates were high two years ago, the normal 6% rate was changed to a floating rate tied to the prime rate and the special 4% rate was eliminated in P.L. 93-625. In discussing the change the Senate Finance Committee report says:

"In those cases where the 4-percent interest rate applies, although an extension of time to pay a tax may be appropriate in certain cases in order to avoid unnecessary hardship, the committee sees no sound reason to permit some taxpayers to pay interest at a lower rate than other taxpayers are required to pay on underpayments of tax. Relief from the hardship of paying taxes in a lump sum should not also mean that the interest rate should be reduced if payments are made in installments. This is particularly so if a closely held business owned by an estate, or a business which has recovered an expropriation loss, is or can be earning a



significantly higher return on the tax money which it presently can, in effect, borrow from the Government at 4-percent." S. Rep. No. 93-1357, 93d Cong., 2d Sess. (1974).

## 2. Analysis of Proposals

### a. Lower Interest Rate

This form of relief is modest in effect. The net savings to the estate is not the full amount of the interest reduction, but rather this amount less the income tax savings from the payment of the larger amount of interest. As to interest on tax deferred under section 6166, I call your attention to Revenue Ruling 74-239, IRB 1975-24 at 14, which establishes an untenable distinction between such interest and interest on a bank loan to pay the estate tax.

Three approaches have been suggested - a fixed rate, a percentage of the floating rate and 2% under the floating rate. The obvious fixed rate is 4% which was the old rate; the obvious percentage is two-thirds which would reestablish the relationship between the former 4 and 6% rates. For the foreseeable future, which is not long, the 4% rate should give slightly greater relief. A fixed rate has the advantage of permitting the estate to know its tax liability (including interest) is fixed, which should make planning for its payment somewhat easier.

If this Committee decides to grant relief in the form of a lower interest rate, a decision must then be made



on whether a dollar ceiling should be imposed on the amount of the deferred estate tax as to which the lower rate would be applied. The Administration's proposal would reinstate the 4% rate fully with respect to only the interest on the tax attributable to qualifying assets of \$300,000. If the asset exceeds this figure, there would be a dollar for dollar step-down in the qualifying amount and a corresponding step-down in the application of the 4% rate. If the asset exceeds \$600,000, no relief would be granted.

Dollar limitations in the tax law generally indicate an unwillingness or inability to make a "clean" policy decision. If this Committee decides to reinstate a lower interest rate on estate tax deferred under section 6166, I would hope that no limitation would be imposed. Based upon my experience, the cash flow problem is just as real for a large business as for a small business. In fact, it is often worse because the estate tax is proportionately larger due to the progressive rate structure.

b. Increase in Estate Tax Exemption

Closely held business assets (including farms), which for convenience I will consider as those qualifying under section 6166, form only a small part of the estates of all decedents. Figures are hard to come by, and I hope my fellow panelist James Smith is able to give us some help on this



point. My best guess is that the figures does not exceed 15%.

An increase in the exemption would benefit all decedents paying some estate tax. Why should tax relief in a large aggregate amount be granted to all such decedents to solve a problem for 15% of them? The only way to answer this question that makes any sense is to say that creating distinctions between types of assets for estate tax purposes is so undesirable that in order to protect the 15% the same relief must be given to the other 85%. The point may be made most dramatically by pointing out that the revenue loss from granting total estate tax forgiveness for all closely held business assets would be less than increasing the exemption to \$150,000 or more.

c. Tax Relief Proposals.

(1) Qualification Requirements

The three other types of relief proposals summarized above contain qualification requirements which vary considerably. In general, there is a "before death" requirement and an "after death" requirement.

(a) Time Requirement

(i) Before Death

One purpose of this requirement is to prevent acquisitions "in contemplation of death" in order to take



advantage of the tax benefit. If the tax benefit is small, the problem is not serious. The problem increases in significance as the tax benefit increases. A long holding period, say five years, seems undesirable. If the object of the relief is to permit the family to continue in the business, as I believe it should be, the length of time the decedent has been in the business should not be important.

If a "before death" time requirement is imposed, it should be no longer than the estate tax "contemplation of death" rule. This rule should, I submit, be revised to create a fixed rule, say two years, which disregards the decedent's motive.

(ii) After Death

The need for some "after death" requirement is obvious. If the estate sells the asset six months after the death of the decedent, there is no reason to give relief. The most frequently suggested period is five years. A single time requirement will exert a significant influence on the decision to continue the business even though it is not economically viably or only marginally productive, particularly when the tax benefit is great. This seems undesirable. To illustrate, one proposal would exempt from all estate tax a farm of less than a stated value if held for five years after death. If the farm were marginal, the family would have



to decide whether they should hang on for five years to save the estate tax.

A single time requirement presents another problem when it is not satisfied. The estate will have taken advantage of the benefit, which must then be recaptured. Doing this may be troublesome. For example, if the benefit is an alternate method of valuing the asset which produces an estate tax savings, when is the fair market value of the asset to be determined? Will both valuations be made on the estate tax return, or will fair market value be determined only after the time requirement is violated? Suppose the asset goes to one beneficiary, but the potential tax liability to someone else, including a charity. This would create some potential problems.

(b) Section 6166

The Administration's proposal uses section 6166 for determining the qualification requirements. Under this section, there is no holding period requirement prior to death. The decedent could have acquired the asset ten years or three years or one day before death. Section 6166 does require that the asset constitute 35% of the decedent's gross estate or 50% of his taxable estate. The taxable estate is determined after allowance of all deductions and the \$60,000 exemption. One of these deductions is



the marital deduction, which may be as much as 50% of the adjusted gross estate (gross estate less funeral and administration expenses and claims). Thus, an asset may qualify under section 6166 even though it is less than 25% of a decedent's adjusted gross estate. Put another way, qualification would exist even though liquid assets constituted 75% of the estate. The soundness of granting relief in such a case seems questionable. A higher percentage requirement than contained in section 6166 in the range of 60 to 70% of the decedent's adjusted gross estate seems appropriate.

In basing relief upon the requirements of section 6166, a decision must necessarily be made that the acceleration provisions of subsection (h) are sufficient to eliminate non-meritorious cases where the relief should be ended. This is debatable. Acceleration - loss of the right to continue to defer the payment of the estate tax attributable to the qualifying asset - occurs if "aggregate withdrawals of money and other property from the trade or business" equal or exceed 50% of its value or that percentage of the value of the interest in the business is "distributed, sold, exchanged or otherwise disposed of". Thus, if the qualifying asset is a farm and 49% is sold six months after death, the estate tax attributable to the entire value of the farm continues to be eligible for full deferral. Similarly,



if the qualifying asset is stock and 49% is sold, there is no loss of the right to defer the payment of estate tax. Leaving aside whether this is the correct result for purposes of section 6166, granting the same tax relief in such a case as would occur if the sale has not been made seems questionable.

Other policy questions are presented by the use of section 6166(h) to ferret out non-deserving cases. One of the requirements for section 6166 qualification of a farm is that the decedent participate in the management of the business. See Revenue Ruling 75-366, IRB 1975-34 at 25, which also holds that a crop sharing arrangement does constitute a business. Section 6166(h) says nothing about the termination of a business. Thus, a farm would appear to continue to qualify even though a member of the family does not participate in the active management of the business and the land is leased for cash to a tenant. With qualifying stock, section 6166 continues to apply when no member of the family is active in the management of the company.

The policy question is whether tax relief should be granted in cases where the family is an "investor" rather than an "operator". In deciding this question, one should recognize that drawing a clear line between these two general terms would not be easy. Suppose one of four



children operates the farm, and the other three are absentee owners. How should this case be handled? The implications of an "operator" requirement in the case of a surviving spouse are troublesome. Finally, how would an "operator" concept be applied when the qualifying asset is in a trust?

Although section 6166 has been in force for 18 years, there has been little case law development and ruling activity. Many unanswered questions exist regarding its application. If tax relief turns entirely on the application of this provision, it will come under increasing scrutiny. Before this occurs, the section should be reexamined.

(2) Form of Relief

(a) Special Valuation Method

Two benefits would result from a special valuation method - (1) valuation of the asset should be simpler, thus reducing controversies with the Internal Revenue Service, and (2) the method would produce a lower valuation, thus reducing the estate tax on the asset. The amount of the tax reduction would necessarily be imprecise and depend upon what valuation resulted from the application of the special method. Also, as was discussed in the hearings in the afternoon of March 15th, the selection of a special method which will produce fair results as between similarly situated estates is not easy.



(b) Administration Proposal

The Administration's relief is a five year moratorium on payment of the tax without interest and a stretch-out from ten years to twenty years of the deferred payment period. The five year moratorium is in effect a five year non-interest bearing loan in the amount of the estate tax attributable to the qualifying asset. Based upon a 6% interest rate, which appears conservative, the "forgiveness" would be 25% of the tax on the asset. The use of a moratorium period seems questionable in several respects. First, its effect will be to delay sales of qualifying assets which for economic reasons (other than delay in paying the estate tax) should be sold. A sale would not only cause an acceleration of the estate tax on the qualifying asset but would end the moratorium period. Second, the desirability of having all "forgiveness" in the first five years when the tax deferral period is much longer may be questioned. Why not spread the relief over the entire deferral period? Also, the need for a payment period to twenty years - twenty-five years from the date of death when combined with the moratorium period - is debatable. My experience indicates that where the business is economically viable ten years is a sufficient period to raise funds to pay the estate tax. If a twenty or twenty-five year period is used, the likelihood of the death of a



second owner before the tax is paid is significantly increased and care will have to be given to integrating the timing of the payment from both estates.

(c) Tax Forgiveness

Total tax forgiveness has been proposed for farms of \$200,000 or less. Such forgiveness creates a serious problem of equity as regards owners of other assets.

The other forms of tax relief discussed above are in reality partial tax forgiveness. Another alternative is to grant such forgiveness directly over the period the payment of the tax is deferred under section 6166 in the form of reduced annual payments. If deemed desirable, the forgiveness could be coupled with a corresponding partial forgiveness of interest. Partial forgiveness of each installment payment has the advantage of not having the tax relief turn upon a single event, such as retention for five years, but rather upon continued retention during the entire deferral period. Thus, this form of relief should minimize the likelihood that tax benefit would have a significant bearing on decisions to continue the business or to dispose of it. Neutralizing the tax consequences of these decisions is desirable.

There remains the question of how the forgiveness should be handled. One approach would be to forgive a fixed



percentage of each payment. Another approach would be to have the percentage forgiveness increase with the passage of time. The choice between these two approaches depends on how fast it is desired to give the relief.

### 3. Technical Changes

There are a number of changes which should be made in various sections of the Code that are generally concerned with the liquidity problem and the payment of estate taxes.

#### a. Section 6165 - Bond

This section authorizes the Service when an extension of time is granted to pay the estate tax to require the estate to furnish a bond in an amount not to exceed twice the amount covered by the extension. The cost of a bond is no different from the payment of additional estate tax. The bond requirement should be eliminated unless the Service can demonstrate that it is needed.\* If the bond requirement is not eliminated, alternate security devices to a bond should be provided as recommended by the 1968 Treasury Studies and there should be a uniform practice followed by all District Directors in requiring bonds. No such practice now exists.

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\* The estate tax lien provided by section 6321 remains in effect until ten years after a decedent's death.



b. Section 2204 - Executor's Personal Liability for Tax

When payment of estate tax is extended the executor remains personally liable for the payment of the tax. This potential liability, when coupled with the bonding requirement of section 6165 and the estate tax lien of section 6321, seems like legislative overkill. The continuing personal liability of the executor has restricted the use of section 6166. Consideration should be given to eliminating the personal liability of the executor after the estate tax has been finally determined and all estate tax has been paid except amounts as to which an extension has been granted, particularly if the bonding requirement is retained.

c. Section 303 - Stock Redemptions and Avoiding Dividend Treatment

Section 303 permits redemptions of stock included in a decedent's gross estate to be treated as an exchange of property and not as the receipt of a dividend to the extent of death taxes and funeral and administration expenses if certain requirements are met. Imposition of a dividend treatment would present a serious liquidity problem for a decedent's estate in need of cash to pay estate taxes. Thus, sections 303 and 6166 are each aimed at providing relief for an estate's liquidity problem. The percentage requirement of section 303 - 50% of the taxable estate or 35% of the gross



estate - is the same as that applicable under section 6166. The time periods under the two sections are, however, different. The estate tax may be deferred for ten years under section 6166 but a qualified redemption under section 303 must in general be accomplished within three years after the estate tax return is filed. Since the redemption proceeds may be used to make the installment payments under section 6166, the time requirement of section 303 should be extended to ten years to conform with section 6166.

Sections 303 and 6166 also differ regarding their application to stock of two or more corporations. Section 303 has a 75% multiple corporation rule - the decedent's gross estate must include 75% of the value of the outstanding stock - while section 6166 has a 50% multiple corporation rule. The percentage should be the same for each section. Further, a 50% requirement is too high and should be lowered to 33 1/3%.

d. Section 6161(a)(2) - Permissive Extensions

This provision permits the Service to grant an extension of time to pay the estate tax for up to ten years if payment of the tax would result in "undue hardship" to the estate. The word "undue" should be eliminated since no one is sure what it means but it suggests that something more than "hardship" is needed. "Hardship" alone should be a sufficient ground for a permissive extension.



e. Section 6166 - Ten Year Extension

This provision contains alternate requirements in the case of stock - 20% or more of the voting stock or 10 or less shareholders. The 10 or less shareholder test is too restrictive and should be broadened to include at least 25 shareholders.

A problem exists concerning the application of section 6161(h) to trust property. Under this provision certain events may cause an acceleration of the deferred payments. One of these events occurs if 50% or more of the interest in the closely held business "is distributed, sold, exchanged or otherwise disposed of". Treas. Reg. §20.6166-3(e)(1) states:

"A transfer by the executor of an interest in a closely held business to a beneficiary or trustee named in the decedent's will or to an heir who is entitled to receive it under the applicable intestacy law does not constitute a distribution thereof for purposes of determining whether 50 percent or more of an interest in a closely held business has been distributed, sold, exchanged, or otherwise disposed of."

This result appears to be inconsistent with the result when the distribution is made from trust property which is included in a decedent's gross estate. Treas. Reg. §20.6166-3(e)(3) provides:

"An interest in a closely held business may be 'distributed' by either a trustee who received it from the executor, or a trustee of an interest which is in-



cluded in the gross estate under section 2035 through 2038, or section 2041."

There is no rational basis for any such distribution. Why should a distribution by an executor be "clean" and a distribution by a trustee of a revocable trust used as a will substitute be "tainted"? This trap for the unwary should be eliminated. Section 6166(h) should be revised to make clear that a distribution of property by a trustee will not cause an acceleration of the payment of deferred estate tax.

#### 4. Conclusion

About six weeks ago I spent an afternoon in Des Moines discussing the farm problem with two knowledgeable people. Based upon this discussion, my instincts and some reading in the area, I conclude that much of the problem could be eliminated by proper estate planning. While that may give superficial support to the snide statement made about tax lawyers and accountants in The Wall Street Journal editorial of March 10, 1976 entitled "The President's Estate-Tax Proposal", the cost will be far lower than paying "high" estate taxes.

I am skeptical about granting any relief for farms and closely held businesses now, except reinstating the special 4% interest rate on estate tax deferred under section 6166. This section should be reexamined, perhaps



as a part of a study dealing with the extent of the liquidity problem. I commend Senators Packwood and Nelson and their staffs for S.3139 which was introduced on March 15th. See Congressional Record, March 15, 1976, S3379. Its combination tax credit approach, and the frank recognition of the problem which an "operator" test presents, shows a sensitivity and depth of analysis which is lacking in an earlier bill (S.2819) dealing with the same subject and supported by these two Senators and others. Progress is being made.

VII. Summary

My approach to the areas assigned to this panel is:

1. Substitute an estate tax credit of \$20,700, the estate tax now payable on a taxable estate of \$100,000, for the exemption of \$60,000.
2. Retain the current gift tax exemption of \$30,000 and the gift tax annual exclusion at \$3,000.
3. Leave the present estate tax rates intact through 70% and eliminate the rates above that percentage.
4. Have the estate tax rates apply to gift transfers, except that the rate would be 20% on all taxable gift transfers under \$100,000.
5. Do not subject unrealized appreciation at death to another tax unless you are prepared to tax appreciation



which passes to a surviving spouse and qualifies for the marital deduction. If you do change the law, reduce the estate tax rates.

6. Reinstate the 4% interest rate on estate tax deferred under section 6166. Be skeptical of granting any further relief to farms and closely held businesses pending a study of the liquidity problem, but if further relief is to be granted do so directly by partial forgiveness of the estate tax.

Any overall position must consider the areas assigned to the other panel. For the record my views on the subjects assigned to the other panel are:

1. Have the estate tax rates reflect taxable transfers for gift tax purposes.
2. Increase the marital deduction to the greater of \$250,000 or one-half of the decedent's gross estate.
3. Impose a tax on certain trust transfers that are not taxed under current law.



APPENDIX ANumber of Estate Tax Returns  
in Relation to Total Deaths

| <u>Filing</u>      | <u>Total<br/>Number of<br/>Returns<br/>Filed</u> | <u>Taxable<br/>Returns<br/>Filed</u> | <u>Deaths</u> <sup>1/</sup> | Ratio of   |  |
|--------------------|--|--------------------------------------|-----------------------------|--|--|
|                    |  |                                      |                             | <u>Total<br/>Returns<br/>to<br/>Deaths<br/>(Percent)</u> | <u>Taxable<br/>Returns<br/>to<br/>Deaths<br/>(Percent)</u> |
| 1941               | 15,977   | 13,336                               | 1,432,000                   | 1.1  | 0.9  |
| 1951               | 27,958   | 18,941                               | 1,468,000                   | 1.9  | 1.3  |
| 1961               | 64,538   | 45,439                               | 1,708,000                   | 3.8  | 2.7  |
| 1970               | 133,944  | 93,424                               | 1,926,000                   | 7.0  | 4.9  |
| 1973               | 174,899  | 120,761                              | 1,964,000                   | 8.9  | 6.1  |
| 1976 <sup>2/</sup> | 229,118  | 155,782                              | 2,002,750                   | 11.4   | 7.8  |
| 1985 <sup>3/</sup> | 473,976  | 321,224                              | 2,258,600                   | 21.0   | 14.2   |

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<sup>1/</sup> In preceding year.

SOURCE: Statistics of Income. Estate Tax Returns, 1965, 1969 and 1972; Statistical Abstract of The United States.

<sup>2/</sup> Based on extrapolation of 1970 to 1973 trend.

<sup>3/</sup> Based on extrapolation of 1961 to 1973 trend.



APPENDIX BAnalysis of the Average Percentage Payable in Tax  
(Before Credits) by Estates of Various Sizes

|                   | (1)                | (2)   | (3)              |
|-------------------|--------------------|---|------------------|
| Size of<br>Estate | Taxable<br>Estates | Taxable Estates<br>Before Applica-<br>tion of Exemption | Gross<br>Estates |
| Over 5 Million    | 60%                | 60%   | 27%              |
| 2 - 5 Million     | 42%                | 42%   | 24%              |
| 500,000-2 Million | 33%                | 31%   | 18%              |
| Under 500,000     | 22%                | 17%   | 6%               |

The table is derived from figures in Tables 1 and 12 of "Statistics of Income 1972-Estate Tax Returns", IRS Publication 764 (4-75). Use of the pre-credit "gross estate tax" is appropriate because the four credits all represent dollars actually paid for some death or gift tax in lieu of the tax fixed by the federal rate schedule. Similarly, it seems appropriate that the various estate tax deductions be subtracted before measuring progressivity. The deduction for expenses and debts represents dollars actually paid, which do not reach heirs. The marital and charitable deductions are expressions of a public policy favoring tax free gifts to spouses and charities. Thus column 1 shows the average percentage of taxable estates of various sizes payable in tax.

Arguably, the \$60,000 exemption, which represents dollars the decedent can dispose of as he sees fit, should be added back before measuring progressivity. Column 2 does this, and shows a still more progressive tax because it reflects the total of \$2.4 billion in otherwise taxable estates that paid no tax because of the exemption.

Finally, for those who desire to ignore all deductions, column 3 shows the percentage of gross estates of various sizes paid in tax. (Both this column and column 2 understate progressivity because gross estates less than \$60,000 are omitted.)







CREDIT OF 20,700 = Tax On 100,000      BREAK-EVEN ESTATE:  
 after exemption                      550,000  
 before exemption

| TAXABLE<br>ESTATE BEFORE<br>EXEMPTION OF: | TAX PAYABLE<br>WITH 60,000<br>EXEMPTION | TAX PAYABLE<br>WITH ABOVE<br>CREDIT | NET BENEFIT (DETRI-<br>MENT) TO ESTATE FROM<br>SUBSTITUTING CREDIT<br>FOR EXEMPTION | NET BENEFIT (DETRI-<br>MENT) AS % OF TAX<br>DUE WITH 60,000<br>EXEMPTION |
|---|---|-------------------------------------|---|--|
| 30,000                                    | 0                                       | 0                                   | 0   | -  |
| 50,000                                    | 0                                       | 0                                   | 0   | -  |
| 80,000                                    | 1,600                                   | 0                                   | 1,600   | 100  |
| 90,000                                    | 3,000                                   | 0                                   | 3,000   | 100  |
| 100,000                                   | 4,800                                   | 0                                   | 4,800   | 100  |
| 120,000                                   | 9,500                                   | 6,000                               | 3,500   | 36.8   |
| 160,000                                   | 20,700                                  | 18,000                              | 2,700   | 13   |
| 200,000                                   | 32,700                                  | 30,000                              | 2,700   | 8.3  |
| 300,000                                   | 62,700                                  | 61,000                              | 1,700   | 2.7  |
| 400,000                                   | 94,500                                  | 93,000                              | 1,500   | 1.6  |
| 500,000                                   | 126,500                                 | 125,000                             | 1,500   | 1.2  |
| 600,000                                   | 159,700                                 | 160,000                             | (300)   | (.2)   |
| 1,000,000                                 | 303,500                                 | 305,000                             | (1,500)   | (.5)   |
| 10,000,000                                | 6,042,500                               | 6,067,500                           | (24,900)  | (.4)   |







APPENDIX DI. Flat 14% AET

- A. Taxable Estate of 500,000  
Appreciation of 250,000

AET of 14% x 250,000 = 35,000  
AET = 14% of appreciation

- B. Taxable Estate of 5,000,000  
Appreciation of 2,500,000

AET of 14% x 2,500,000 = 350,000  
AET = 14% of appreciation

II. AET of 25% after basis step-up for estate tax attributable to appreciation

- A. Taxable Estate of 500,000  
Appreciation of 250,000

Estate tax = 145,700  
Estate tax attributable to appreciation = 72,850  
New basis = 250,000 + 72,850 = 322,850  
Appreciation subject to AET = 500,000 - 322,850 = 177,150  
AET = 25% x 177,150 = 44,287.50  
AET = 17.7% of appreciation

- B. Taxation Estate of 5,000,000  
Appreciation of 2,500,000

Estate tax - 2,468,200  
Estate tax attributable to appreciation = 1,234,100  
New basis = 2,500,000 + 1,234,100 = 3,734,100  
Appreciation subject to AET = 5,000,000 - 3,734,100 = 1,265,900  
AET = 25% x 1,265,900 = 316,475  
AET = 12.7% of appreciation

III. Summary

|                  | <u>Flat 14% AET</u>       | <u>25% AET after<br/>Step-up for estate tax</u> |
|------------------|---------------------------|---|
| 500,000 estate   | AET = 14% of appreciation | AET = 17.7% of appreciation                     |
| 5,000,000 estate | AET = 14% of appreciation | AET = 12.7% of appreciation                     |



Statement as Panelist at Estate and Gift Tax Hearings,  
Committee on Ways and Means  
Congress of the United States

-  
Carl S. Shoup  
-

March 23, 1976  
-

1. Constructive Realization of Capital Gains and Losses  
at Death and Upon Transfer by Gift

An accrued capital gain should be construed as realized, for income tax, when the property is transferred either by a lifetime gift or at death ("constructive realization").

Likewise, an accrued capital loss should be deemed realized upon these occasions.

These provisions would increase the equity of the individual income tax, without impairing that of the estate and gift taxes, and would reduce existing distortions in the capital market. They should be accompanied by a more liberal treatment of capital losses.

An accrued capital gain could no longer escape income tax forever, as is now possible through transfer of an appreciated property at death. Such property now obtains a new, high, basis equal to its value at time of death. Consequently, none of the gain that has accrued during the life of the decedent will ever be subject to income tax.

Such gain is of course included in the total amount subject to the estate tax, but so also are savings bank deposits, for instance, that have been built up out of taxed wages, salaries, interest and dividends. Although the estate tax treats both kinds of capital alike, the income tax favors the kind of capital that takes the form of an accrued gain -- not to mention the lower tax rate granted to taxable capital gains.

Tax equity would be further increased by allowing a capital loss that had accrued to be taken into account to reduce income tax. At present, an accrued capital loss on property passed at death simply vanishes, for income tax purposes,



and can never be used. Meanwhile, those individuals who have realized their capital losses before death have been able to reduce their income taxes, in one year or another, at least to the limited extent allowed by present law.

By analogy with the gains case, decedents with depreciated property do pay less estate tax than if the property had not depreciated, but so too do those who have sold such property before death and thus have realized the loss.

From these facts it can be seen that the present income tax law exerts pressure on prospective decedents to sell securities, land, and other property that has already fallen greatly in price, and to hold those properties that have already risen greatly in price. Such pressures tends to force down the market price of property that has already fallen, and to push up still further the prices of appreciated properties. There are enough non-tax distortions in the securities and real estate markets already, with their wide and often irrational swings, without adding a further distortion that increases the momentum of a downward or upward price movement.

As to lifetime gifts, the unfairness and distortions are almost as bad. The possibility of taxing the gain does not vanish completely, since the donor's basis must be used by the donee if he sells at a gain. But the donee may later pass the property at death, instead, thus wiping out the gain, for income tax, or he may give it to a second donee, thus further postponing the tax on the gain.

For capital losses, a large part of the loss may easily become unavailable, even upon realization. This occurs when the property falls in value before the donor transfers it, and falls still further while in the hands of the donee. In that event the donee can take as a capital loss only the decline in value that has occurred while he was holding the property. The loss in value before then is never usable for income tax.

The remarks up to this point about capital losses would be even more significant if such losses were given treatment more nearly equivalent to that accorded capital gains. The existing income tax law is unfair on this score, since it limits the deduction of a net capital loss in any one year, against ordinary income, to a mere \$1,000. This is a ridiculously small allowance. It seems to imply that those who incur capital losses are not so badly off after all -- they must have gains, sooner or later, against which they offset the losses, then or in a carry-over year. But we all know that this is not the universal experience, perhaps not even a common pattern, at least not within the narrow range of \$1,000. To be sure, the net capital loss deduction against ordinary income should not be



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unlimited in amount, since the taxpayer does have an advantage in possessing the option whether to realize or not at any given time, and since capital gains are taxed so lightly. But, at the least, the limit on the capital loss deduction should be materially expanded.

An objection often made to constructive realization of gain at death is that property may have to be sold to raise the money to pay income tax. But this same objection is not offered as a reason for repealing the estate tax. Yet the two taxes are really on the same footing. It is a matter of the prospective decedent having been put on notice, and, with due foresight, arranging his affairs accordingly, just as a real estate taxpayer must do every year, whether the property is a farm, a small commercial business property, or or other non-liquid parcel of property.

What this objection does validly say is that the transition to the new system should not be too abrupt, and that for some time, at least, a certain extension of the period for payment of the income tax should be granted, subject to ordinary safeguards for the revenue.

The income tax paid on the capital gain would of course be deducted from the estate before applying the estate tax rates. For example, let the decedent's estate reach into the 77 per cent bracket, and let a capital gain of \$20,000 be taxed at 25 per cent (in fact, the rate would probably be higher). The income tax is then \$5,000. The estate tax is less than it would otherwise be, by 77 per cent of \$5,000, or \$3,850. The net increase in the two taxes taken together is \$5,000 minus \$3,850, or \$1,150, which is only 5.75 per cent of the constructive gain.

It may be asked at this point whether the saving to be achieved by holding on to an appreciated asset rather than selling it shortly before death is enough to induce such holding, and to create the distortions in the capital market described above. The answer is still yes, for two reasons. First, the saving is a substantially larger percentage of after-tax income, which is what the taxpayer is looking at. Secondly, the holder of the appreciated asset, not knowing when he will die, will tend not to take much account of the interaction of the two taxes (income tax and estate tax), and will regard the income tax to be paid if he does sell the asset as something to be compared with what he thinks of as a zero tax on the gain if he holds it until death; he forgets about the future estate tax.

Most estates, of course, do not reach the 77 per cent bracket. A taxable estate of, say, \$1,100,000 is in the 39 per cent bracket. If a 25 per cent income tax were levied on a \$20,000 capital gain in this estate, the estate tax would be only



\$1,950 lower than otherwise (instead of \$3,850 lower, as above). The two taxes combined would rise by a net amount of \$3,050 (instead of by only \$1,150) -- \$5,000 income tax, less \$1,950 decrease in estate tax --, which is 15.25 per cent of the capital gain (instead of 5.75 per cent).

## 2. Exemptions

The \$60,000 estate tax exemption has remained unchanged since 1942; so too has the lifetime exemption of \$30,000 under the gift tax and the annual exclusion of \$3,000 per donee. Allowing for inflation, these are worth appreciably less than half of what they were 34 years ago.

On the other hand, the marital deduction was introduced in 1948, allowing deduction of half of the gross estate less claims and expenses, that is, half the adjusted gross estate, and of half of any gift to a spouse.

Taking this marital deduction into account, we see that the average estate passed per spouse under the estate tax can be as high as \$90,000, without any estate tax being due. This occurs when the spouse first to die bequeaths \$120,000, of which \$60,000 is non-taxable under the marital deduction, and the second spouse bequeaths \$60,000 -- a total of \$180,000, or an average of \$90,000. Thus a family block of wealth of \$120,000 can, under certain circumstances, pass through generations without attracting estate tax. The first spouse leaves \$60,000 to the other, and \$60,000 to the children, and the second spouse passes the \$60,000 on to the children, and this pattern is repeated.

Moreover, the existence of the marital deduction, stated as a percentage of the adjusted gross estate (not as a fixed sum), makes every dollar of increase in the exemption worth two dollars in tax-free estate. An exemption of \$60,001 would permit tax-free passage, not of \$120,001, but of \$120,002 by the first spouse in the example above, and of course of \$60,001 by the second spouse. The marital deduction contributes "leverage" to the exemption.

Under an exemption of \$150,000, as proposed March 5, 1976 by the President, each older generation could bequeath to the younger a total of \$300,000 without having to pay any estate tax (the spouse first to die would leave \$150,000 to the other spouse, and \$150,000 to the children; the second spouse, \$150,000 to the children).

The examples for these specified amounts are extreme in that they imply foreknowledge of which spouse is to die first. But if both spouses have property of at least \$120,000, the sequence of \$120,000 non-taxable and \$60,000 non-taxable is available, whatever the order of deaths.



Significance of the Beginning Bracket Rates  
in Deciding on Size of Exemption

If the estate tax rate schedule starts at a very low level of rate, and if the rate rises very slowly, the exemption can be small without causing hardship. The hardship depends on the average rate of the tax relative to the adjusted gross estate, not on the marginal rate into which the tax reaches.

The existing bracket rate schedule starts at 3 per cent on the first \$5,000, rises only to 7 per cent on the next \$5,000, and is 11 per cent on the next \$10,000.

The total tax on a taxable estate of \$20,000 is thus \$1,600. With the exemption at \$60,000, an estate of \$80,000 pays a maximum tax, that is, when none of it goes to a surviving spouse, of \$1,600, or 2 per cent of the estate. (If all of the \$80,000 is concentrated in the hands of the spouse first to die, no estate tax at all is payable.)

The same 2 per cent average rate is found for a family with \$160,000, if all of it is concentrated in the hands of the spouse first to die, who passes half of it to the other spouse and half to the children: each spouse's estate pays \$1,600 tax, a total of \$3,200. If, at the other extreme, the \$160,000 is concentrated in the hands of the spouse to die last, the estate tax is \$20,700, or 12.9 per cent. -- but all of this tax is payable at the later date.

Accordingly, although the \$60,000 exemption may from a historical viewpoint appear low, in view of inflation of prices, the net result of this exemption, the low starting bracket rates and the marital deduction is evidently not one of hardship for estates in, say, the range up to \$200,000, or what might be thought of in some sense as small estates.

Gift Tax Exemption

As with the estate tax exemption, any increase in the lifetime gift tax exemption of \$30,000, or any increase in the annual per donee exclusion of \$3,000 would be "leveraged" for a gift to a spouse, by the marital deduction of 50 per cent. Taking just one year, we see that one spouse can give another \$66,000 free of gift tax. If the exemption were raised by \$10,000, to \$40,000, the tax-free interspousal transfer, maximum for one year, would rise by \$20,000 (not by \$10,000), to \$86,000.

Abstracting for a moment from the \$30,000 exemption, a spouse can transfer \$6,000 to the other, gift-tax-free, each year.



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In general, there seems to be no need for increasing the \$30,000 lifetime exemption. The \$3,000 exclusion per donee per year is much too large to be justified as a "small gifts" exclusion to avoid administrative trouble or compliance inconvenience; it should be reduced.

#### Credit Against Tax versus Exemption

If the \$60,000 estate exemption is deemed inadequate (not the opinion expressed here), it could be supplemented by a credit against tax, the same for every taxpayer, in place of increasing that exemption.

For an equivalent revenue loss, the fixed credit would give more relief to the smaller now-taxable estates and less to the large, than would an increase in the exemption.

Ultimately, consideration should be given to replacing the \$60,000 exemption by a credit against tax. The credit method, in effect, takes an exemption out of the bottom brackets, while the existing method takes it out of the top brackets.

Such a shift from exemption to credit could achieve either of two goals, or, to some degree, each: (1) make the estate tax more progressive (reducing the tax on the smaller estates, increasing it on the larger), (2) allow lower marginal (bracket) rates for the present degree of progressivity. It is the marginal rate that creates disincentives to save, to work, and so on.

As to the gift tax, I have elsewhere in these Hearings submitted a statement supporting an integrated gift-estate tax, and describing in some detail the recently enacted United Kingdom tax of this type, termed "capital transfer tax." In the course of integrating the two taxes, a single credit against tax could be built into the new structure, in place of an exemption.

#### Rates

If the exemption is raised, and perhaps even if it is not, the starting rate could be made higher than 3 per cent; and with a higher exemption, even the 7 per cent and perhaps the 11 per cent rate would be unduly low. The top rate of 77 per cent should not be raised, in view of the pressures at the margin for tax avoidance<sup>or</sup> evasion; it might even be lowered somewhat (the United Kingdom's new tax has a top rate of 75 per cent -- but the top income tax rates are much higher than in the United States, even including the highest state tax, and the Labor Government is proposing an annual net wealth tax).



If the gift tax remains unintegrated with the estate tax, the rates of the gift tax should be raised appreciably; there is little to support the existing difference, especially since the gift tax is only on gift net of tax.

#### Liquidity Problems

Whether serious problems of liquidity now exist under the estate and gift tax is a question of fact, one with which I am not familiar, but it is worth recalling that liquidity considerations with other taxes, notably the real estate tax, have not given rise to wide application of long-delay techniques for payment. Given sufficient notice, taxpayers can usually adjust without undue hardship. The provisions already granted for postponement of payment of estate tax seem on their face to be more than adequate for all but perhaps a few instances.

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STATEMENT OF MICHAEL J. GRAETZ,  
PROFESSOR OF LAW, UNIVERSITY OF VIRGINIA  
BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS  
ON THE SUBJECT OF ESTATE AND GIFT TAX REVISION  
March 23, 1976

Mr. Chairman and Members of the Committee:

I greatly appreciate your invitation to appear before you today to discuss possible revision of the tax laws with respect to estate and gift tax rates and exemptions, liquidity and appreciation at death.

Rates and Exemptions

In all candor, Mr. Chairman, I am baffled and discouraged by the changes the Congress seems likely to make with respect to the estate tax exemption. Proposals to increase the estate tax exemption from its present level of \$60,000 to \$150,000 or even \$200,000 have developed a political momentum which seems to promise enactment. Such a change is unjustified and would be manifestly unfair to the American people.

How can you justify tax relief designed for the wealthiest 10 percent of the population?

How can you justify a 20 percent reduction in the estate tax base when the projected deficit is nearly \$50 billion?

How can you justify reducing taxes on inherited wealth by more than \$1 billion when you are contemplating a \$5 billion increase in payroll taxes on wages?

I cannot understand how you can be persuaded of the need for estate tax relief by the arguments you have heard. The burden of the estate tax is simply not that great. In fiscal year 1974,



the estate and gift taxes are estimated to produce less than \$6 billion of total federal government revenues of \$351 billion, less than two percent of the total -- an amount roughly equivalent to the revenues produced by the cigarette tax. More than ninety percent of all persons who die in the United States this year will owe no estate tax.

In 1972, the nearly 78 million Americans who filed income tax returns, had an average income of \$9600 and paid income tax at an average rate of 12.5 percent. In that same year, 175,000 estate tax returns were filed for decedents with an average net worth of more than \$193,000; their average estate tax rate was 12.2 percent. Many claimants for income tax relief (or payroll tax relief) have more appealing cases -- in both economic and equity terms -- than the beneficiaries of decedents subject to the estate tax.

Despite its low revenue yield and the low average rate of tax the estate tax has been an important contributor to progressivity in our tax system. In 1972, for individuals filing individual income tax returns, the average ratio of tax to adjusted gross income was 12.2 percent. The total tax paid where the average tax was 12.5 percent or more was \$58 billion. If these tax payers had paid at the average 12.2 percent rate, their tax would have been \$41.3 billion. Thus, the total revenue raised through individual income taxes in excess of the average rate was \$16.7 billion. By comparison, the fiscal year 1972 estate and gift tax collections from upper income decedents were \$5.4 billion. Thus, the estate and gift taxes contributed nearly one-third as much to the progressivity of our tax structure as



did the individual income tax.\* - The estate tax makes this significant contribution to progressivity because -- even with the current \$60,000 exemption -- it is a tax on the wealthiest decedents.\*\* And I should add that the estate tax -- with its current exemption and rate structure -- imposes a lesser tax on inheritances than would be collected if bequests were taxed as income under the income tax.

Over 100 years ago, the estate tax was praised as a "large source of revenue" that could "be most conveniently collected."\*\*\* Estate tax revenues should be increased, not reduced. Today, by lowering the estate tax exemption, modernizing the rate schedule and eliminating methods of tax avoidance to collect more estate tax revenue, Congress could narrow the deficit, finance domestic programs or reduce personal income taxes.

It is often said that opponents of tax increases hide behind selected widows. This is especially true with respect to estate taxes since it is not necessary to search for the widows. Those who oppose increased estate taxes will relate to the Congress the plight of the young widow with four minor children to put through college. They will rightfully point out that \$200,000 at 8 percent

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\*This analysis does not include the effects of the corporate income tax, excise taxes or employment taxes which raise difficult questions of shifting, but it is not expected that their inclusion would affect the conclusion that the estate and gift taxes contribute a significant amount of progressivity in our tax system.

\*\*Estimates of personal wealth in the United States indicated in 1969 that only 5.4 percent of the population had a net worth in excess of \$60,000, the current estate tax exemption. Only 1.7 percent of the population had net worth in excess of \$150,000 -- the President's proposed exemption.

\*\*\*32 Cong. Globe App. 232 (1862).



earns only \$16,000 a year, and that this sum will hardly buy beef at today's prices, much less a college education. But it would be foolish to structure the basic estate tax exemption and rates to provide for this widow when her problems can be dealt with directly, by increasing the marital deduction and by providing a special dependency deduction for minor children. (The 1968 Treasury studies included an "orphans exclusion" which would exempt any transfer to an orphan child of the decedent under age 21, to the extent of \$3000 times the number of years remaining until the child reaches twenty-one. A similar allowance could be provided for all minor children.) Differences in family circumstances are taken into account under our income tax system by the personal exemptions. There is no reason that such differences should not be taken into account under the estate tax.

In the majority of cases, there will be no minor children to support. In 1972, over 62 percent of the assets included in the estates of decedents subject to the estate tax were held by persons aged 70 or over at the time of death. Census data indicates that it is likely that less than 3 percent of these individuals were survived by children age 18 or under. The children of these decedents are far more likely to be aged 30 or 40 with significant income of their own. By dealing with the problems of the surviving spouse and minor children directly, through the marital deduction and special dependency deductions, rather than through the general rate structure and exemption level, additional revenue can be raised from those most able to pay and relief will be granted where it is most needed.

Objections are often raised to proposals to increase estate taxes on the grounds that the estate tax is a tax on savings and



our tax system is already biased against savings. If the Committee is concerned that savings are taxed too heavily in our total tax system because of personal and corporate income taxes and property taxes as well as estate tax, a reduction in the impact on savings by reducing lifetime income or property taxes seems to me a wiser course than reduced estate taxes.

Estate taxes seem less likely to impinge upon individual incentives to earn and invest than do lifetime income or property taxes. If estate taxes are viewed as imposing a burden on the beneficiaries, they seem very unlikely to reduce incentives of the beneficiaries; on the contrary, heavier taxes might inspire the beneficiaries to work harder or save more to compensate for the tax. Since bequests (and gifts) are free of income tax to the recipient, heavier transfer taxes seem appropriate.

#### The Estate Tax Problems of Farms and Family Businesses --

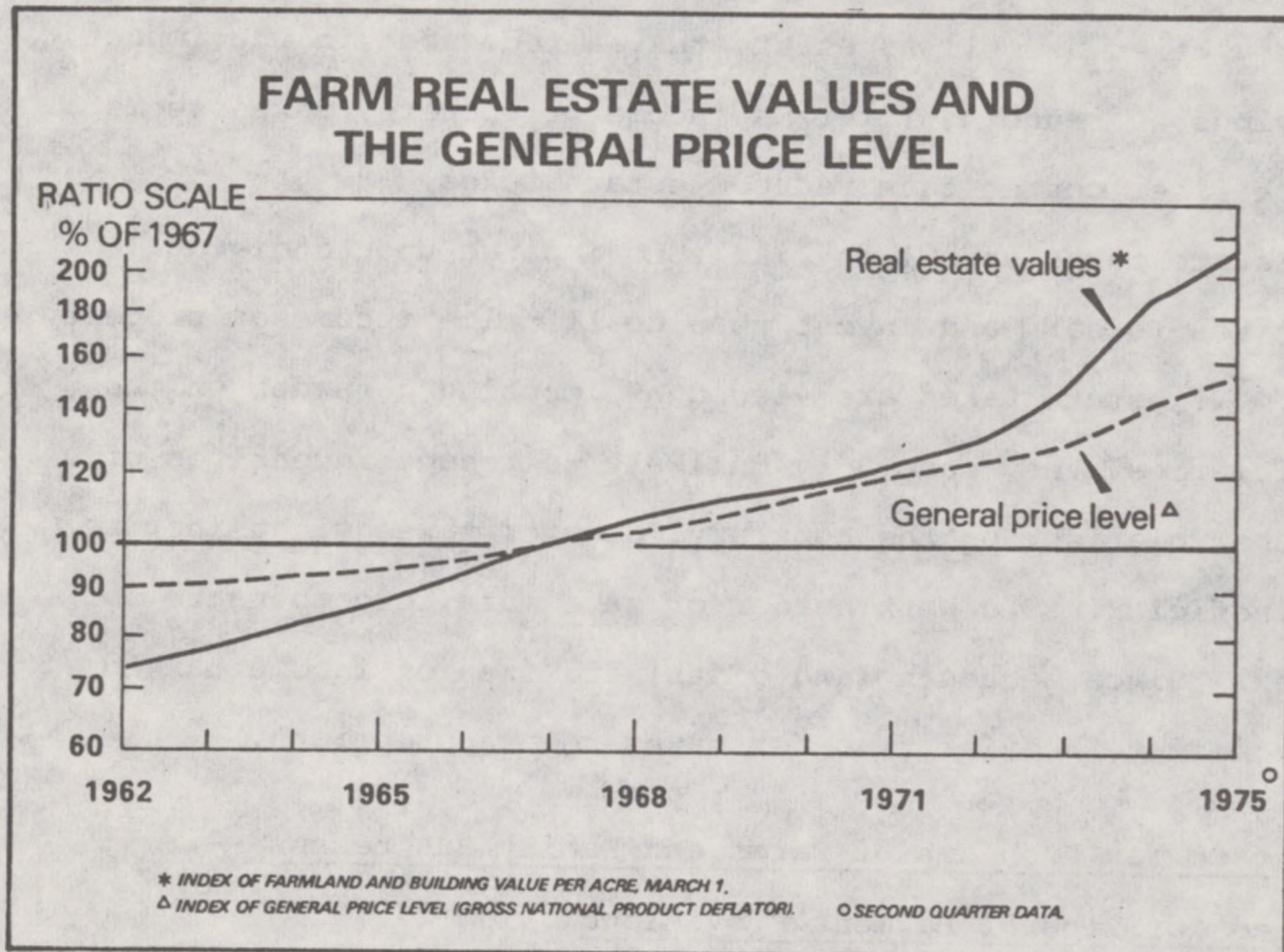
##### The Need for Liberal Payment Provisions

The arguments for estate tax relief have been most actively advanced by farmers complaining about the effects of inflation. They seem to have convinced many in Congress and the Administration that their claim for relief is just. Even Secretary Simon has testified that "inflation has had a particularly serious impact upon the family farm."

But this is simply not the case. In recent years, the value of farmland has risen at a rate faster than the rate of increase of prices generally. While the wealth of large segments of the American people has been eroded by inflation, the wealth of farmers generally -- in constant dollars -- has increased. The



following Table compares the rise in farm real estate values with the rise in the general price level.\*



It is a fact that the increase in farm real estate values has resulted in more farmers being subject to estate tax. And in many cases this produces genuine hardship. Funds are often simply not available to pay estate taxes. But this "liquidity" problem does not justify general estate tax relief. And one should be careful to distinguish a genuine liquidity problem from an heir's desire to continue to speculate on further price increases of land rather than selling at the current market value.

It is useful to put the liquidity problem in context. For

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\*Source: United States Department of Agriculture, Agricultural Finance Outlook, Nov. 1975 at 7.



all taxable estates in 1972, the primary liquid assets were 4.5 times the amount of tax. Liquid assets are higher in relation to tax for small estates than for large estates, but even for estates over \$10,000,000 the liquid assets were twice the tax. Fifty-five percent of total assets could readily be converted to cash and this does not include any real estate or notes and mortgages much of which would be converted to cash without too much difficulty.

These data are not intended to suggest that the "liquidity" problem is not serious for certain estates, merely to indicate that this is not a general problem. Relief should be limited to those estates where illiquid assets constitute a substantial percentage of the estate. And relief should not be so substantial to cause persons to concentrate investments in illiquid assets. In many instances careful business and estate planning can help to eliminate any liquidity problem; the estate tax subsidy to illiquidity should not render such planning uneconomical.

Generous extended payment rules can be provided. If a market-rate of interest is charged, the period for payment can be greatly extended. The Federal Land Bank will lend money to farmers to pay estate taxes for as much as a 40-year period. I see no objection to a similar deferral provided by the tax Code. But it is essential to require a market rate of interest. Reduction of the rate from 7 percent to 4 percent is not warranted. Why should the wealthiest 10 percent of the people receive a lower rate of interest on estate tax than that generally available for other deferred tax payments? The zero rate of interest proposed by the Treasury for a five year period is the equivalent



of a 28 percent reduction in estate tax, assuming a 7 percent discount rate.

If you are concerned with the potential decline in value of farm or business assets (or an unrealistic estate tax valuation), then it would seem reasonable for the government to share the risk. No personal liability of the heirs or the executor need be required; the farm or business assets alone could secure the payment of tax. If the business is sold for less than its estate tax value, a proportionate reduction in tax might be provided.

Many have suggested that farms be valued at less than the market value for estate tax purposes, that the estate tax value should be its value as a farm based on a capitalization of earnings. The sole justification for such a valuation is that the higher estate tax value -- the subdivision value -- forces sale of the land for its highest valued use. If the Committee wishes to enable heirs to select the time to sell the family farm, it could provide that the estate tax attributable to the difference in values could be postponed, with normal interest, so long as the heirs continued to use the land for farming. When the farm is sold at the higher value, deferred estate tax and interest would be due.

#### Unrealized Appreciation at Death

Many have described the present treatment of unrealized appreciation at death, under which the beneficiary of property receives a stepped-up basis equal to the fair market value of the property as of the date of the decedent's death, as the major shortcoming of the existing income tax laws.



Proponents of change have suggested two general plans to eliminate the present failure to tax the appreciation of assets transferred at death: (1) a tax on the appreciation accrued up until the time of death, even though it remains unrealized, or (2) a requirement that the decedent's basis be carried over, so that the total appreciation is taxed when the asset is eventually sold.

There are two proposals for taxing unrealized gains at death. First, a capital gains tax on unrealized appreciation may be imposed whenever property is transferred at death. The leading deathtime capital gains tax proposal was detailed in the Treasury Tax Reform Studies published in February, 1969. Second, an "additional estate tax" (AET) may be levied on the unrealized appreciation passing with the estate. The AET scheme, proposed by the American Bankers Association (ABA), would levy a tax at a flat rate above and beyond the existing estate tax and would apply to the net appreciation of a decedent's assets transferred at death or within two years prior to death.

A tax on unrealized appreciation accruing during the decedent's lifetime would produce three benefits: greater equity, reduction of the "lock-in" effect, and additional revenue.

The equity consideration is generally described in terms of the greater tax on estates built up on the one hand out of earnings, interest, dividends, or realized gains which have been fully taxed during the decedent's lifetime compared to the tax on estates, on the other hand, in which unrealized appreciation is substituted for current income. Such unrealized gains are income, and while it may not be administratively feasible or



reasonable to tax such gains as they accrue but remain unrealized, it is appropriate to tax them at death.

A second argument made for changing the capital gains tax is based on the contention that owners of appreciated property, aware of the stepped-up basis to be given to the beneficiaries of their estate, commonly refuse to sell such property prior to death and thereby "lock-in" assets that would otherwise be traded in the marketplace. This "lock-in" effect is thought undesirable as it reflects an artificially induced decision not to trade, and is therefore a distortion of a normal capital flow. Clearly the current system does influence certain taxpayers to hold until death greatly appreciated assets which they might otherwise sell during life. However, none of the outstanding proposals will eliminate this "lock-in" effect. Moreover, because the deleterious economic effects of "lock-in" are unclear, it is questionable whether an effort to avoid this problem is worth the increased complexity it would entail.

This is particularly true since any provisions designed to mitigate the effect of a deathtime tax will reinforce "lock-in." For example, the Treasury proposal will perpetuate some "lock-in" effect since it contains provisions exempting from deathtime capital gains tax small estates (under \$60,000) which are not subject to the estate tax, and transfers of appreciated property to the surviving spouse. Further, it is generally conceded that the proposal will not apply the minimum tax on tax preferences to deathtime gains. Those aspects of the Treasury proposal would undoubtedly induce the same persons who hold assets until death under present law in order to take advantage of the stepped-up basis to continue to do so.



Although the ABA proposal, like the Treasury proposal will not solve the "lock-in" problem, either plan will reduce the tax benefits of holding assets until death. The carryover basis plans, on the other hand, may actually amplify the "lock-in" effect. Once an untaxed asset passes to the beneficiary he will be particularly reluctant to sell since he would have to pay tax on the gain that accrued during the decedent's lifetime.

Increasing the federal fisc is a third reason for reform. Taxing unrealized gains at death could produce an estimated \$1.5 to \$4 billion in additional revenue annually, depending on the rate of tax and the exemptions. The ABA and Treasury proposals would use this revenue to reduce estate and gift taxes. For the reasons stated earlier, I would prefer to see income taxes reduced. The revenue gain from implementing a carryover basis law is difficult to predict since such revenue will be realized only when assets are sold by beneficiaries or by the decedent's estate. The carryover basis alternative is generally considered less severe because there is less of an immediate impact at the time of death.

The principal disadvantage of change is that the new law is likely to be considerably more complex than present law. Although the existing law which provides a step-up of basis without tax on unrealized gains is inequitable, it is quite simple. In contrast, the Treasury proposal, which attempts to achieve rather precise equity, is unduly complex. In evaluating and choosing among the different proposals for change, Congress must inevitably strike a balance between such potential complexity and the anticipated improvement in tax equity. The choice



between equity and simplicity is like the economist's classic choice between guns and butter; to get more of one, it is necessary to sacrifice some of the other. At one end of the sliding scale, we can achieve almost total equity by completely sacrificing simplicity. It is only when the tax laws become somewhat less equitable that complexity reaches manageable proportions.

Replacing the stepped-up basis treatment of capital assets will increase complexity in two ways. First, each of the reform proposals would require a determination of the basis of a capital asset either in the decedent's hands or as of a new valuation date. Either determination will prolong the time necessary to resolve the tax liabilities of an estate. This will of course increase the costs of administering estates. Second, the proposals will involve the completion of additional forms, compilation of records concerning the decedent's basis and date of acquisition, the need to correspond with beneficiaries, and the contestation of additional issues, all of which will add substantially to the time and cost of administering estates.

The carryover basis proposals seem to involve more inherent complexity than proposals for a tax on appreciation at death. This is true because the carryover proposals require not only determination of the basis of transferred assets but also maintenance of records of basis over several generations. Moreover, with a carryover basis, it would no longer be possible to divide assets by simple fractions or percentages. Each asset would carry with it a potential tax liability which would affect its real value. Proponents also call for a complex reallocation



of basis at death to prevent marshalling of assets to give low basis assets to untaxed charities and lower bracket beneficiaries.

On balance, I would opt for taxing gains at death along the lines of the 1968 Treasury proposal, but with substantial modifications to reduce the proposal's complexity. In addition, to maintain the conceptual integrity of the tax, it seems necessary to tax the interest element of life insurance proceeds.

If the AET approach is taken and the estate tax computed prior to the tax on appreciation, the basis of assets should be adjusted upward to reflect the estate tax paid and avoid the problem of double-taxation. I would also apply graduated rates, rather than a flat rate and exempt appreciation on assets bequeathed to public charities.

Because of the importance of this subject, I am submitting with this statement a law review article published in 1973 which contains my specific recommendations.

#### Conclusion

In conclusion, Mr. Chairman, I would like to again urge that this Committee refrain from reporting a bill which reduces the overall level of estate and gift taxes. Higher estate taxes are to be preferred over higher income taxes. Estate tax revenues should be increased and not reduced.

If the Committee should determine not to raise additional revenue from estate and gift taxes, there is still need for revision. The application of these taxes to equal estates varies tremendously depending upon the manner in which the fortune is transferred. Avoidance of tax by carefully structured transfers



should not be tolerated even if one views the estate tax -- much as the minimum tax -- primarily as a backup to the income tax, so that accumulations from tax-exempt interest and other sources of tax preference income will be taxed at death.

As I have indicated, you should adopt a tax on appreciation at death and provide new extended payment provisions for estate taxes on farms and closely-held businesses. Although these are not matters covered by this panel, I would also urge that you adopt a unified transfer tax system which would subject all lifetime and deathtime transfers to a single rate structure on a cumulative basis, in the way the gift tax works today, with the transfer at death being the final transfer taxed at the brackets determined by adding it to lifetime transfers; that you impose an additional tax on generation-skipping trusts; and that you increase the marital deduction for estates of moderate size.

Finally, I would like to say a word about a practical pitfall in any attempt to revise the estate and gift tax laws. Each of the issues of estate and gift tax reform is highly complex and extremely controversial. One of my fears is that there may be so many compromises when Congress does consider these matters that the opportunity to simplify and to achieve greater equity may be lost and that any revised system of transfer taxes may be no more equitable or logical and no less complex than the one which now exists. Moreover, the present law is generally understood and a new body of law may raise questions that affect substantial numbers of taxpayers and which require many years for the courts and the Treasury to resolve. I would



urge the Committee to determine at the outset its goals with regard to estate and gift tax reform, to maintain an overview of the changes to be made and to guard against undue complexity and illogical compromises.



STATEMENT OF DONALD MC DONALD  
Montgomery, McCracken, Walker & Rhoads  
Philadelphia, Pennsylvania  
before  
THE COMMITTEE ON WAYS AND MEANS  
UNITED STATES HOUSE OF REPRESENTATIVES  
on the subject of  
FEDERAL ESTATE AND GIFT TAXES  
March 23, 1976

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SUMMARY

Exemptions and Rates

The exemptions from estate or gift tax should be increased to reflect the reduced actual purchasing power of the dollar since they were last set.

The initial rates on taxable estates and gifts should progress more gradually in the lower brackets. Much of the present unwarranted progression would be eliminated by an increase in the exemptions.

Nonliquid Estates

To speed up settlement of estates the statutory period for assessment of estate tax should be reduced from three years to one year.

The practice of granting extensions in hardship cases should be liberalized.

In closely held corporations the income tax law should be amended to (1) permit, without penalty, pre-death accumulations of corporate earnings to fund corporate buy-out agreements, and (2) extend the period for Section 303 redemptions from the present approximately four years to any additional period for which the payment of estate tax may be deferred.



Section 6166 should be modified to extend the installment payment privilege to the estate tax attributable to any nonliquid asset (rather than solely an interest in a closely held business).

Security arrangements, such as mortgages and escrow agreements, rather than bonds, should be encouraged as a precondition to granting an extension of time to pay estate tax, or discharging an executor or other fiduciary from personal liability, particularly when time for payment of estate tax has been granted.

The interest rate on deferred payments of estate tax should be reduced.

#### Unrealized Appreciation at Time of Death

No additional income tax or additional estate tax should be imposed to increase the "cost of dying".

No carryover basis, periodically considered by this Committee ever since 1919, should be enacted.

Since inflation has contributed substantially to "gain" under present income tax concepts, if death or gift is to be treated as an income taxable event, the income tax law should be amended to eliminate "illusory" income by improving cost or basis to reflect changes in the consumer price index since the date of acquisition.

If gain is to be recognized at death or gift it should be broadly applied under income tax rules and not keyed to the estate or gift tax exemption; similarly it should apply regardless of the destination of the property, whether to the widow, the children, or a charity. Exemptions, if any, should depend on the nature of the property, for example residences, or personal effects.



Mr. Chairman, Members of the Committee:

It is an honor to appear before you today to discuss certain aspects of proposed changes in our estate and gift taxes. It is a particular pleasure to join this distinguished panel. I approach the subject with the outlook of a lawyer who for thirty years has spent his professional time in the tax law representing clients most of whom had average estates.

Exemptions and Rates Under the Estate and Gift Taxes

The present \$60,000 exemption was set in 1942. At that time unskilled wages were 35 to 40 cents an hour. A \$10,000 life insurance policy provided about four times the average family income for a year. Tuition at a top college or law school was \$400. The consumer price index in 1967 terms would have been 48.8%. In January of this year it stood at 166.7%. In large part as a result of this inflation and not as a result in increase in underlying wealth, ten times as many decedents are now required to file estate tax returns as were required in 1942. I would therefore submit for your serious consideration in line with bills introduced by many of your colleagues, by distinguished Senators, and proposals by the Administration, that the exemption from estate taxes and gift taxes be increased to reflect the change in the consumer price index. This would mean an increase in the exemption to approximately \$200,000. This change would also have the advantage of eliminating the requirement for the filing of estate tax returns by 79% of those who were required to file estate tax returns in 1973.

Although the present estate tax rate begins at 3% on the first taxable \$5,000, it increases to 30% at \$100,000 and to 77% of taxable transfers above \$10,000,000. The American Law Institute felt that the



progression in estates below \$250,000 was excessively rapid. I join in this feeling. There is a considerable difference between the rate of tax on annual income, either from property or from work, and a rate of tax which is acceptable when it is levied upon the underlying property which produces that income. Many people are willing to pay a 25 or 30% income tax if they have reached those brackets. They would balk considerably at paying a 25 or 30% tax on their wealth at its fair market value each year. A 30% real estate tax would be unthinkable. The estate tax is, in effect, a capital levy upon the wealth of this country in the hands of individuals. Since, in effect, an exemption from estate tax is a rate bracket of zero, if the estate tax exemption is increased to \$200,000 much of the rapid progression in the lower brackets presently in existence would be eliminated.

#### The Treatment of Nonliquid Estates

In many estates even of moderate size the present estate tax rates already present a difficult problem in finding the cash needed to pay the state taxes, the Federal taxes, the funeral expenses, and the administration expenses. If any additional taxes were imposed at the time of death this "liquidity" problem, even now in need of liberalization, becomes even more severe.

The present Internal Revenue Code contains provisions intended to permit an extension of the time for payment of estate tax in the case of undue "hardship", Section 6161, or a "closely held business", Section 6166. Experience has shown that little use of these installment payment privileges is presently being made, partly because certain other provisions of the Internal Revenue Code create barriers to the use of these privileges. Under existing Section 6165 District



Directors may require as a precondition to the granting of an extension of time to pay taxes, that the taxpayer furnish a bond for up to double the amount with respect to which an extension is granted. Administrative practice under Section 6165 varies widely and the procedure may be expensive to taxpayers.

Consideration should be given to changes in the present rules: (1) to make it easier for estates to qualify for installment payment of death taxes where they own unmarketable properties or face hardship in raising cash; (2) to discharge an executor or other fiduciary from personal liability for taxes on nonliquid assets when the time for payment of those taxes has been extended, provided that the executor or fiduciary pays those taxes on properties in his possession or control which are not subject to the extension, and furnishes a security interest in lieu of bond in the nonliquid assets in his possession or control for payment of the taxes on such properties; (3) to permit pre-death accumulations of earnings in a corporation for the purpose of making redemptions from deceased stockholders; and (4) to extend the period within which such redemption can be made at capital gain rates to include any period for which extension is available for payment of estate taxes.

#### Section 6161

Section 6161 of the Code presently provides that an extension of time for payment of estate tax may be granted at the discretion of the District Director upon a showing that timely payment of the tax would result in undue hardship to the estate. The regulations under Section 6161 define undue hardship only in terms of the salability of property. Thus the regulations provide that a "sale of property



at a price equal to its current fair market value, where a market exists, is not ordinarily considered as resulting in an undue hardship. However, a sale of property at a sacrifice price, or on a severely depressed market would constitute an undue hardship."

The definition of undue hardship as contained in the regulations seems unduly restricted. For example, it is not clear under the regulations whether undue hardship exists in a case where the average estate tax is 50% of the gross estate and the gross estate is composed of 50% liquid assets and 50% non-liquid, non-income producing assets. Similarly, the regulations do not cover the situation where the liquid assets are not in the hands of the executor as, for example, in the case of jointly held property, gifts in contemplation of death, life insurance passing to named beneficiaries or a specific bequest to a charity. Finally, assets which take the form of payments to be received in the future, either under contract or otherwise as, for example, annuities, insurance renewal commissions, contingent fees, and recoveries under a death claim, are not covered in the regulations. All of these assets must be valued and included in gross estate for Federal estate tax purposes, even though they yield no present cash with which to pay the tax.

Consideration should be given to a clarification, by amendment of Section 6161 or otherwise, of the circumstances under which an extension will be granted in the foregoing situations.

#### Section 6166

Although a more liberal administration of the District Director's discretion under Section 6161 will mitigate some hardships, if it is desired to assure an executor pressed for prompt payment of estate taxes a more liberal automatic extension when the estate con-



tains unmarketable assets, modifications of Section 6166 could be considered. The present installment payment provision is limited to "an interest in a closely held business", which must represent at least 20% of the value of the business or the business must have ten or fewer partners or shareholders, and the interest must represent more than 35% of the gross estate or 50% of the taxable estate. Moreover, the election must be made when the return is filed, not when the values and tax payable have been finally determined. Such interests by no means cover the areas in which the executor may have serious problems in raising the cash to pay debts and taxes and to administer the estate, much less provide for the survivors. As pointed out above, many unmarketable minority interests, items of income in respect of a decedent such as renewal commissions or contingent fees, or claims or property subject to claims in litigation fall outside the definition, yet they may have substantial value and be subjected to a substantial tax.

Consideration could be given to providing the installment payment privileges as to estate taxes on all nonliquid assets with elimination of the present percentage requirements of Section 6166. The executor could be given an election to pay the tax in installments on any property included in the gross estate which is not a liquid asset as the Administration initially defined it. At the same time the proportion of estate tax attributable to the readily marketable property should be paid promptly. Consideration could also be given to extending the time for making such election beyond the time of filing the return in order to cover cases where the valuation of the asset was increased upon examination of the return.



Section 6165

The requirement of a bond as a condition to any extension may, as a practical matter, make it impossible to obtain such extension. Furthermore, as pointed out above, administrative practice varies widely in this area. Consideration should be given to use of security arrangements such as mortgages, pledges, and escrow agreements in lieu of bonds. The provisions relating to security interests could follow the basic pattern and terminology established by the Uniform Commercial Code, which has now been adopted in a majority of the States. The proposed revision of Section 6165 would provide that the decedent's interest in any nonliquid asset included in the gross estate would constitute adequate collateral to secure the payment of taxes imposed with respect to that interest. The tax applicable to any asset would be the average rate (determined by dividing the net tax payable by the taxable estate) multiplied by the value finally determined for the decedent's interest in that asset. Such collateral would be adequate to secure the Government's interest, since the tax with respect to any asset will always be smaller than the value of the asset itself. No exception would be necessary if the asset is heavily encumbered at death, since only the remaining value of the asset is subject to tax. The District Director should be entitled to all notices and rights granted to a creditor or stockholder and failure to give such notices would constitute default, enabling the District Director to enforce his security interest of his estate tax lien.



Section 6601(b)

Consideration should be given to a fair rate of interest on the amount of estate tax extended. Present law provides a variable rate now 7%. While this rate poses less hardship if an extension must be obtained it is far better than the 9% in effect up until February 1st. I would suggest for the Committee's consideration that the 2% differential which formerly existed in the law until 1975, that is, 2% below the rate of interest normally charged on deficiencies, be re-established.

Section 2204

Presently, if the time for payment of estate tax has been extended, the executor cannot obtain a release from personal liability, the other fiduciaries cannot obtain a release in any event. One of the stated objectives of the proposed acceleration of payment of tax and more prompt audits is to permit shortening the process of administration and earlier distribution of the assets to beneficiaries. An executor or fiduciary subject to personal liability for estate tax is unlikely to make distribution. Therefore, consideration should be given to the following changes.

The executor would be released if, as to the property in his possession and control, all unextended estate taxes, at the estate's average estate tax rate have been paid and security interests have been created for any extended estate taxes on that property.

Any other fiduciary or person subject to personal liability, except to the extent of his beneficial interest in the property, would be released if, as to the property in his possession and control, all unextended estate taxes, at the estate's average estate tax rate have been paid and security interests have been created



for any extended estate taxes on that property.

#### Section 303

To make funds more readily available to meet the liquidity problems, present Section 303 could be amended to extend the period for redemptions at capital gain rates, presently about 4-1/2 years, to equal any additional period for which the payment of estate taxes has been extended, with reduction or elimination of the present percentage requirements.

#### Section 531

To make funds more readily available for early payment of estate taxes, thus minimizing the need for extension of time, Section 537(a)(3) of the Code, amended by the Tax Reform Act of 1969 to permit post-death accumulation of earnings for Section 303 redemptions, could be further amended to permit pre-death accumulations of earnings to fund corporate buy-out agreements.

#### Unrealized Appreciation at Time of Death

Present law gives a new basis the date of death value or the alternate value, whichever was used in the estate tax return, to practically all property included in the gross estate. That rule had a long piecemeal development from 1921 when the statute first covered the basis of donated or inherited property, up to and including its final development in the Internal Revenue Code of 1954. In November of 1919 the Secretary of the Treasury had submitted a Memorandum to the Ways and Means Committee pointing out that this permitted unrealized gains due to appreciation taking place during the previous ownership to escape taxation. In 1963 and again in 1969 this problem has been before this Committee. It is thoroughly explored in the material carefully selected and assembled for you



by your staff in the Committee print "Background Materials on Federal Estate and Gift Taxation" which each of you has.

The proponents of the suggestion that the unrealized appreciation at death be subject either to a capital gains tax or an additional estate tax, have relied predominantly on two arguments for the change. In an effort to reduce the capital gains tax rates the stock exchanges persistently argued that the capital gains tax has a lock-in effect. The lock-in effect results in thinner markets, hampers the optimum allocation of investment funds, and accentuates price fluctuations. To reduce the revenue loss from reduced capital gains rates economists and the Treasury countered by insisting upon recognition of gain on transfers by gift or at death. The Treasury studies pointed out that a system which allows the gain to escape tax by reason of the stepped up basis rules increases the lock-in effect as the investor ages. They also strongly emphasized the "discrimination" between those who hold appreciated property until it gets a stepped up basis on their death, and others. They point to the fact that the salaried person who has nothing but cash has paid income tax on all property remaining in his estate. The conservative investor who puts his money in fixed maturities, savings accounts or government bonds, has paid an income tax on all the property in his estate. They cannot then understand why the man who has persistently held farm land or developed a profitable small business should escape income tax on the appreciation in the net value of his estate. The differences, constantly a source of concern to the saver and investor, between these situations are of no importance. The 1969 U.S. Treasury Department "Tax Reform Studies and Proposals" and the most avid proponents of taxing capital gain at death



recognize a number of problems emphasized by those who oppose change from the present law.

Under a progressive income tax and possibly as a result of the experience in the early forties with income in respect of a decedent, they concede that it would be unfair to tax the entire appreciation in a single taxable period. They recognize that so long as estate taxes and administration costs already impose a financial burden on the estate, provisions for the installment payment of estate tax in hardship cases and the provision for the redemption of stock in closely held corporations should be liberalized. One proponent also suggested that tax on unreasonable accumulated earnings would have to be modified.

Notwithstanding an opinion prepared for the occasion from the office of the Chief Counsel of the Treasury, it appears that there is at least a respectable difference of opinion whether an income tax on appreciation at the time of gift or death transfers would be constitutional.

The arguments which have come to my attention against either proposal, recognition of gain or loss or the alternative often suggested, a carryover of basis at death, can be briefly summarized as follows:

The tax difference now called a "loophole" or "preference", may be intentional. Gifts are now taxed more lightly than death transfers and repeatedly the time or amount of income tax may depend upon the nature or source of the income.

Any "loophole" closing almost always adds complexity to the Code. Incidentally, I received an interesting comment in opposition



to a change in present law from a former estate and gift tax examiner, a worker in the fields rather than a policy maker in Treasury or Congress. He pointed out that whatever the rules to be developed were, they would apparently increase the computational problems of gift tax credits, marital and charitable deductions, State and foreign death tax credits, and deductions and credits for previously taxed property. He overlooked the problems of allocating and collecting tax from property passing outside the probate estate.

Unless riddled with exemptions, in its pure form the proposal would penalize the smaller and middle sized estates, whose assets consist of a greater percentage of stock in closely held corporations or family held lands. Although the Secretary of the Interior has testified that the proposal would free up more land for young farmers, he forgets that on the other side it would probably force older farmers to sell their lands at lower prices.

The most prevalent objections arose from the increased need for cash at the time of death - the liquidity problem. It would increase the pressures to sell control of smaller businesses, to merge them into larger corporations whose stock is more liquid, and might create a particularly difficult problem for the holder of a minority interest in a relatively unmarketable business. Income averaging, installment payments and a liberalization of Section 303 permitting a corporation to redeem its stock, would not fully answer the problem of raising cash. Even the alternate carryover basis proposal no more than mitigates the liquidity problem. Any sales by the estate to pay taxes will immediately give rise to income taxable gain. Many, if not all of the complex rules for income in respect of a decedent will need to be continued to provide proper credit for the estate tax paid



on property subject thereafter to deferred income tax.

The proposal to tax gains at death seems to favor the speculator or trader as against the long term investor. Because of the uncertainty of time of death it will be practically impossible to plan an estate to have sufficient liquid assets at all times to meet the estate and income tax burdens. This leads to a conclusion that the proposal does not mitigate the lock-in effect, since the increased uncertainty will lead more investors to postpone, even if they cannot escape, the income tax burden. Similarly, the desire to postpone tax will create substantially the same lock-in effect if a carryover basis is provided. The proposal will discourage high risk investment. It may be argued that while the potential step-up in basis is a factor to consider in investing, since it is available to all, it is hard to see how it involves any practical discrimination.

Opponents of the proposal have also argued that in addition to the usual uncertainty of death, any change in well established rules leads to uncertainty and confusion both for the administration and the taxpayers as to the precise content of the new law.

Among the most prevalent objections both to the realization and carryover proposals, and most importantly to the carryover proposal is the extreme difficulty of obtaining adequate basis records. In either proposal the problem is complicated by the fact that the best lead to such records will now be dead. Moreover, it is argued that fiduciaries need additional protection from mistakes from this cause. While since 1921 the gift tax statute has placed on the Commissioner the burden, along with the taxpayer, of providing facts as to basis, he has not been particularly cooperative. In one liti-



gated case he attempted to establish a zero basis. Other supporters of the proposal have suggested that most records would be on the computers in Martinsburg but that overestimates what has been programmed into the machines. Most of us who practiced before 1954 can remember the extreme difficulties we faced even in the limited area proving the basis of jointly held property which then had a carryover basis through an estate. Those in favor of the proposal, however, argue that tax exemption cannot depend on inadequate records.

If such a proposal is adopted you will have to face the question as to whether it should be retroactive. In other words, if these changes are made I would highly recommend that a beginning inventory similar to the 1913 cut-off date should be required. Such a proposal might work relatively well as it did in Pennsylvania when an income tax was imposed as to listed stocks and bonds, but the problem of establishing a basis for all privately held wealth as of any given date will be enormous. Any of you who have had to argue estate tax valuations with a Revenue Agent will understand that the problem is being doubled.

The Treasury Studies estimated that almost 40% of the appreciation which was escaping tax at death belonged to decedents not required to file estate tax returns. I have some difficulty in understanding why a minimum exemption was proposed exactly equal to the estate tax exemption. It is not estate taxes which are being escaped, it is income taxes. If the tax truly is to prevent discrimination between those who sell and those who don't, and represents a tax on the "income" enjoyed by the decedent, the tax would raise more revenue if it were uniformly applied to all property including that passing to the widow or to the children or to charities. Logically,



it would seem also to be equally applicable to all decedents who were required to file a final income tax return. If there are to be any exemptions for administrative and valuation purposes it would seem they should depend more on the nature of the property, for example, residences or personal effects, than its destination.

Finally, I am concerned in these proposals, as well as in the income tax law itself, that in the measurement of capital gains, what is proposed to be taxed is in large part an illusory gain.

As tax lawyers we are very accustomed to figure gain or depreciation solely on original cost. As an architect's son I watched a house being built in 1937. That house cost \$7,500. That house has recently been sold for over \$50,000. It doesn't have any more rooms in it. It is not any bigger. It doesn't provide any more comfortable living and yet there has been a drastic increase in its money value. If that house were sold, to buy another of the same size providing the same living accommodations would probably cost more than \$50,000. There is concern now that the average cost of a new residence in this country is \$40,000. Your Committee has already recognized as a matter of income taxation that to be fair to those who had held houses for a long period of time, if they reinvested the proceeds from their sale in a new house within a limited period, that they should not be taxed on the illusory gain. Very much the same thing is true in the case of farm lands which have been held in a family for a long period or in many cases in the plants of small business. It is noteworthy that in the smaller estate tax returns, real estate is a larger proportion of the estate than in larger estates. Unfortunately, the statistics of income do not show the difference between the three



hundredths of a percent of corporate stock which is freely traded and the balance of corporate stock representing closely held corporations. I would therefore recommend that if your Committee seriously considers an additional tax on unrealized appreciation in property at death, that it reconsider the general basis rules so that what is taxed is true appreciation and not simply a reflection of the decline in the purchasing power of the dollar.

As a practitioner constantly faced with the increasing complexity not only of the Code but of the tax return each year, I earnestly request that before adopting these changes you and your staffs give serious consideration to the details and the practical application of these proposals. The background materials and the objections which have been voiced to this Committee in prior hearings are worth serious consideration.



James D. Smith

TESTIMONY TO THE HOUSE WAYS AND MEANS COMMITTEE  
THE DISTRIBUTION AND COMPOSITION OF WEALTH HOLDINGS  
AND THEIR IMPLICATIONS FOR ESTATE TAX REFORM\*

Introduction

My name is James D. Smith. I am an economist with a long standing interest in the distribution of wealth and its implications for both politics and economics.

I have at times been dismayed that the Congress is forced to do its work with such a paucity of empirical data to guide it. I am particularly pleased, therefore, to be able to provide the Committee with data bearing on the distribution of wealth and its taxation at death. There were a number of questions addressed to me by the Committee's Chief of Staff, Mr. Woodsworth. We have tried to answer as many of the questions as possible in the short time available to us to do the computer work and type the text.

\*Grants from the National Science Foundation and the Ford Foundation to The Urban Institute support the past and on-going research which make it possible to provide this rather unusual data on the distribution of personal wealth in the United States. The specific information provided to the committee today required the sustained computing efforts of my colleague, Stephen D. Franklin, who has collaborated with me on much of the work I have done in this area in recent years. Terry Moyer stretched her days into nights to prepare the tables and text in the short time available to us.



Fortunately, grants from the National Science Foundation and The Ford Foundation to The Urban Institute permitted the basic preparation of the data base for the information presented below. Several years ago, after a long frustrating struggle by other agencies (including the Office of Statistical Standards) and myself, members of the Congress and of the White House Staff induced the Internal Revenue Service to release to me computer tapes of estate tax returns. None of the tapes contain the names or street addresses of tax filers. I burden you with this point because in the meat axe approach to protecting citizens from government dirty tricks, it is very easy to cut off the informational base needed to formulate wise public policy. Clearly, tax return data which do not contain positive identifiers, which I limit to name, street address and social security number, should be readily available to researchers and policy makers in and out of government. They form the primary basis for accessing the fairness of the tax system, making rational change in the tax statutes and addressing a host of economic and social issues.

I shall proceed by first describing the population of wealth holders whose death is likely to cause the filing of an estate tax return under the existing statute and under a range of filing thresholds the Committee may wish to consider. In the process, I



shall present information on the types of assets held by the potential estate tax population. For the sake of brevity, I shall not describe the procedures used to obtain the data, but they have been published in several places. A number of these publications have been provided the Committee already. Should there be further questions about methodology, I would be happy to answer them following my oral testimony.

Second, I shall deal specifically with the issue of liquidity and the transfer of assets between spouses, both of which appear in the Administration's proposals for reform.

The estate tax produces relatively little revenue, \$3 bil. compared to \$103 bil. from the personal income tax and \$36 bil. from the corporate income tax. It was never intended to be a basic source of public funds. Its purposes have been and I hope will continue to be (1) an impediment to the accumulation of such great economic power in the hands of the few as to undermine the political efficacy of the many, and (2) a mechanism to even out a bit of the life chances of children who had the foresight to choose rich parents and those lacking prescience. Thus, the estate tax is one of a class of instruments intended to make the market and political systems fairer and, perhaps, more efficient games. Given its peculiar functions, it is important to insure that it provide for horizontal and vertical equity, i.e., that equals are treated equally and nonequals unequally.



Unfortunately, the estate tax is not the best suited type of death tax for achieving its intended ends. Many of the problems (including that of liquidity) associated with the estate tax would be less troublesome if we had an inheritance tax. Under the present system of levying a tax against the value of the entire estate, the potential inheritance of a poor heir and a rich one are diminished by the same proportion. There is little point in worrying about equity among the dead and of any power that they may exercise. If a goal of the estate tax is to disperse of economic power, it would be well to tax inheritances on the basis of the combined prior wealth and inheritance of the legatees. Such a system could permit the transfer of rather sizeable amounts of wealth without any tax to persons of modest means and tax quite heavily wealth flowing to the affluent. I shall return to this issue later.

#### The Distribution of Wealth in the United States

Statistical estimates of the distribution of wealth in 1972 are presented for families and individuals in Charts 1 and 2. Chart 1 is for individuals and Chart 2 for families. In most uses of wealth distribution data we would be interested in an economic unit such as the family, because it gives us a better view of one's economic status than does the wealth he holds in his own name. This is particularly true of the very young and very old. However, for purposes of formulating estate tax policies, the individual is the natural tax unit. The data in Charts 1 and 2 are plotted on log-normal scales to facilitate

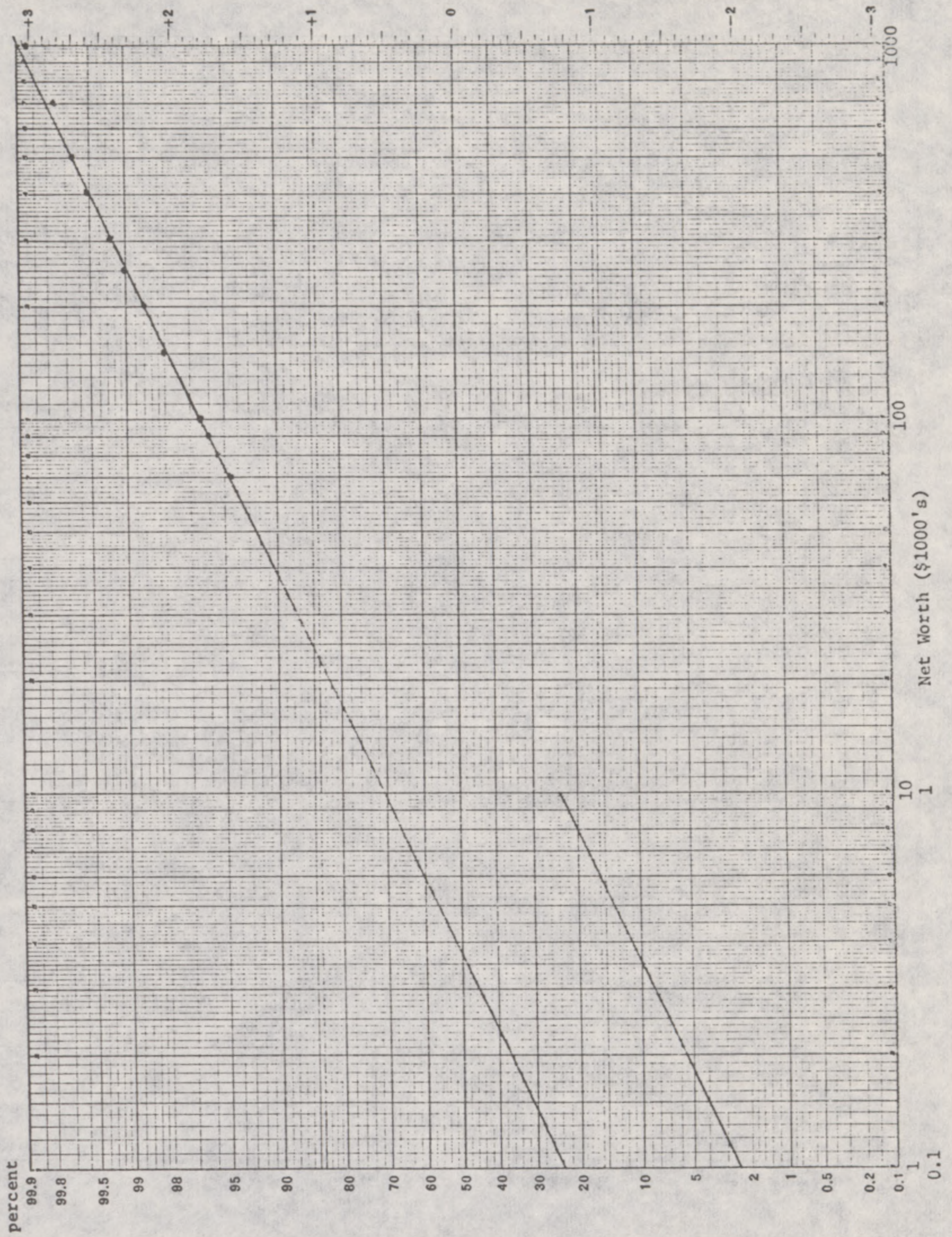


NO. 31.376. LOGARITHMIC NORMAL.



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CHART 1  
PERCENT OF PERSONS WITH NET WORTH LESS THAN SPECIFIED AMOUNTS, 1972



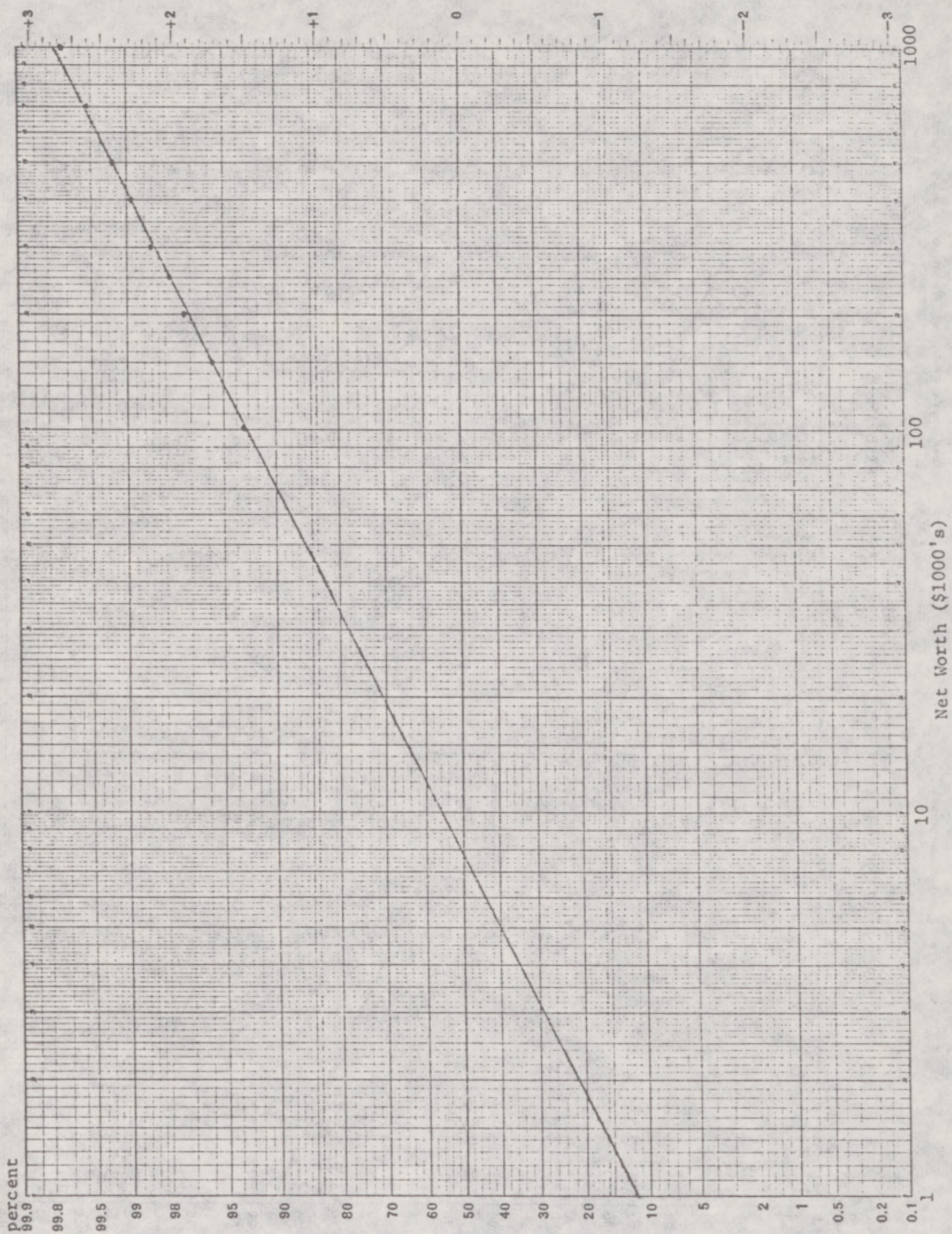


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CHART 2  
PERCENT OF FAMILIES WITH NET WORTH BELOW SPECIFIED AMOUNTS, 1972





their extrapolation. In Chart 1 the left most portion of the extrapolation extended off the paper and it is shown below the rest of the curve in the left third of the Chart.

For practical purposes, a quarter of all U. S. citizens owned nothing (less than \$100 on Chart 1) in 1972. Many of these unpropertied persons were, of course, children, but also included are the old, and young adults living in poverty. About 55 percent of all individuals had a net worth of less than \$5,000, and I am not talking simply about financial assets, but include houses, automobiles and personal effects in the manner in which the IRS views these things. Only about 7 percent of the population had a net worth of \$60,000 or more in 1972. Nobody below this 7 percent of the population has his estate taxed if he dies, and for practical purposes, one is probably safe in saying that only the estates of the richest 5 percent of the population are taxed at all under the present estate tax system.

For some perspective about the types of assets held by the super-rich (those with a net worth of \$60,000 or more), let us turn back to those persons with a net worth of \$60,000 or more. In Table 1 we show the assets held by this affluent group of Americans in comparison with all Americans in the years 1969 and 1972.

It is apparent from the table that a substantial share of the total value of several types of assets are held by this group of wealth-holders. Taking into account the normal statistical errors attendant on data such as these, citizens with a net worth



TABLE 1

## SHARE OF SUPER RICH IN WEALTH OF ALL PERSONS, 1969 AND 1972\*

| Asset                       | 1969           |                          |                          | 1972           |                          |                          |
|-----------------------------|----------------|--------------------------|--------------------------|----------------|--------------------------|--------------------------|
|                             | The Super Rich | All Persons <sup>c</sup> | Share Held by Super Rich | The Super Rich | All Persons <sup>c</sup> | Share Held by Super Rich |
|                             | billions \$    | billions \$              | percent                  | billions \$    | billions \$              | percent                  |
| Real estate                 | 324.7          | 1187.0                   | 27.4                     | 443.0          | 1403.7                   | 31.6                     |
| Corporate stock             | 494.8          | 781.3 <sup>a</sup>       | 63.3                     | 580.5          | 870.9 <sup>a</sup>       | 66.7                     |
| State and local bonds       | 20.7           | 26.4 <sup>a</sup>        | 78.4                     | 33.8           | 36.1 <sup>a</sup>        | 93.6                     |
| Corporate and foreign bonds | 13.2           | 9.4                      | 100.0                    | 26.7           | 34.6                     | 77.2                     |
| Savings bonds               | 15.8           | 51.1                     | 30.9                     | 21.2           | 53.6                     | 39.6                     |
| Other federal bonds         | 23.1           | 31.1 <sup>a</sup>        | 74.3                     | 32.9           | 33.7 <sup>a</sup>        | 97.6                     |
| Notes and mortgages         | 49.2           | 35.3                     | 100.0                    | 68.9           | 77.5                     | 88.9                     |
| Cash                        | 155.3          | 476.2                    | 32.6                     | 217.7          | 748.8                    | 29.1                     |
| Business assets             | 67.8           | 171.6                    | 39.5                     | 66.8           | 177.3                    | 37.7                     |
| Other assets                | 86.4           | 745.5                    | 11.6                     | 151.0          | 819.3                    | 18.4                     |
| Total assets                | 1251.0         | 3514.8                   | 35.6                     | 1645.0         | 4255.5                   | 38.8                     |
| Debts                       | 107.0          | 424.6                    | 25.2                     | 148.2          | 808.5                    | 18.3                     |
| Net worth                   | 1144.0         | 3090.2                   | 37.0                     | 1496.8         | 3447.0                   | 43.5                     |
| Number of persons (mil.)    | 5.0            | 124.2 <sup>b</sup>       | 4.0                      | 6.9            | 131.9 <sup>b</sup>       | 5.2                      |

\*We normally define the super-rich as the 4-5% of the adult population with a net worth of \$60,000 on.

<sup>a</sup>Includes 54.3 percent of assets held in trust funds.<sup>b</sup>Population age 20 and over.<sup>c</sup>Preliminary national balance sheets.



of \$60,000 or more in both 1969 and 1972 held practically all the value of personally held state and local bonds, federal bonds (other than savings bonds), notes and mortgages and foreign and corporate bonds.

The most popular asset of the affluent is corporate stock, followed by real estate. As a group, the rich hold a surprisingly high proportion (13 percent) of their portfolio in cash (demand and time deposits). (See Table 2). If various types of bonds and notes and mortgages are added to cash holdings it turns out that 25 percent of the wealth of the rich is in a highly liquid form. Although some of the corporate stock held by the rich is that of closely held by corporations, the overwhelming share represents traded securities, which are highly liquid. The general conclusion suggested by these data is that the rich, as a group, maintain very liquid portfolios. Because we had access to the micro data, it was possible for us to look behind these aggregate data. We shall return to this question a bit latter, after we have laid out the general characteristics of the rich.

Looking at the distribution of wealth over a period of years one is struck by the constancy of its concentration. Because a dollar value such as \$60,000 implies different levels of real wealth in different years as price levels change, secular movement in wealth concentration is best looked at by taking some fixed percent of the population arrayed by wealth level. In Table 3 the share of the nation's personally owned wealth held by



TABLE 2

The Portfolio Composition of the  
Super-Rich, 1972

| Asset                       | Percent of total assets |
|-----------------------------|-------------------------|
| Real estate                 | 27                      |
| Corporate stock             | 35                      |
| State and local bonds       | 2                       |
| Corporate and foreign bonds | 2                       |
| Savings bonds               | 2                       |
| Other federal bonds         | 2                       |
| Notes and mortgages         | 4                       |
| Cash                        | 13                      |
| Business assets             | 4                       |
| Other assets                | 9                       |
| Total assets                | 100                     |
| Debt                        | 9                       |



TABLE 3  
SHARES OF RICHEST<sup>a</sup> 0.5 PERCENT AND 1.0 PERCENT OF PERSONS IN NATIONAL WEALTH,  
1953, 1958, 1962, 1965, 1969 and 1972

| Asset                             | 1953                                      |                                       |         | 1958                                      |                                       |         | 1962                                      |                                       |          |
|-----------------------------------|---|---------------------------------------|---------|---|---------------------------------------|---------|---|---------------------------------------|----------|
|                                   | Value Held by Richest<br>100.0% 0.5% 1.0% | Share Held<br>by Richest<br>0.5% 1.0% | percent | Value Held by Richest<br>100.0% 0.5% 1.0% | Share Held<br>by Richest<br>0.5% 1.0% | percent | Value Held by Richest<br>100.0% 0.5% 1.0% | Share Held<br>by Richest<br>0.5% 1.0% | percent  |
| Real estate <sup>b</sup>          | \$ 439.0                                  | \$ 45.0                               | \$ 68.0 | \$ 621.5                                  | \$ 62.5                               | \$ 93.9 | \$ 770.0                                  | \$ 79.6                               | \$117.8  |
| Corporate stock <sup>c</sup>      | 151.5                                     | 116.6                                 | 130.8   | 264.1                                     | 175.9                                 | 199.2   | 426.4                                     | 227.3                                 | 264.4    |
| Bonds                             | 72.8                                      | 33.0                                  | 38.3    | 87.0                                      | 31.3                                  | 36.0    | 94.5                                      | 33.2                                  | 38.4     |
| Cash <sup>d</sup>                 | 160.1                                     | 20.9                                  | 28.8    | 216.0                                     | 22.5                                  | 32.8    | 278.3                                     | 28.9                                  | 42.5     |
| Debt instruments <sup>e</sup>     | 34.0                                      | 8.2                                   | 10.9    | 43.7                                      | 12.5                                  | 16.3    | 51.5                                      | 16.5                                  | 21.8     |
| Life insurance (CSV) <sup>f</sup> | 64.5                                      | 6.6                                   | 9.1     | 79.9                                      | 7.5                                   | 11.3    | 93.8                                      | 7.1                                   | 10.7     |
| Trusts <sup>g</sup>               | 20.5                                      | 17.5                                  | 18.8    | 30.3                                      | 25.8                                  | 27.9    | 46.1                                      | NA                                    | NA       |
| Miscellaneous <sup>h</sup>        | 222.8                                     | 12.5                                  | 19.8    | 312.9                                     | 19.8                                  | 24.9    | 379.4                                     | 39.8                                  | 52.7     |
| Total assets                      | \$1144.7                                  | \$242.8                               | \$305.7 | \$1625.1                                  | \$332.0                               | \$414.4 | \$2093.9                                  | \$432.4                               | \$548.3  |
| Liabilities                       | \$ 140.0                                  | \$ 21.3                               | \$ 29.0 | \$ 227.4                                  | \$ 29.2                               | \$ 38.3 | \$ 314.0                                  | \$ 47.8                               | \$ 61.0  |
| Net worth                         | \$1004.7                                  | \$221.5                               | \$276.7 | \$1396.7                                  | \$302.8                               | \$376.1 | \$1779.9                                  | \$384.6                               | \$487.3  |
| Number of persons                 | 0.80                                      | 1.60                                  |         | 0.87                                      | 1.74                                  |         | .93                                       | 1.87                                  |          |
|                                   |   |                                       |         |   |                                       |         |   |                                       |          |
| Asset                             | 1965                                      |                                       |         | 1969                                      |                                       |         | 1972                                      |                                       |          |
|                                   | Value Held by Richest<br>100.0% 0.5% 1.0% | Share Held<br>by Richest<br>0.5% 1.0% | percent | Value Held by Richest<br>100.0% 0.5% 1.0% | Share Held<br>by Richest<br>0.5% 1.0% | percent | Value Held by Richest<br>100.0% 0.5% 1.0% | Share Held<br>by Richest<br>0.5% 1.0% | percent  |
| Real estate <sup>b</sup>          | \$ 917.7                                  | \$ 94.4                               | \$135.8 | \$1188.8                                  | \$117.0                               | \$170.7 | \$1403.7                                  | \$150.9                               | \$ 225.0 |
| Corporate stock <sup>c</sup>      | 596.6                                     | 317.2                                 | 364.9   | 832.1                                     | 366.3                                 | 423.3   | 870.9                                     | 429.3                                 | 491.7    |
| Bonds                             | 103.6                                     | 57.5                                  | 63.2    | 133.9                                     | 63.7                                  | 71.5    | 158.0                                     | 82.5                                  | 94.8     |
| Cash <sup>d</sup>                 | 366.0                                     | 43.7                                  | 62.7    | 496.9                                     | 48.1                                  | 71.2    | 748.8                                     | 63.6                                  | 101.2    |
| Debt instruments <sup>e</sup>     | 53.3                                      | 19.8                                  | 25.4    | 72.4                                      | 21.9                                  | 29.6    | 77.5                                      | 30.3                                  | 40.8     |
| Life insurance (CSV) <sup>f</sup> | 107.2                                     | 6.5                                   | 10.9    | 127.2                                     | 8.4                                   | 13.8    | 143.0                                     | 6.2                                   | 10.0     |
| Trusts <sup>g</sup>               | 57.5                                      | 49.0                                  | 52.7    | 69.9                                      | 60.0                                  | 64.5    | 99.4                                      | 80.3                                  | 89.4     |
| Miscellaneous <sup>h</sup>        | 456.6                                     | 36.3                                  | 49.1    | 632.8                                     | 47.0                                  | 68.7    | 853.6                                     | 59.5                                  | 83.3     |
| Total assets                      | \$2601.0                                  | \$575.4                               | \$712.7 | \$3484.1                                  | \$672.4                               | \$848.8 | \$4255.5                                  | \$822.4                               | \$1046.9 |
| Liabilities                       | \$ 413.3                                  | \$ 57.0                               | \$ 73.1 | \$ 557.5                                  | \$ 75.8                               | \$100.5 | \$ 808.5                                  | \$100.7                               | \$ 131.0 |
| Net worth                         | \$2187.7                                  | \$518.4                               | \$639.6 | \$2926.6                                  | \$596.7                               | \$748.1 | \$3447.0                                  | \$721.7                               | \$ 915.9 |
| Number of persons                 | .97                                       | 1.94                                  |         | 1.01                                      | 2.03                                  |         | 1.04                                      | 2.09                                  |          |



the richest 1.0 percent and 0.5 percent of persons is displayed. It can be seen there that the share held by the richest one-half of one percent of the population has been measured repeatedly at between 22 and 24 percent of the total, over a period of nearly two decades. If we go back more years, there is evidence that at times there have been trends toward less concentration. My colleague, Robert J. Lampman, of the University of Wisconsin, has provided us with estimates for selected years from 1922 through 1956. When his estimates are added to our own, a picture of the historical trend emerges. (See Chart 3) Wealth in the United States has become less concentrated in the last half century. Both the diminution is not great, and it all occurred in periods when the market system was functioning under duress or was in administrative abeyance, specifically the Great Depression and World War II.

So far we have looked only at individuals because they are the more relevant unit in the administration of a death tax. However, in viewing the success of death taxes as an impediment to the concentration of economic power, it is important to recognize that wealthy individuals are likely to marry other wealthy individuals and thus accelerate accumulation of greater wealth by taking advantage of certain economies of scale. In Table 4 data on the wealth holding of families with \$1,000,000 net worth or more in 1972 is shown. They are not exactly the economic creme de creme, but they are a rather select group, the richest three-tenths of one percent of all families. In spite of their relative fewness, these families owned 15 percent of the



CHART 3  
ECONOMIC INEQUALITY

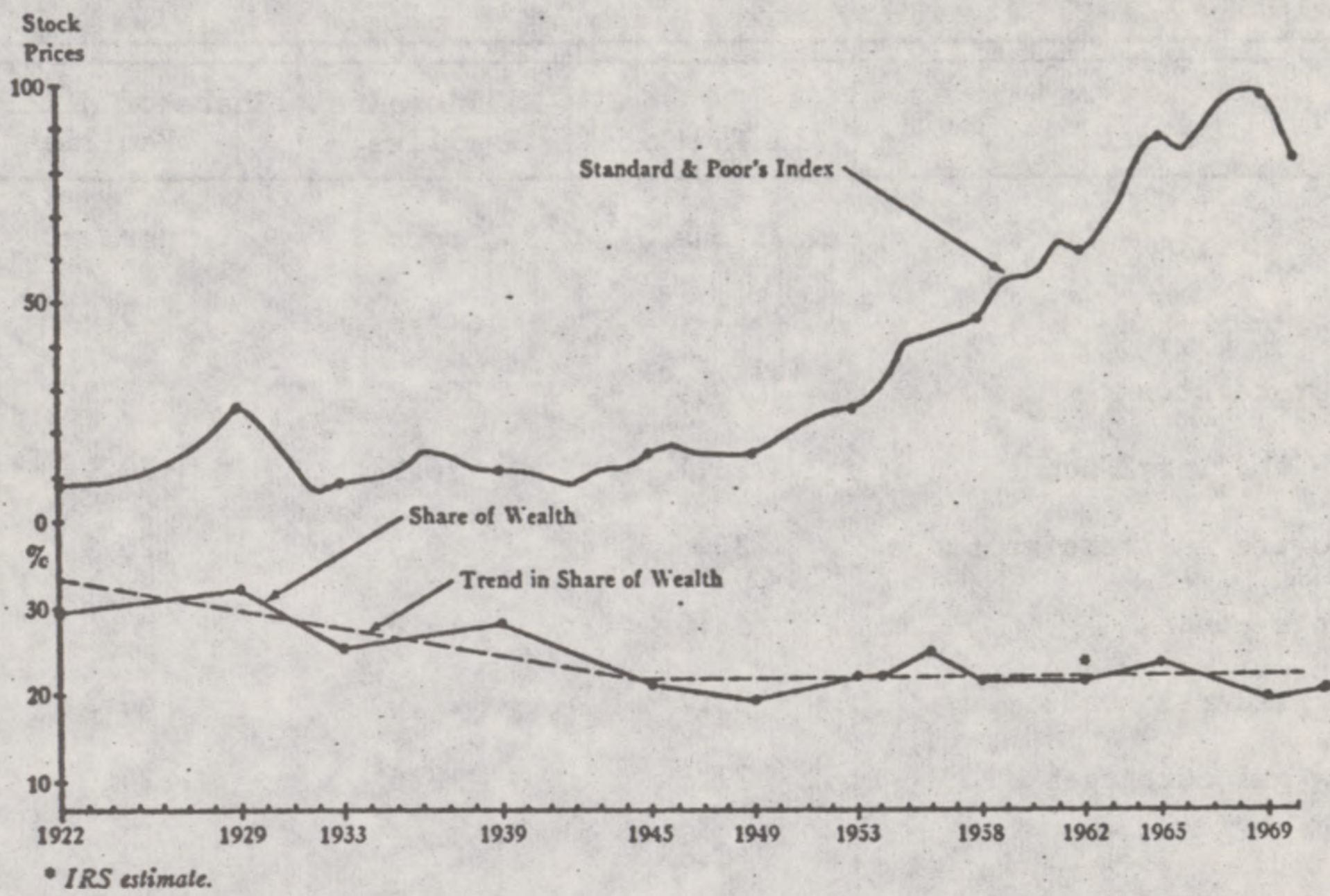


FIGURE 1—SHARE OF WEALTH HELD BY RICHEST 0.5 PERCENT OF POPULATION, AND STOCK PRICES, 1922 TO 1972



TABLE 4

## THE SHARE OF MILLIONAIRE FAMILIES IN NATIONAL WEALTH, 1972

| Asset                           | All Families <sup>b</sup> | Millionaire Families | Share of Millionaire Families |
|---------------------------------|---------------------------|----------------------|-------------------------------|
|                                 | <i>billions \$</i>        | <i>billions \$</i>   | <i>percent</i>                |
| Real estate                     | 1403.7                    | 78.4                 | 5.6                           |
| Corporate stock                 | 870.9 <sup>c</sup>        | 306.8                | 35.2                          |
| State and local bonds           | 36.1 <sup>c</sup>         | 26.3                 | 72.9                          |
| Corporate and foreign bonds     | 34.6                      | 9.3                  | 26.9                          |
| Savings bonds                   | 53.6                      | 4.6                  | 8.6                           |
| Other federal bonds             | 33.7                      | 23.0                 | 68.3                          |
| Notes and mortgages             | 77.5                      | 18.6                 | 24.0                          |
| Cash                            | 748.8                     | 27.5                 | 3.7                           |
| Business assets                 | 177.3                     | 20.1                 | 11.3                          |
| Other assets                    | 819.3                     | 50.8                 | 6.2                           |
| Gross assets                    | 4255.5                    | 560.7                | 13.2                          |
| Debt                            | 808.5                     | 45.1                 | 5.6                           |
| Net worth                       | 3447.0                    | 515.6                | 15.0                          |
| Number of families <sup>a</sup> | 69,894,000                | 194,073              | 0.3                           |

<sup>a</sup>Includes one-person families. Source: Current Population Reports, July 1975, Series P-20, No. 282.

<sup>b</sup>Balance sheet estimates are preliminary.

<sup>c</sup>Includes 54.3 percent of assets in personal and common trusts.



net worth, 36 percent of the corporate stock, 73 percent of the state and local bonds and 68 percent of the federal bonds (excluding savings bonds).

#### The Issue of Liquidity

The President and others have pointed out that the estates of some decedents may suffer a hardship in paying their estate taxes because of lack of liquidity. The issue is felt to be particularly important in the case of family farms and small businesses. There is little question that converting assets to a liquid form to pay taxes may pose a financial burden on some estates. From a policy point of view, there are a number of questions that must be answered before one is comfortable recommending legislation to alleviate the alleged liquidity problem:

1. How extensive is the liquidity problem?
2. Are there other nonliquid assets, such as personal effects, jewelry, art, household durables and the like, which also pose a liquidity problem?
3. Is a lack of liquidity in estates an inadvertant condition of the decedent's prior economic life or is it in part due to prior inter-vivos transfers of liquid assets to the legatees who may use them to pay estate taxes?



4. Is the estate the correct unit of analysis for deciding whether a liquidity problem exists? Is not the liquidity of the legatee a relevant consideration?

These are questions which occurred to us and we have tried to shed some light on them by use of the data. We technically are in a position to do considerably more than we have presented, but time and resources have constrained us to the analysis which follows.

In Table 5 we show the assets of estates filing 706s in 1973. The assets are organized by size of economic estate and by an arbitrary designation of liquid or nonliquid. Economic estate is defined as the value of gross estate less debts and lifetime transfers. A fairly high proportion of the total value of small estates is nonliquid, but the proportion decreases steadily with size of economic estate.

To get a better view of what was going on behind these aggregate numbers, we computed for each estate a ratio of federal estate taxes plus costs of administering to liquid assets minus debts. Liquid assets were those shown in Table 5. This ratio is believed to be a conservative index of the estate's ability to pay estate taxes without the forced liquidation of less marketable assets. The distribution of the ratio by size of economic estate for all returns, and those with and without unincorporated business and/or farm assets is shown in Table 6.



TABLE 5  
VALUE OF SPECIFIED ASSETS BY SIZE OF ECONOMIC ESTATE,  
DECEDENTS, ESTATE TAX RETURNS, 1973  
(MILLIONS OF DOLLARS)

| SIZE OF<br>ECONOMIC ESTATE<br>(\$THOUSANDS) | LIQUID ASSETS               |                             |                           |                                   |                    |                                 |
|---|-----------------------------|-----------------------------|---------------------------|-----------------------------------|--------------------|---------------------------------|
|   | STATE AND<br>LOCAL<br>BONDS | FEDERAL<br>SAVINGS<br>BONDS | OTHER<br>FEDERAL<br>BONDS | CORP AND<br>FOREIGN<br>BONDS      | CORPORATE<br>STOCK | CASH<br>AND NOTES<br>FACE VALUE |
| DEFICIT                                     | 0.1                         | 0.4                         | 2.3                       | 0.9                               | 19.1               | 6.6                             |
| 0 < 60                                      | 0.2                         | 8.4                         | 2.0                       | 3.1                               | 48.2               | 94.7                            |
| 60 < 80                                     | 3.8                         | 85.4                        | 15.3                      | 28.3                              | 350.3              | 792.7                           |
| 80 < 100                                    | 6.1                         | 83.8                        | 16.8                      | 35.9                              | 412.4              | 723.6                           |
| 100 < 150                                   | 15.8                        | 154.1                       | 44.3                      | 89.7                              | 1054.1             | 1320.6                          |
| 150 < 200                                   | 20.1                        | 84.5                        | 48.3                      | 64.7                              | 823.3              | 737.7                           |
| 200 < 300                                   | 40.5                        | 99.6                        | 77.4                      | 93.9                              | 1196.1             | 799.1                           |
| 300 < 500                                   | 72.2                        | 73.8                        | 109.4                     | 91.6                              | 1586.1             | 641.4                           |
| 500 < 1,000                                 | 155.2                       | 47.2                        | 158.8                     | 85.8                              | 1942.3             | 499.9                           |
| 1,000+                                      | 523.3                       | 25.7                        | 505.6                     | 93.8                              | 4813.7             | 443.3                           |
| ALL ESTATES                                 | 837.3                       | 662.9                       | 980.3                     | 587.7                             | 12245.7            | 6059.5                          |
|   |                             |                             |                           |                                   | 1421.7             | 2193.3                          |
| SIZE OF<br>ECONOMIC ESTATE<br>(\$THOUSANDS) | NONLIQUID ASSETS            |                             |                           |                                   |                    | GRAND<br>TOTAL                  |
|   | ANNUITIES                   | TOTAL<br>LIQUID<br>ASSETS   | REAL<br>ESTATE            | FARM AND<br>NONCORP<br>BUS ASSETS | OTHER<br>ASSETS    |                                 |
| DEFICIT                                     | 0.2                         | 43.9                        | 20.9                      | 6.5                               | 4.6                | 295.1                           |
| 0 < 60                                      | 4.2                         | 250.0                       | 214.2                     | 20.2                              | 27.6               | 1017.5                          |
| 60 < 80                                     | 16.5                        | 1647.9                      | 936.8                     | 44.4                              | 109.1              | 1236.2                          |
| 80 < 100                                    | 22.4                        | 1672.1                      | 917.9                     | 49.8                              | 109.3              | 1205.4                          |
| 100 < 150                                   | 45.8                        | 3484.5                      | 1742.9                    | 122.2                             | 203.7              | 2330.0                          |
| 150 < 200                                   | 23.9                        | 2244.8                      | 988.0                     | 70.2                              | 126.2              | 1349.6                          |
| 200 < 300                                   | 24.7                        | 2834.2                      | 1118.4                    | 108.7                             | 146.2              | 1568.3                          |
| 300 < 500                                   | 20.2                        | 3019.3                      | 966.2                     | 112.4                             | 157.5              | 1460.2                          |
| 500 < 1,000                                 | 19.8                        | 3240.4                      | 813.1                     | 119.2                             | 173.4              | 1306.3                          |
| 1,000+                                      | 20.2                        | 6749.2                      | 1069.7                    | 236.8                             | 269.3              | 1965.5                          |
| ALL ESTATES                                 | 197.8                       | 25186.2                     | 8788.1                    | 890.4                             | 1326.9             | 13734.1                         |
|   |                             |                             |                           |                                   | 2728.7             | 38920.3                         |



TABLE 6

PERCENT DISTRIBUTION OF RETURNS WITH LIQUID ASSETS BY SIZE OF ECONOMIC ESTATE  
AND RATIO OF (ESTATE TAX + COSTS) TO (LIQUID ASSETS - DEBTS)

| TYPE OF RETURN<br>AND<br>ECONOMIC ESTATE | NUMBER OF<br>RETURNS<br>(THOUSANDS) | RATIO OF (TAX + COSTS) TO (LIQUID ASSETS - DEBTS) |         |         |         |      |       |
|--|-------------------------------------|---|---------|---------|---------|------|-------|
|  |                                     | 0<.25   | .25<.50 | .50<.75 | .75<1.0 | 1.0+ | ALL   |
| percent                                  |                                     |   |         |         |         |      |       |
| NO FARM OR NONCORP<br>BUSINESS ASSETS    |                                     |   |         |         |         |      |       |
| 1 < 60,000                               | 6765.0                              | 49.9  | 11.1    | 6.7     | 4.6     | 27.7 | 100.0 |
| 60,000 < 80,000                          | 31391.0                             | 86.2  | 7.4     | 2.1     | 1.2     | 3.1  | 100.0 |
| 80,000 < 100,000                         | 24205.0                             | 87.3  | 7.1     | 1.6     | 0.9     | 3.1  | 100.0 |
| 100,000 < 150,000                        | 35126.0                             | 84.9  | 8.8     | 2.4     | 1.0     | 2.8  | 100.0 |
| 150,000 < 200,000                        | 15132.0                             | 76.8  | 14.2    | 3.4     | 1.6     | 4.0  | 100.0 |
| 200,000 < 300,000                        | 12648.0                             | 66.4  | 23.4    | 4.3     | 1.2     | 4.8  | 100.0 |
| 300,000 < 500,000                        | 8022.0                              | 53.1  | 36.0    | 4.1     | 1.8     | 5.1  | 100.0 |
| 500,000 < 1 MILLION                      | 4485.0                              | 41.6  | 47.5    | 4.3     | 1.8     | 4.8  | 100.0 |
| 1 MILLION+                               | 2262.0                              | 41.3  | 47.7    | 4.8     | 1.9     | 4.3  | 100.0 |
| ALL RETURNS                              | 140036.0                            | 77.5  | 13.6    | 2.9     | 1.4     | 4.7  | 100.0 |
| SOME FARM OR NONCORP<br>BUSINESS ASSETS  |                                     |   |         |         |         |      |       |
| 1 < 60,000                               | 596.0                               | 44.3  | 19.0    | 6.0     | 7.7     | 23.0 | 100.0 |
| 60,000 < 80,000                          | 3482.0                              | 65.5  | 15.8    | 5.5     | 3.6     | 9.6  | 100.0 |
| 80,000 < 100,000                         | 3485.0                              | 63.3  | 17.2    | 6.6     | 2.9     | 9.9  | 100.0 |
| 100,000 < 150,000                        | 6156.0                              | 57.2  | 19.0    | 8.4     | 3.3     | 12.0 | 100.0 |
| 150,000 < 200,000                        | 3152.0                              | 51.4  | 23.2    | 8.9     | 4.6     | 11.8 | 100.0 |
| 200,000 < 300,000                        | 3420.0                              | 46.2  | 26.2    | 8.2     | 6.0     | 13.5 | 100.0 |
| 300,000 < 500,000                        | 2251.0                              | 37.1  | 33.2    | 10.4    | 5.0     | 14.3 | 100.0 |
| 500,000 < 1 MILLION                      | 1423.0                              | 35.3  | 34.8    | 11.2    | 4.8     | 13.9 | 100.0 |
| 1 MILLION+                               | 878.0                               | 31.8  | 40.1    | 11.6    | 5.0     | 11.5 | 100.0 |
| ALL RETURNS                              | 24843.0                             | 52.7  | 22.8    | 8.2     | 4.2     | 12.1 | 100.0 |
| ALL RETURNS                              |                                     |   |         |         |         |      |       |
| 1 < 60,000                               | 7361.0                              | 49.4  | 11.8    | 6.6     | 4.9     | 27.3 | 100.0 |
| 60,000 < 80,000                          | 34873.0                             | 84.1  | 8.2     | 2.4     | 1.4     | 3.7  | 100.0 |
| 80,000 < 100,000                         | 27690.0                             | 84.2  | 8.4     | 2.2     | 1.1     | 4.0  | 100.0 |
| 100,000 < 150,000                        | 41282.0                             | 80.8  | 10.3    | 3.3     | 1.3     | 4.2  | 100.0 |
| 150,000 < 200,000                        | 18284.0                             | 72.4  | 15.8    | 4.4     | 2.1     | 5.4  | 100.0 |
| 200,000 < 300,000                        | 16068.0                             | 62.1  | 24.0    | 5.1     | 2.2     | 6.6  | 100.0 |
| 300,000 < 500,000                        | 10273.0                             | 49.6  | 35.4    | 5.4     | 2.5     | 7.1  | 100.0 |
| 500,000 < 1 MILLION                      | 5908.0                              | 40.1  | 44.4    | 5.9     | 2.5     | 7.0  | 100.0 |
| 1 MILLION+                               | 3140.0                              | 38.6  | 45.6    | 6.7     | 2.8     | 6.3  | 100.0 |
| ALL RETURNS                              | 164879.0                            | 73.7  | 15.0    | 3.7     | 1.8     | 5.8  | 100.0 |



It is clear from the table that the liquidity problem is less extensive than one might expect. Nearly three-quarters of the returns filed in 1973 had a ratio of taxes and costs to liquid assets minus debts of less than .25, and 91 percent paid taxes of no more than 75 percent of their liquid assets after prior payment of all debts. Only about 6 percent of the estates filing returns in 1973 had taxes and costs equal to or greater than their liquid assets once all debts had been accounted for.

The administration's point is not without merit, the ratio is distributed differently for estates in which farm and business assets are present and those in which they are not. About 16 percent of the estates filed in 1973 with business and/or farm assets had a ratio of taxes plus costs equal to .75 or more of their liquid assets once debts had been subtracted, compared to 4 percent for estate without business and farm assets.

The estate tax base includes within it certain lifetime transfers which though not the property of the estate, are included for purposes of tax computation if they were made in contemplation of death or were for less than fair money's value. These transfers add to the taxes but have not been included as part of liquid assets in our ratio. When the returns are tabulated after excluding those with lifetime transfers, there is a further diminution of the proportion of estates with a high ratio of taxes to liquid assets. (See Table 7) Other inter-vivos transfers may well have been made to potential heirs by the decedent. If there is a tendency for estate planning



TABLE 7

PERCENT DISTRIBUTION OF RETURNS WITH LIQUID ASSETS BY SIZE OF ECONOMIC ESTATE  
AND RATIO OF (ESTATE TAX + COSTS) TO (LIQUID ASSETS - DEBTS)  
(EXCLUDING RETURNS WITH LIFETIME TRANSFERS)

| TYPE OF RETURN<br>AND<br>ECONOMIC ESTATE | NUMBER OF<br>RETURNS<br>(THOUSANDS) | RATIO OF (TAX + COSTS) TO (LIQUID ASSETS - DEBTS) |         |         |         |      |       |
|--|-------------------------------------|---|---------|---------|---------|------|-------|
|  |                                     | 0<.25   | .25<.50 | .50<.75 | .75<1.0 | 1.0+ | ALL   |
| percent                                  |                                     |   |         |         |         |      |       |
| NO FARM OR NONCORP<br>BUSINESS ASSETS    |                                     |   |         |         |         |      |       |
| 1 < 60,000                               | 2024.0                              | 77.6  | 9.1     | 3.8     | 3.0     | 6.5  | 100.0 |
| 60,000 < 80,000                          | 29245.0                             | 87.0  | 7.3     | 2.1     | 1.1     | 2.5  | 100.0 |
| 80,000 < 100,000                         | 22372.0                             | 88.1  | 6.7     | 1.5     | 0.8     | 2.9  | 100.0 |
| 100,000 < 150,000                        | 32306.0                             | 86.1  | 8.4     | 2.2     | 0.9     | 2.3  | 100.0 |
| 150,000 < 200,000                        | 13606.0                             | 79.0  | 12.8    | 3.2     | 1.5     | 3.6  | 100.0 |
| 200,000 < 300,000                        | 11234.0                             | 67.8  | 22.9    | 4.0     | 1.1     | 4.2  | 100.0 |
| 300,000 < 500,000                        | 6952.0                              | 54.9  | 35.0    | 4.0     | 1.8     | 4.4  | 100.0 |
| 500,000 < 1 MILLION                      | 3805.0                              | 42.5  | 48.1    | 3.7     | 1.6     | 4.2  | 100.0 |
| 1 MILLION+                               | 1879.0                              | 41.8  | 49.0    | 4.2     | 1.4     | 3.7  | 100.0 |
| ALL RETURNS                              | 123423.0                            | 80.3  | 13.0    | 2.5     | 1.2     | 3.1  | 100.0 |
| SOME FARM OR NONCORP<br>BUSINESS ASSETS  |                                     |   |         |         |         |      |       |
| 1 < 60,000                               | 273.0                               | 53.8  | 24.2    | 5.5     | 3.7     | 12.8 | 100.0 |
| 60,000 < 80,000                          | 3346.0                              | 65.9  | 15.5    | 5.3     | 3.8     | 9.5  | 100.0 |
| 80,000 < 100,000                         | 3232.0                              | 64.0  | 16.5    | 6.6     | 3.2     | 9.7  | 100.0 |
| 100,000 < 150,000                        | 5689.0                              | 57.8  | 18.6    | 8.2     | 3.3     | 12.0 | 100.0 |
| 150,000 < 200,000                        | 2870.0                              | 51.5  | 24.3    | 9.0     | 4.1     | 11.1 | 100.0 |
| 200,000 < 300,000                        | 3083.0                              | 46.3  | 26.7    | 7.4     | 6.0     | 13.6 | 100.0 |
| 300,000 < 500,000                        | 1994.0                              | 37.3  | 33.1    | 10.7    | 4.9     | 14.0 | 100.0 |
| 500,000 < 1 MILLION                      | 1233.0                              | 35.5  | 34.9    | 11.2    | 4.5     | 13.9 | 100.0 |
| 1 MILLION+                               | 740.0                               | 31.4  | 40.8    | 11.8    | 5.1     | 10.9 | 100.0 |
| ALL RETURNS                              | 22460.0                             | 53.6  | 22.7    | 8.0     | 4.1     | 11.6 | 100.0 |
| ALL RETURNS                              |                                     |   |         |         |         |      |       |
| 1 < 60,000                               | 2297.0                              | 74.8  | 10.9    | 4.0     | 3.1     | 7.3  | 100.0 |
| 60,000 < 80,000                          | 32591.0                             | 84.8  | 8.1     | 2.4     | 1.4     | 3.2  | 100.0 |
| 80,000 < 100,000                         | 25604.0                             | 85.1  | 7.9     | 2.2     | 1.1     | 3.7  | 100.0 |
| 100,000 < 150,000                        | 37995.0                             | 81.9  | 9.9     | 3.1     | 1.3     | 3.8  | 100.0 |
| 150,000 < 200,000                        | 16476.0                             | 74.2  | 14.8    | 4.2     | 2.0     | 4.9  | 100.0 |
| 200,000 < 300,000                        | 14317.0                             | 63.2  | 23.7    | 4.7     | 2.1     | 6.3  | 100.0 |
| 300,000 < 500,000                        | 8946.0                              | 50.9  | 34.6    | 5.5     | 2.5     | 6.5  | 100.0 |
| 500,000 < 1 MILLION                      | 5038.0                              | 40.8  | 44.9    | 5.5     | 2.3     | 6.5  | 100.0 |
| 1 MILLION+                               | 2619.0                              | 38.8  | 46.7    | 6.3     | 2.4     | 5.7  | 100.0 |
| ALL RETURNS                              | 145883.0                            | 76.2  | 14.5    | 3.4     | 1.6     | 4.4  | 100.0 |



purposes, to transfer liquid assets to those who will be named as heirs, the liquidity problem will be even less a matter of concern for public policy. The IRS has the ability to match estate and gift tax returns of decedents. They have done this once in the past. If the Committee would care to request the Internal Revenue Service to provide a computer tape of such matched returns with the names, street addresses and Social Security numbers removed, we would be prepared to analyze it for its implications for estate and gift tax reform.

Finally, let me pursue the matter of liquidity a bit further. With all due respect to the Administration's proposal, I suggest that it is not the liquidity of the estate that should be the controlling issue. The real burden, the only meaningful burden of a death tax is that which falls upon the living. A death tax levied against a very nonliquid estate is not a liquidity problem to an heir who is himself in a liquid position, or if he is rich so that access to the capital market is relatively easy.

We can provide a limited amount of insight into the liquidity and wealth position of the heirs by looking at the one class of human heirs, spouse, who are identified on the 706. In Table 8 we show the proportion of distributable estates which are left to spouse by sex of decedent. Married men, on average left (or the court distributed) 65 percent of their estate to their surviving spouses. Married women left about 50 percent to their spouses. We can by making a not too heroic assumption that husbands and wives share roughly equally in the ownership of assets, ask the



TABLE 8  
PROPORTION OF ESTATE DISTRIBUTED TO SPECIFIED HEIRS FOR ALL  
DECEDENTS BY MARITAL STATUS AND SIZE OF ECONOMIC ESTATE

| ECONOMIC<br>ESTATE<br>(\$THOUSANDS) | DISTRIBUTABLE<br>ESTATE<br>(\$MILLIONS) | PERCENT TO<br>SPOUSE | PERCENT TO<br>CHARITY AND<br>GOVERNMENT | PERCENT TO<br>FUNERAL AND<br>ADMINISTRATION | PERCENT TO<br>OTHER<br>HEIRS | LIFETIME<br>TRANSFERS<br>(\$MILLIONS) |
|-------------------------------------|---|----------------------|---|---|------------------------------|---------------------------------------|
| MARRIED                             |   |                      |   |   |                              |                                       |
| 0 < 60                              | 449.8                                   | 28.5                 | 1.2                                     | 4.2   | 66.1                         | 276.8                                 |
| 60 < 80                             | 1294.5                                  | 63.5                 | 0.2                                     | 4.6   | 31.6                         | 74.6                                  |
| 80 < 100                            | 1472.7                                  | 68.4                 | 0.2                                     | 4.1   | 27.3                         | 60.6                                  |
| 100 < 150                           | 3212.8                                  | 71.2                 | 0.4                                     | 3.9   | 24.5                         | 131.7                                 |
| 150 < 200                           | 1860.0                                  | 67.2                 | 0.6                                     | 4.0   | 28.2                         | 82.2                                  |
| 200 < 300                           | 2153.6                                  | 63.5                 | 0.8                                     | 4.1   | 31.5                         | 97.8                                  |
| 300 < 500                           | 2141.9                                  | 56.3                 | 1.2                                     | 4.3   | 38.3                         | 131.0                                 |
| 500 < 1,000                         | 2051.5                                  | 52.4                 | 1.6                                     | 4.5   | 41.5                         | 91.4                                  |
| 1,000+                              | 3616.9                                  | 44.4                 | 9.0                                     | 4.1   | 42.5                         | 168.5                                 |
| ALL ESTATES                         | 18253.7                                 | 58.9                 | 2.4                                     | 4.1   | 34.5                         | 1114.6                                |
| WIDOWED                             |   |                      |   |   |                              |                                       |
| 0 < 60                              | 448.4                                   | 0.0                  | 7.0                                     | 4.2   | 88.8                         | 382.4                                 |
| 60 < 80                             | 1034.9                                  | 0.0                  | 2.0                                     | 6.7   | 91.3                         | 55.6                                  |
| 80 < 100                            | 903.5                                   | 0.0                  | 2.4                                     | 6.5   | 91.0                         | 53.4                                  |
| 100 < 150                           | 1568.3                                  | 0.0                  | 3.4                                     | 6.5   | 90.1                         | 114.5                                 |
| 150 < 200                           | 977.3                                   | 0.0                  | 5.4                                     | 6.3   | 88.3                         | 65.4                                  |
| 200 < 300                           | 1227.6                                  | 0.0                  | 6.0                                     | 6.6   | 87.4                         | 89.7                                  |
| 300 < 500                           | 1167.9                                  | 0.0                  | 6.3                                     | 6.3   | 87.3                         | 70.8                                  |
| 500 < 1,000                         | 1190.8                                  | 0.0                  | 9.0                                     | 5.9   | 85.1                         | 93.5                                  |
| 1,000+                              | 2059.7                                  | 0.0                  | 25.8                                    | 6.2   | 68.0                         | 194.3                                 |
| ALL ESTATES                         | 10578.4                                 | 0.0                  | 9.1                                     | 6.3   | 84.6                         | 1119.5                                |
| SINGLE                              |   |                      |   |   |                              |                                       |
| 0 < 60                              | 86.8                                    | 0.0                  | 14.8                                    | 5.7   | 79.5                         | 67.8                                  |
| 60 < 80                             | 273.2                                   | 0.0                  | 5.3                                     | 7.3   | 87.4                         | 12.7                                  |
| 80 < 100                            | 235.5                                   | 0.0                  | 6.0                                     | 7.4   | 86.7                         | 13.5                                  |
| 100 < 150                           | 381.5                                   | 0.0                  | 6.7                                     | 7.4   | 85.9                         | 6.9                                   |
| 150 < 200                           | 273.8                                   | 0.0                  | 12.0                                    | 7.4   | 80.6                         | 12.9                                  |
| 200 < 300                           | 294.6                                   | 0.0                  | 15.9                                    | 7.3   | 76.9                         | 4.8                                   |
| 300 < 500                           | 271.5                                   | 0.0                  | 17.3                                    | 6.9   | 75.7                         | 17.9                                  |
| 500 < 1,000                         | 257.7                                   | 0.0                  | 18.8                                    | 6.9   | 74.3                         | 8.9                                   |
| 1,000+                              | 454.4                                   | 0.0                  | 36.0                                    | 6.4   | 57.5                         | 25.4                                  |
| ALL ESTATES                         | 2529.1                                  | 0.0                  | 16.0                                    | 7.0   | 76.9                         | 170.9                                 |
| SEPARATED                           |   |                      |   |   |                              |                                       |
| 0 < 60                              | 3.2                                     | 0.0                  | 0.1                                     | 6.2   | 93.7                         | 1.6                                   |
| 60 < 80                             | 1.5                                     | 0.0                  | 0.0                                     | 5.6   | 94.4                         | 0.0                                   |
| 80 < 100                            | 2.3                                     | 0.0                  | 0.3                                     | 11.4  | 88.3                         | 0.0                                   |
| 100 < 150                           | 2.4                                     | 0.0                  | 0.0                                     | 5.7   | 94.3                         | 0.0                                   |
| 150 < 200                           | 0.7                                     | 0.0                  | 0.0                                     | 9.1   | 90.9                         | 0.0                                   |
| 200 < 300                           | 2.1                                     | 0.0                  | 0.0                                     | 7.0   | 93.0                         | 0.0                                   |
| 300 < 500                           | 0.9                                     | 0.0                  | 0.4                                     | 8.6   | 91.0                         | 0.0                                   |
| 500 < 1,000                         | 3.8                                     | 0.0                  | 7.3                                     | 8.4   | 84.2                         | 0.0                                   |
| 1,000+                              | 1.1                                     | 0.0                  | 87.9                                    | 8.5   | 3.6                          | 0.0                                   |
| ALL ESTATES                         | 18.1                                    | 0.0                  | 7.0                                     | 7.7   | 85.3                         | 1.7                                   |
| DIVORCED                            |   |                      |   |   |                              |                                       |
| 0 < 60                              | 38.0                                    | 0.0                  | 8.6                                     | 6.3   | 85.1                         | 26.9                                  |
| 60 < 80                             | 83.9                                    | 0.0                  | 2.7                                     | 7.8   | 89.5                         | 3.0                                   |
| 80 < 100                            | 61.7                                    | 0.0                  | 2.6                                     | 7.5   | 89.9                         | 0.9                                   |
| 100 < 150                           | 110.1                                   | 0.0                  | 1.7                                     | 7.4   | 90.9                         | 8.1                                   |
| 150 < 200                           | 73.4                                    | 0.0                  | 8.2                                     | 8.0   | 83.8                         | 4.7                                   |
| 200 < 300                           | 85.1                                    | 0.0                  | 4.9                                     | 6.5   | 88.6                         | 2.7                                   |
| 300 < 500                           | 84.5                                    | 0.0                  | 8.3                                     | 7.2   | 84.5                         | 4.3                                   |
| 500 < 1,000                         | 97.8                                    | 0.0                  | 5.9                                     | 7.0   | 87.0                         | 6.8                                   |
| 1,000+                              | 297.2                                   | 0.0                  | 42.3                                    | 5.7   | 52.1                         | 1.5                                   |
| ALL ESTATES                         | 931.7                                   | 0.0                  | 16.9                                    | 6.7   | 76.3                         | 59.0                                  |



TABLE 8 (continued)  
PROPORTION OF ESTATE DISTRIBUTED TO SPECIFIED HEIRS FOR FEMALE  
DECEDENTS BY MARITAL STATUS AND SIZE OF ECONOMIC ESTATE

| ECONOMIC<br>ESTATE<br>(\$THOUSANDS) | DISTRIBUTABLE<br>ESTATE<br>(\$MILLIONS) | PERCENT TO<br>SPOUSE | PERCENT TO<br>CHARITY AND<br>GOVERNMENT | PERCENT TO<br>FUNERAL AND<br>ADMINISTRATION | PERCENT TO<br>OTHER<br>HEIRS | LIFETIME<br>TRANSFERS<br>(\$MILLIONS) |
|-------------------------------------|---|----------------------|---|---|------------------------------|---------------------------------------|
| <b>MARRIED</b>                      |   |                      |   |   |                              |                                       |
| 0 < 60                              | 114.9                                   | 19.9                 | 2.8                                     | 4.2   | 73.1                         | 83.2                                  |
| 60 < 80                             | 260.2                                   | 52.3                 | 0.5                                     | 4.9   | 42.3                         | 14.5                                  |
| 80 < 100                            | 256.8                                   | 58.5                 | 0.2                                     | 4.3   | 37.1                         | 6.3                                   |
| 100 < 150                           | 476.6                                   | 57.5                 | 0.8                                     | 4.1   | 37.6                         | 22.2                                  |
| 150 < 200                           | 270.4                                   | 51.0                 | 0.7                                     | 4.5   | 43.7                         | 10.7                                  |
| 200 < 300                           | 296.0                                   | 46.7                 | 1.2                                     | 4.4   | 47.6                         | 15.4                                  |
| 300 < 500                           | 283.1                                   | 39.4                 | 1.8                                     | 4.3   | 54.5                         | 32.5                                  |
| 500 < 1,000                         | 258.3                                   | 36.6                 | 2.7                                     | 4.2   | 56.6                         | 15.4                                  |
| 1,000+                              | 453.0                                   | 29.3                 | 12.0                                    | 3.7   | 55.0                         | 51.5                                  |
| ALL ESTATES                         | 2669.4                                  | 44.9                 | 3.0                                     | 4.2   | 47.8                         | 251.8                                 |
| <b>WIDOWED</b>                      |   |                      |   |   |                              |                                       |
| 0 < 60                              | 303.7                                   | 0.0                  | 4.6                                     | 4.2   | 91.2                         | 258.3                                 |
| 60 < 80                             | 684.1                                   | 0.0                  | 2.1                                     | 6.7   | 91.3                         | 34.4                                  |
| 80 < 100                            | 618.3                                   | 0.0                  | 2.3                                     | 6.5   | 91.2                         | 39.4                                  |
| 100 < 150                           | 1052.2                                  | 0.0                  | 3.2                                     | 6.5   | 90.3                         | 87.6                                  |
| 150 < 200                           | 649.6                                   | 0.0                  | 6.0                                     | 6.3   | 87.7                         | 49.5                                  |
| 200 < 300                           | 820.8                                   | 0.0                  | 6.7                                     | 6.5   | 86.8                         | 64.7                                  |
| 300 < 500                           | 810.0                                   | 0.0                  | 6.4                                     | 6.1   | 87.5                         | 50.6                                  |
| 500 < 1,000                         | 812.0                                   | 0.0                  | 9.4                                     | 5.9   | 84.7                         | 75.1                                  |
| 1,000+                              | 1381.4                                  | 0.0                  | 25.2                                    | 6.1   | 68.7                         | 154.7                                 |
| ALL ESTATES                         | 7132.0                                  | 0.0                  | 9.1                                     | 6.2   | 84.7                         | 814.3                                 |
| <b>SINGLE</b>                       |   |                      |   |   |                              |                                       |
| 0 < 60                              | 58.9                                    | 0.0                  | 19.5                                    | 5.1   | 75.4                         | 51.6                                  |
| 60 < 80                             | 139.0                                   | 0.0                  | 6.4                                     | 7.1   | 86.5                         | 10.1                                  |
| 80 < 100                            | 128.8                                   | 0.0                  | 7.7                                     | 7.1   | 85.2                         | 11.3                                  |
| 100 < 150                           | 202.4                                   | 0.0                  | 7.4                                     | 7.2   | 85.4                         | 4.6                                   |
| 150 < 200                           | 137.1                                   | 0.0                  | 14.1                                    | 7.4   | 78.5                         | 7.1                                   |
| 200 < 300                           | 148.0                                   | 0.0                  | 20.9                                    | 6.7   | 72.3                         | 3.6                                   |
| 300 < 500                           | 129.9                                   | 0.0                  | 18.1                                    | 6.9   | 75.0                         | 5.2                                   |
| 500 < 1,000                         | 127.8                                   | 0.0                  | 21.2                                    | 6.4   | 72.4                         | 6.8                                   |
| 1,000+                              | 194.9                                   | 0.0                  | 39.8                                    | 6.3   | 54.0                         | 0.6                                   |
| ALL ESTATES                         | 1266.8                                  | 0.0                  | 17.7                                    | 6.8   | 75.5                         | 100.9                                 |
| <b>SEPARATED</b>                    |   |                      |   |   |                              |                                       |
| 0 < 60                              | 2.3                                     | 0.0                  | 0.1                                     | 4.4   | 95.5                         | 1.5                                   |
| 60 < 80                             | 1.5                                     | 0.0                  | 0.0                                     | 5.6   | 94.4                         | 0.0                                   |
| 80 < 100                            | 0.0                                     | 0.0                  | 0.0                                     | 0.0   | 0.0                          | 0.0                                   |
| 100 < 150                           | 0.7                                     | 0.0                  | 0.0                                     | 6.2   | 93.8                         | 0.0                                   |
| 150 < 200                           | 0.0                                     | 0.0                  | 0.0                                     | 0.0   | 0.0                          | 0.0                                   |
| 200 < 300                           | 1.9                                     | 0.0                  | 0.0                                     | 6.2   | 93.8                         | 0.0                                   |
| 300 < 500                           | 0.7                                     | 0.0                  | 0.6                                     | 9.4   | 90.0                         | 0.0                                   |
| 500 < 1,000                         | 2.7                                     | 0.0                  | 0.0                                     | 4.4   | 95.6                         | 0.0                                   |
| 1,000+                              | 0.0                                     | 0.0                  | 0.0                                     | 0.0   | 0.0                          | 0.0                                   |
| ALL ESTATES                         | 9.7                                     | 0.0                  | 0.1                                     | 5.4   | 94.6                         | 1.5                                   |
| <b>DIVORCED</b>                     |   |                      |   |   |                              |                                       |
| 0 < 60                              | 18.5                                    | 0.0                  | 8.5                                     | 5.2   | 86.3                         | 15.9                                  |
| 60 < 80                             | 35.8                                    | 0.0                  | 2.8                                     | 7.4   | 89.8                         | 1.5                                   |
| 80 < 100                            | 32.7                                    | 0.0                  | 3.5                                     | 7.5   | 89.0                         | 0.4                                   |
| 100 < 150                           | 55.8                                    | 0.0                  | 1.5                                     | 7.5   | 91.1                         | 4.8                                   |
| 150 < 200                           | 31.8                                    | 0.0                  | 8.3                                     | 7.2   | 84.5                         | 1.7                                   |
| 200 < 300                           | 36.9                                    | 0.0                  | 9.0                                     | 5.8   | 85.2                         | 0.9                                   |
| 300 < 500                           | 38.0                                    | 0.0                  | 9.3                                     | 7.0   | 83.7                         | 0.8                                   |
| 500 < 1,000                         | 47.2                                    | 0.0                  | 7.1                                     | 6.2   | 86.7                         | 1.5                                   |
| 1,000+                              | 175.2                                   | 0.0                  | 49.2                                    | 4.4   | 46.4                         | 0.4                                   |
| ALL ESTATES                         | 471.9                                   | 0.0                  | 21.9                                    | 5.9   | 72.1                         | 27.9                                  |



TABLE 8 (continued)  
PROPORTION OF ESTATE DISTRIBUTED TO SPECIFIED HEIRS FOR MALE  
DECEDENTS BY MARITAL STATUS AND SIZE OF ECONOMIC ESTATE

| ECONOMIC<br>ESTATE<br>(\$THOUSANDS) | DISTRIBUTABLE<br>ESTATE<br>(\$MILLIONS) | PERCENT TO<br>SPOUSE | PERCENT TO<br>CHARITY AND<br>GOVERNMENT | PERCENT TO<br>FUNERAL AND<br>ADMINISTRATION | PERCENT TO<br>OTHER<br>HEIRS | LIFETIME<br>TRANSFERS<br>(\$MILLIONS) |
|-------------------------------------|---|----------------------|---|---|------------------------------|---------------------------------------|
| <b>MARRIED</b>                      |   |                      |   |   |                              |                                       |
| 0 < 60                              | 334.9                                   | 31.4                 | 0.7                                     | 4.2   | 63.7                         | 193.6                                 |
| 60 < 80                             | 1034.3                                  | 66.4                 | 0.1                                     | 4.6   | 28.9                         | 60.1                                  |
| 80 < 100                            | 1215.8                                  | 70.5                 | 0.3                                     | 4.0   | 25.2                         | 54.2                                  |
| 100 < 150                           | 2736.2                                  | 73.6                 | 0.4                                     | 3.8   | 22.2                         | 109.4                                 |
| 150 < 200                           | 1589.5                                  | 69.9                 | 0.6                                     | 3.9   | 25.5                         | 71.5                                  |
| 200 < 300                           | 1857.6                                  | 66.2                 | 0.8                                     | 4.0   | 29.0                         | 82.4                                  |
| 300 < 500                           | 1858.8                                  | 58.8                 | 1.1                                     | 4.3   | 35.8                         | 98.5                                  |
| 500 < 1,000                         | 1793.1                                  | 54.7                 | 1.4                                     | 4.5   | 39.3                         | 76.1                                  |
| 1,000+                              | 3164.0                                  | 46.6                 | 8.6                                     | 4.1   | 40.7                         | 117.0                                 |
| ALL ESTATES                         | 15584.4                                 | 61.3                 | 2.3                                     | 4.1   | 32.3                         | 862.7                                 |
| <b>WIDOWED</b>                      |   |                      |   |   |                              |                                       |
| 0 < 60                              | 144.8                                   | 0.0                  | 12.0                                    | 4.2   | 83.8                         | 124.1                                 |
| 60 < 80                             | 350.8                                   | 0.0                  | 1.8                                     | 6.7   | 91.4                         | 21.3                                  |
| 80 < 100                            | 285.2                                   | 0.0                  | 2.8                                     | 6.6   | 90.6                         | 14.0                                  |
| 100 < 150                           | 516.1                                   | 0.0                  | 3.9                                     | 6.5   | 89.6                         | 26.9                                  |
| 150 < 200                           | 327.7                                   | 0.0                  | 4.1                                     | 6.2   | 89.7                         | 15.8                                  |
| 200 < 300                           | 406.8                                   | 0.0                  | 4.6                                     | 6.7   | 88.8                         | 25.0                                  |
| 300 < 500                           | 357.9                                   | 0.0                  | 6.3                                     | 6.7   | 87.0                         | 20.3                                  |
| 500 < 1,000                         | 378.8                                   | 0.0                  | 8.1                                     | 5.9   | 86.0                         | 18.4                                  |
| 1,000+                              | 678.3                                   | 0.0                  | 27.1                                    | 6.4   | 66.5                         | 39.6                                  |
| ALL ESTATES                         | 3446.4                                  | 0.0                  | 9.3                                     | 6.4   | 84.3                         | 305.3                                 |
| <b>SINGLE</b>                       |   |                      |   |   |                              |                                       |
| 0 < 60                              | 27.9                                    | 0.0                  | 4.9                                     | 7.0   | 88.1                         | 16.2                                  |
| 60 < 80                             | 134.2                                   | 0.0                  | 4.1                                     | 7.5   | 88.4                         | 2.6                                   |
| 80 < 100                            | 106.7                                   | 0.0                  | 3.9                                     | 7.7   | 88.5                         | 2.2                                   |
| 100 < 150                           | 179.2                                   | 0.0                  | 5.9                                     | 7.7   | 86.4                         | 2.3                                   |
| 150 < 200                           | 136.7                                   | 0.0                  | 9.8                                     | 7.4   | 82.8                         | 5.8                                   |
| 200 < 300                           | 146.6                                   | 0.0                  | 10.7                                    | 7.8   | 81.5                         | 1.2                                   |
| 300 < 500                           | 141.6                                   | 0.0                  | 16.7                                    | 6.9   | 76.4                         | 12.7                                  |
| 500 < 1,000                         | 129.9                                   | 0.0                  | 16.5                                    | 7.4   | 76.1                         | 2.1                                   |
| 1,000+                              | 259.5                                   | 0.0                  | 33.2                                    | 6.5   | 60.2                         | 24.8                                  |
| ALL ESTATES                         | 1262.4                                  | 0.0                  | 14.4                                    | 7.3   | 78.3                         | 70.0                                  |
| <b>SEPARATED</b>                    |   |                      |   |   |                              |                                       |
| 0 < 60                              | 0.9                                     | 0.0                  | 0.0                                     | 10.8  | 89.2                         | 0.2                                   |
| 60 < 80                             | 0.0                                     | 0.0                  | 0.0                                     | 0.0   | 0.0                          | 0.0                                   |
| 80 < 100                            | 2.3                                     | 0.0                  | 0.3                                     | 11.4  | 88.3                         | 0.0                                   |
| 100 < 150                           | 1.7                                     | 0.0                  | 0.0                                     | 5.5   | 94.5                         | 0.0                                   |
| 150 < 200                           | 0.7                                     | 0.0                  | 0.0                                     | 9.1   | 90.9                         | 0.0                                   |
| 200 < 300                           | 0.2                                     | 0.0                  | 0.0                                     | 13.6  | 86.4                         | 0.0                                   |
| 300 < 500                           | 0.3                                     | 0.0                  | 0.0                                     | 6.9   | 93.1                         | 0.0                                   |
| 500 < 1,000                         | 1.1                                     | 0.0                  | 24.7                                    | 18.1  | 57.2                         | 0.0                                   |
| 1,000+                              | 1.1                                     | 0.0                  | 87.9                                    | 8.5   | 3.6                          | 0.0                                   |
| ALL ESTATES                         | 8.4                                     | 0.0                  | 15.1                                    | 10.4  | 74.5                         | 0.2                                   |
| <b>DIVORCED</b>                     |   |                      |   |   |                              |                                       |
| 0 < 60                              | 19.4                                    | 0.0                  | 8.6                                     | 7.4   | 84.0                         | 11.0                                  |
| 60 < 80                             | 48.1                                    | 0.0                  | 2.7                                     | 8.1   | 89.2                         | 1.5                                   |
| 80 < 100                            | 29.0                                    | 0.0                  | 1.7                                     | 7.4   | 91.0                         | 0.5                                   |
| 100 < 150                           | 54.4                                    | 0.0                  | 1.9                                     | 7.4   | 90.8                         | 3.3                                   |
| 150 < 200                           | 41.5                                    | 0.0                  | 8.1                                     | 8.5   | 83.3                         | 3.0                                   |
| 200 < 300                           | 48.2                                    | 0.0                  | 1.7                                     | 7.0   | 91.3                         | 1.8                                   |
| 300 < 500                           | 46.5                                    | 0.0                  | 7.4                                     | 7.4   | 85.2                         | 3.6                                   |
| 500 < 1,000                         | 50.6                                    | 0.0                  | 4.8                                     | 7.8   | 87.4                         | 5.3                                   |
| 1,000+                              | 122.0                                   | 0.0                  | 32.4                                    | 7.4   | 60.2                         | 1.1                                   |
| ALL ESTATES                         | 459.8                                   | 0.0                  | 11.8                                    | 7.6   | 80.7                         | 31.1                                  |



TABLE 8 (continued)  
 PROPORTION OF ESTATE DISTRIBUTED TO SPECIFIED HEIRS FOR ALL  
 DECEDENTS BY MARITAL STATUS AND SIZE OF ECONOMIC ESTATE  
 (EXCLUDING RETURNS WITH LIFETIME TRANSFERS)

| ECONOMIC<br>ESTATE<br>(\$THOUSANDS) | DISTRIBUTABLE<br>ESTATE<br>(\$MILLIONS) | PERCENT TO<br>SPOUSE | PERCENT TO<br>CHARITY AND<br>GOVERNMENT | PERCENT TO<br>FUNERAL AND<br>ADMINISTRATION | PERCENT TO<br>OTHER<br>HEIRS |
|-------------------------------------|---|----------------------|---|---|------------------------------|
| <b>MARRIED</b>                      |   |                      |   |   |                              |
| 0 < 60                              | 128.0                                   | 63.8                 | 0.0                                     | 7.4   | 28.7                         |
| 60 < 80                             | 1156.2                                  | 66.7                 | 0.2                                     | 4.8   | 28.3                         |
| 80 < 100                            | 1324.2                                  | 70.8                 | 0.2                                     | 4.2   | 24.9                         |
| 100 < 150                           | 2878.7                                  | 73.9                 | 0.2                                     | 3.9   | 22.0                         |
| 150 < 200                           | 1621.6                                  | 70.2                 | 0.5                                     | 4.1   | 25.2                         |
| 200 < 300                           | 1831.4                                  | 65.9                 | 0.7                                     | 4.2   | 29.2                         |
| 300 < 500                           | 1771.3                                  | 58.9                 | 1.0                                     | 4.4   | 35.7                         |
| 500 < 1,000                         | 1670.3                                  | 53.6                 | 1.4                                     | 4.5   | 40.5                         |
| 1,000+                              | 2787.0                                  | 46.8                 | 6.3                                     | 4.2   | 42.7                         |
| ALL ESTATES                         | 15168.7                                 | 62.7                 | 1.6                                     | 4.3   | 31.4                         |
| <b>WIDOWED</b>                      |   |                      |   |   |                              |
| 0 < 60                              | 50.1                                    | 0.0                  | 3.9                                     | 7.7   | 88.4                         |
| 60 < 80                             | 916.1                                   | 0.0                  | 1.7                                     | 6.9   | 91.4                         |
| 80 < 100                            | 786.7                                   | 0.0                  | 2.3                                     | 6.7   | 91.0                         |
| 100 < 150                           | 1343.2                                  | 0.0                  | 3.0                                     | 6.7   | 90.3                         |
| 150 < 200                           | 831.6                                   | 0.0                  | 4.9                                     | 6.5   | 88.6                         |
| 200 < 300                           | 1029.9                                  | 0.0                  | 5.6                                     | 6.8   | 87.6                         |
| 300 < 500                           | 967.3                                   | 0.0                  | 6.4                                     | 6.5   | 87.1                         |
| 500 < 1,000                         | 979.9                                   | 0.0                  | 8.4                                     | 6.1   | 85.5                         |
| 1,000+                              | 1460.5                                  | 0.0                  | 18.7                                    | 6.7   | 74.6                         |
| ALL ESTATES                         | 8365.4                                  | 0.0                  | 7.1                                     | 6.6   | 86.3                         |
| <b>SINGLE</b>                       |   |                      |   |   |                              |
| 0 < 60                              | 12.9                                    | 0.0                  | 1.8                                     | 9.7   | 88.4                         |
| 60 < 80                             | 249.1                                   | 0.0                  | 4.8                                     | 7.5   | 87.7                         |
| 80 < 100                            | 209.4                                   | 0.0                  | 5.5                                     | 7.6   | 86.9                         |
| 100 < 150                           | 351.4                                   | 0.0                  | 7.0                                     | 7.5   | 85.5                         |
| 150 < 200                           | 243.1                                   | 0.0                  | 11.4                                    | 7.5   | 81.1                         |
| 200 < 300                           | 270.7                                   | 0.0                  | 15.7                                    | 7.3   | 77.0                         |
| 300 < 500                           | 229.7                                   | 0.0                  | 16.2                                    | 7.2   | 76.6                         |
| 500 < 1,000                         | 221.0                                   | 0.0                  | 18.4                                    | 7.1   | 74.5                         |
| 1,000+                              | 362.9                                   | 0.0                  | 33.5                                    | 6.8   | 59.7                         |
| ALL ESTATES                         | 2150.2                                  | 0.0                  | 14.8                                    | 7.3   | 77.9                         |
| <b>SEPARATED</b>                    |   |                      |   |   |                              |
| 0 < 60                              | 1.3                                     | 0.0                  | 0.0                                     | 11.8  | 88.2                         |
| 60 < 80                             | 1.1                                     | 0.0                  | 0.0                                     | 7.7   | 92.3                         |
| 80 < 100                            | 1.8                                     | 0.0                  | 0.0                                     | 12.2  | 87.8                         |
| 100 < 150                           | 2.4                                     | 0.0                  | 0.0                                     | 5.7   | 94.3                         |
| 150 < 200                           | 0.7                                     | 0.0                  | 0.0                                     | 9.1   | 90.9                         |
| 200 < 300                           | 2.1                                     | 0.0                  | 0.0                                     | 7.0   | 93.0                         |
| 300 < 500                           | 0.5                                     | 0.0                  | 0.7                                     | 11.2  | 88.1                         |
| 500 < 1,000                         | 3.2                                     | 0.0                  | 8.7                                     | 9.3   | 82.0                         |
| 1,000+                              | 1.1                                     | 0.0                  | 87.9                                    | 8.5   | 3.6                          |
| ALL ESTATES                         | 14.3                                    | 0.0                  | 8.8                                     | 8.8   | 82.4                         |
| <b>DIVORCED</b>                     |   |                      |   |   |                              |
| 0 < 60                              | 10.8                                    | 0.0                  | 0.0                                     | 11.4  | 88.6                         |
| 60 < 80                             | 75.3                                    | 0.0                  | 2.9                                     | 7.9   | 89.2                         |
| 80 < 100                            | 56.5                                    | 0.0                  | 2.7                                     | 7.5   | 89.8                         |
| 100 < 150                           | 96.2                                    | 0.0                  | 1.9                                     | 7.5   | 90.6                         |
| 150 < 200                           | 60.6                                    | 0.0                  | 9.8                                     | 8.2   | 82.0                         |
| 200 < 300                           | 77.6                                    | 0.0                  | 5.1                                     | 6.6   | 88.3                         |
| 300 < 500                           | 71.5                                    | 0.0                  | 9.4                                     | 7.3   | 83.3                         |
| 500 < 1,000                         | 71.8                                    | 0.0                  | 6.8                                     | 7.5   | 85.8                         |
| 1,000+                              | 251.6                                   | 0.0                  | 44.2                                    | 5.3   | 50.5                         |
| ALL ESTATES                         | 772.0                                   | 0.0                  | 17.9                                    | 6.8   | 75.3                         |



TABLE 8 (continued)  
 PROPORTION OF ESTATE DISTRIBUTED TO SPECIFIED HEIRS FOR FEMALE  
 DECEDENTS BY MARITAL STATUS AND SIZE OF ECONOMIC ESTATE  
 (EXCLUDING RETURNS WITH LIFETIME TRANSFERS)

| ECONOMIC<br>ESTATE<br>(\$THOUSANDS) | DISTRIBUTABLE<br>ESTATE<br>(\$MILLIONS) | PERCENT TO<br>SPOUSE | PERCENT TO<br>CHARITY AND<br>GOVERNMENT | PERCENT TO<br>FUNERAL AND<br>ADMINISTRATION | PERCENT TO<br>OTHER<br>HEIRS |
|-------------------------------------|---|----------------------|---|---|------------------------------|
| <b>MARRIED</b>                      |   |                      |   |   |                              |
| 0 < 60                              | 25.9                                    | 52.1                 | 0.0                                     | 8.3   | 39.5                         |
| 60 < 80                             | 234.9                                   | 55.2                 | 0.5                                     | 5.0   | 39.3                         |
| 80 < 100                            | 239.7                                   | 60.3                 | 0.1                                     | 4.3   | 35.3                         |
| 100 < 150                           | 427.0                                   | 60.3                 | 0.7                                     | 4.2   | 34.8                         |
| 150 < 200                           | 240.1                                   | 52.8                 | 0.6                                     | 4.6   | 42.0                         |
| 200 < 300                           | 248.7                                   | 48.9                 | 1.2                                     | 4.4   | 45.5                         |
| 300 < 500                           | 222.8                                   | 41.9                 | 1.8                                     | 4.6   | 51.7                         |
| 500 < 1,000                         | 211.3                                   | 37.3                 | 2.6                                     | 4.2   | 55.8                         |
| 1,000+                              | 349.8                                   | 34.3                 | 11.1                                    | 4.0   | 50.5                         |
| ALL ESTATES                         | 2200.1                                  | 49.3                 | 2.6                                     | 4.4   | 43.6                         |
| <b>WIDOWED</b>                      |   |                      |   |   |                              |
| 0 < 60                              | 32.9                                    | 0.0                  | 5.1                                     | 7.4   | 87.5                         |
| 60 < 80                             | 606.1                                   | 0.0                  | 1.8                                     | 6.9   | 91.3                         |
| 80 < 100                            | 538.2                                   | 0.0                  | 2.3                                     | 6.7   | 91.1                         |
| 100 < 150                           | 893.4                                   | 0.0                  | 3.1                                     | 6.7   | 90.2                         |
| 150 < 200                           | 546.7                                   | 0.0                  | 5.2                                     | 6.6   | 88.2                         |
| 200 < 300                           | 686.0                                   | 0.0                  | 6.4                                     | 6.8   | 86.8                         |
| 300 < 500                           | 669.7                                   | 0.0                  | 6.4                                     | 6.3   | 87.3                         |
| 500 < 1,000                         | 652.3                                   | 0.0                  | 8.2                                     | 6.1   | 85.7                         |
| 1,000+                              | 942.1                                   | 0.0                  | 16.8                                    | 6.5   | 76.8                         |
| ALL ESTATES                         | 5567.3                                  | 0.0                  | 6.8                                     | 6.6   | 86.6                         |
| <b>SINGLE</b>                       |   |                      |   |   |                              |
| 0 < 60                              | 4.5                                     | 0.0                  | 4.4                                     | 8.9   | 86.7                         |
| 60 < 80                             | 121.6                                   | 0.0                  | 5.6                                     | 7.5   | 86.9                         |
| 80 < 100                            | 108.3                                   | 0.0                  | 7.8                                     | 7.5   | 84.7                         |
| 100 < 150                           | 186.1                                   | 0.0                  | 7.6                                     | 7.4   | 85.0                         |
| 150 < 200                           | 119.0                                   | 0.0                  | 13.8                                    | 7.5   | 78.6                         |
| 200 < 300                           | 131.0                                   | 0.0                  | 21.0                                    | 6.8   | 72.2                         |
| 300 < 500                           | 111.0                                   | 0.0                  | 19.1                                    | 7.1   | 73.8                         |
| 500 < 1,000                         | 107.4                                   | 0.0                  | 20.3                                    | 6.6   | 73.1                         |
| 1,000+                              | 172.4                                   | 0.0                  | 40.1                                    | 6.2   | 53.7                         |
| ALL ESTATES                         | 1061.4                                  | 0.0                  | 17.5                                    | 7.1   | 75.4                         |
| <b>SEPARATED</b>                    |   |                      |   |   |                              |
| 0 < 60                              | 0.8                                     | 0.0                  | 0.0                                     | 8.9   | 91.1                         |
| 60 < 80                             | 1.1                                     | 0.0                  | 0.0                                     | 7.7   | 92.3                         |
| 80 < 100                            | 0.0                                     | 0.0                  | 0.0                                     | 0.0   | 0.0                          |
| 100 < 150                           | 0.7                                     | 0.0                  | 0.0                                     | 6.2   | 93.8                         |
| 150 < 200                           | 0.0                                     | 0.0                  | 0.0                                     | 0.0   | 0.0                          |
| 200 < 300                           | 1.9                                     | 0.0                  | 0.0                                     | 6.2   | 93.8                         |
| 300 < 500                           | 0.3                                     | 0.0                  | 1.5                                     | 15.6  | 82.9                         |
| 500 < 1,000                         | 2.1                                     | 0.0                  | 0.0                                     | 4.5   | 95.5                         |
| 1,000+                              | 0.0                                     | 0.0                  | 0.0                                     | 0.0   | 0.0                          |
| ALL ESTATES                         | 6.9                                     | 0.0                  | 0.1                                     | 6.6   | 93.3                         |
| <b>DIVORCED</b>                     |   |                      |   |   |                              |
| 0 < 60                              | 4.1                                     | 0.0                  | 0.0                                     | 10.1  | 89.9                         |
| 60 < 80                             | 32.6                                    | 0.0                  | 2.8                                     | 7.6   | 89.7                         |
| 80 < 100                            | 30.2                                    | 0.0                  | 3.7                                     | 7.6   | 88.6                         |
| 100 < 150                           | 48.6                                    | 0.0                  | 1.6                                     | 7.8   | 90.6                         |
| 150 < 200                           | 26.1                                    | 0.0                  | 10.1                                    | 7.0   | 83.0                         |
| 200 < 300                           | 32.9                                    | 0.0                  | 9.6                                     | 5.6   | 84.7                         |
| 300 < 500                           | 31.4                                    | 0.0                  | 11.2                                    | 6.7   | 82.0                         |
| 500 < 1,000                         | 35.3                                    | 0.0                  | 9.4                                     | 6.3   | 84.3                         |
| 1,000+                              | 149.1                                   | 0.0                  | 51.1                                    | 3.9   | 45.0                         |
| ALL ESTATES                         | 390.2                                   | 0.0                  | 23.5                                    | 5.8   | 70.7                         |



TABLE 8 (continued)  
 PROPORTION OF ESTATE DISTRIBUTED TO SPECIFIED HEIRS FOR MALE  
 DECEDENTS BY MARITAL STATUS AND SIZE OF ECONOMIC ESTATE  
 (EXCLUDING RETURNS WITH LIFETIME TRANSFERS)

| ECONOMIC<br>ESTATE<br>(\$THOUSANDS) | DISTRIBUTABLE<br>ESTATE<br>(\$MILLIONS) | PERCENT TO<br>SPOUSE | PERCENT TO<br>CHARITY AND<br>GOVERNMENT | PERCENT TO<br>FUNERAL AND<br>ADMINISTRATION | PERCENT TO<br>OTHER<br>HEIRS |
|-------------------------------------|---|----------------------|---|---|------------------------------|
| <b>MARRIED</b>                      |   |                      |   |   |                              |
| 0 < 60                              | 102.1                                   | 66.8                 | 0.0                                     | 7.2   | 26.0                         |
| 60 < 80                             | 921.3                                   | 69.7                 | 0.1                                     | 4.7   | 25.5                         |
| 80 < 100                            | 1084.5                                  | 73.1                 | 0.2                                     | 4.1   | 22.5                         |
| 100 < 150                           | 2451.7                                  | 76.2                 | 0.1                                     | 3.9   | 19.8                         |
| 150 < 200                           | 1381.5                                  | 73.3                 | 0.5                                     | 4.0   | 22.3                         |
| 200 < 300                           | 1582.7                                  | 68.6                 | 0.6                                     | 4.1   | 26.7                         |
| 300 < 500                           | 1548.5                                  | 61.3                 | 0.9                                     | 4.4   | 33.4                         |
| 500 < 1,000                         | 1459.0                                  | 55.9                 | 1.2                                     | 4.6   | 38.3                         |
| 1,000+                              | 2437.3                                  | 48.6                 | 5.6                                     | 4.2   | 41.6                         |
| ALL ESTATES                         | 12968.7                                 | 64.9                 | 1.5                                     | 4.2   | 29.4                         |
| <b>WIDOWED</b>                      |   |                      |   |   |                              |
| 0 < 60                              | 17.2                                    | 0.0                  | 1.5                                     | 8.3   | 90.2                         |
| 60 < 80                             | 310.0                                   | 0.0                  | 1.5                                     | 7.0   | 91.5                         |
| 80 < 100                            | 248.6                                   | 0.0                  | 2.3                                     | 6.8   | 90.8                         |
| 100 < 150                           | 449.8                                   | 0.0                  | 3.0                                     | 6.7   | 90.4                         |
| 150 < 200                           | 285.0                                   | 0.0                  | 4.4                                     | 6.3   | 89.3                         |
| 200 < 300                           | 343.9                                   | 0.0                  | 4.0                                     | 6.9   | 89.2                         |
| 300 < 500                           | 297.7                                   | 0.0                  | 6.3                                     | 6.9   | 86.8                         |
| 500 < 1,000                         | 327.6                                   | 0.0                  | 8.9                                     | 6.1   | 85.0                         |
| 1,000+                              | 518.4                                   | 0.0                  | 22.1                                    | 7.2   | 70.7                         |
| ALL ESTATES                         | 2798.1                                  | 0.0                  | 7.6                                     | 6.8   | 85.6                         |
| <b>SINGLE</b>                       |   |                      |   |   |                              |
| 0 < 60                              | 8.3                                     | 0.0                  | 0.5                                     | 10.2  | 89.4                         |
| 60 < 80                             | 127.4                                   | 0.0                  | 4.0                                     | 7.6   | 88.4                         |
| 80 < 100                            | 101.1                                   | 0.0                  | 3.0                                     | 7.7   | 89.2                         |
| 100 < 150                           | 165.3                                   | 0.0                  | 6.2                                     | 7.7   | 86.1                         |
| 150 < 200                           | 124.1                                   | 0.0                  | 9.0                                     | 7.5   | 83.6                         |
| 200 < 300                           | 139.7                                   | 0.0                  | 10.7                                    | 7.8   | 81.5                         |
| 300 < 500                           | 118.7                                   | 0.0                  | 13.6                                    | 7.3   | 79.1                         |
| 500 < 1,000                         | 113.6                                   | 0.0                  | 16.6                                    | 7.5   | 75.9                         |
| 1,000+                              | 190.5                                   | 0.0                  | 27.5                                    | 7.4   | 65.1                         |
| ALL ESTATES                         | 1088.8                                  | 0.0                  | 12.1                                    | 7.6   | 80.3                         |
| <b>SEPARATED</b>                    |   |                      |   |   |                              |
| 0 < 60                              | 0.5                                     | 0.0                  | 0.0                                     | 16.5  | 83.5                         |
| 60 < 80                             | 0.0                                     | 0.0                  | 0.0                                     | 0.0   | 0.0                          |
| 80 < 100                            | 1.8                                     | 0.0                  | 0.0                                     | 12.2  | 87.8                         |
| 100 < 150                           | 1.7                                     | 0.0                  | 0.0                                     | 5.5   | 94.5                         |
| 150 < 200                           | 0.7                                     | 0.0                  | 0.0                                     | 9.1   | 90.9                         |
| 200 < 300                           | 0.2                                     | 0.0                  | 0.0                                     | 13.6  | 86.4                         |
| 300 < 500                           | 0.3                                     | 0.0                  | 0.0                                     | 6.9   | 93.1                         |
| 500 < 1,000                         | 1.1                                     | 0.0                  | 24.7                                    | 18.1  | 57.2                         |
| 1,000+                              | 1.1                                     | 0.0                  | 87.9                                    | 8.5   | 3.6                          |
| ALL ESTATES                         | 7.5                                     | 0.0                  | 16.8                                    | 10.9  | 72.3                         |
| <b>DIVORCED</b>                     |   |                      |   |   |                              |
| 0 < 60                              | 6.8                                     | 0.0                  | 0.0                                     | 12.2  | 87.8                         |
| 60 < 80                             | 42.7                                    | 0.0                  | 3.0                                     | 8.1   | 88.8                         |
| 80 < 100                            | 26.4                                    | 0.0                  | 1.6                                     | 7.3   | 91.1                         |
| 100 < 150                           | 47.6                                    | 0.0                  | 2.1                                     | 7.3   | 90.6                         |
| 150 < 200                           | 34.6                                    | 0.0                  | 9.6                                     | 9.1   | 81.4                         |
| 200 < 300                           | 44.8                                    | 0.0                  | 1.8                                     | 7.2   | 90.9                         |
| 300 < 500                           | 40.1                                    | 0.0                  | 8.1                                     | 7.7   | 84.2                         |
| 500 < 1,000                         | 36.5                                    | 0.0                  | 4.2                                     | 8.6   | 87.2                         |
| 1,000+                              | 102.4                                   | 0.0                  | 34.1                                    | 7.4   | 58.6                         |
| ALL ESTATES                         | 381.8                                   | 0.0                  | 12.2                                    | 7.8   | 80.0                         |



question, What is the liquidity burden on the spouse of a tax levied against the estate of the decedent spouse? To simulate this situation, we altered the computer file in the following way:

1. The surviving spouse of each decedent was given assets which mirrored the decedent's estate. This may understate the survivor's wealth and liquidity because debt associated with the cost of last illness is not appropriate to the survivor.
2. The surviving spouse was assigned a tax equal to the proportion the total tax represents by the proportion of the distributable estate received by the spouse.
3. Finally, the ratio of ascribed tax burden to the liquidity of the surviving spouse was calculated and is presented in Table 6.
4. The above procedure was also carried out by assigning to the spouse the rates of joint property reported on the return instead of procedure 1 above.

When these things are done, the liquidity problem, at least for death transfers among spouse, nearly disappears. (See Tables 9 and 10)



TABLE 9  
PERCENT DISTRIBUTION OF RETURNS WITH LIQUID ASSETS BY SIZE OF ECONOMIC ESTATE  
AND RATIO OF (ESTATE TAX + COSTS) TO (LIQUID ASSETS - DEBTS)  
ASSUMING FULL SHARING BETWEEN SPOUSES  
(EXCLUDING RETURNS WITH LIFETIME TRANSFERS)

| TYPE OF RETURN<br>AND<br>ECONOMIC ESTATE | NUMBER OF<br>RETURNS<br>(THOUSANDS) | RATIO OF (TAX + COSTS) TO (LIQUID ASSETS - DEBTS) |         |         |         |      |       |
|--|-------------------------------------|---|---------|---------|---------|------|-------|
|  |                                     | 0<.25   | .25<.50 | .50<.75 | .75<1.0 | 1.0+ | ALL   |
|  |                                     | percent   |         |         |         |      |       |
| NO FARM OR NONCORP<br>BUSINESS ASSETS    |                                     |   |         |         |         |      |       |
| 1 < 60,000                               | 2932.0                              | 85.0  | 7.0     | 2.8     | 0.6     | 4.6  | 100.0 |
| 60,000 < 80,000                          | 14178.0                             | 96.4  | 2.0     | 0.7     | 0.2     | 0.7  | 100.0 |
| 80,000 < 100,000                         | 12593.0                             | 97.5  | 1.1     | 0.4     | 0.1     | 0.9  | 100.0 |
| 100,000 < 150,000                        | 20189.0                             | 97.6  | 1.3     | 0.2     | 0.3     | 0.6  | 100.0 |
| 150,000 < 200,000                        | 8016.0                              | 97.5  | 1.3     | 0.3     | 0.1     | 0.7  | 100.0 |
| 200,000 < 300,000                        | 6412.0                              | 96.9  | 2.1     | 0.4     | 0.3     | 0.3  | 100.0 |
| 300,000 < 500,000                        | 4086.0                              | 96.3  | 1.8     | 0.5     | 0.3     | 1.1  | 100.0 |
| 500,000 < 1 MILLION                      | 2189.0                              | 96.4  | 2.2     | 0.6     | 0.4     | 0.3  | 100.0 |
| 1 MILLION+                               | 1109.0                              | 96.0  | 2.2     | 0.8     | 0.1     | 0.9  | 100.0 |
| ALL RETURNS                              | 71704.0                             | 96.6  | 1.8     | 0.5     | 0.2     | 0.8  | 100.0 |
| SOME FARM OR NONCORP<br>BUSINESS ASSETS  |                                     |   |         |         |         |      |       |
| 1 < 60,000                               | 416.0                               | 80.0  | 7.5     | 2.6     | 0.2     | 9.6  | 100.0 |
| 60,000 < 80,000                          | 2221.0                              | 90.0  | 4.8     | 2.1     | 0.9     | 2.1  | 100.0 |
| 80,000 < 100,000                         | 2383.0                              | 91.6  | 5.2     | 1.3     | 0.5     | 1.5  | 100.0 |
| 100,000 < 150,000                        | 4349.0                              | 90.8  | 5.0     | 1.1     | 1.1     | 2.0  | 100.0 |
| 150,000 < 200,000                        | 2192.0                              | 93.1  | 5.2     | 0.1     | 0.5     | 1.1  | 100.0 |
| 200,000 < 300,000                        | 2349.0                              | 90.1  | 5.9     | 0.7     | 0.7     | 2.6  | 100.0 |
| 300,000 < 500,000                        | 1607.0                              | 87.4  | 6.9     | 2.2     | 0.9     | 2.6  | 100.0 |
| 500,000 < 1 MILLION                      | 1016.0                              | 87.5  | 6.9     | 1.5     | 1.0     | 3.1  | 100.0 |
| 1 MILLION+                               | 623.0                               | 90.4  | 4.8     | 1.4     | 0.8     | 2.6  | 100.0 |
| ALL RETURNS                              | 17156.0                             | 90.2  | 5.5     | 1.2     | 0.8     | 2.2  | 100.0 |
| ALL RETURNS                              |                                     |   |         |         |         |      |       |
| 1 < 60,000                               | 3348.0                              | 84.3  | 7.1     | 2.8     | 0.5     | 5.2  | 100.0 |
| 60,000 < 80,000                          | 16399.0                             | 95.5  | 2.4     | 0.9     | 0.3     | 0.9  | 100.0 |
| 80,000 < 100,000                         | 14976.0                             | 96.6  | 1.7     | 0.6     | 0.2     | 1.0  | 100.0 |
| 100,000 < 150,000                        | 24538.0                             | 96.4  | 2.0     | 0.4     | 0.4     | 0.8  | 100.0 |
| 150,000 < 200,000                        | 10208.0                             | 96.6  | 2.1     | 0.3     | 0.2     | 0.8  | 100.0 |
| 200,000 < 300,000                        | 8761.0                              | 95.1  | 3.1     | 0.5     | 0.4     | 0.9  | 100.0 |
| 300,000 < 500,000                        | 5693.0                              | 93.8  | 3.2     | 1.0     | 0.5     | 1.5  | 100.0 |
| 500,000 < 1 MILLION                      | 3205.0                              | 93.6  | 3.7     | 0.9     | 0.6     | 1.2  | 100.0 |
| 1 MILLION+                               | 1732.0                              | 94.0  | 3.1     | 1.0     | 0.3     | 1.5  | 100.0 |
| ALL RETURNS                              | 88860.0                             | 95.4  | 2.5     | 0.7     | 0.3     | 1.1  | 100.0 |



**TABLE 10**  
**PERCENT DISTRIBUTION OF RETURNS WITH LIQUID ASSETS BY SIZE OF ECONOMIC ESTATE**  
**AND RATIO OF (ESTATE TAX + COSTS) TO (LIQUID ASSETS - DEBTS)**  
**ASSUMING SPOUSE HELD VALUE OF JOINTLY OWNED PROPERTY REPORTED ON 706**  
**(EXCLUDING RETURNS WITH LIFETIME TRANSFERS)**

| TYPE OF RETURN<br>AND<br>ECONOMIC ESTATE | NUMBER OF<br>RETURNS<br>(THOUSANDS) | RATIO OF (TAX + COSTS) TO (LIQUID ASSETS - DEBTS) |         |         |         |      |       |
|--|-------------------------------------|---|---------|---------|---------|------|-------|
|  |                                     | 0<.25   | .25<.50 | .50<.75 | .75<1.0 | 1.0+ | ALL   |
| NO FARM OR NONCORP<br>BUSINESS ASSETS    |                                     | percent   |         |         |         |      |       |
| 1 < 60,000                               | 993.0                               | 83.6  | 9.3     | 2.6     | 0.5     | 4.0  | 100.0 |
| 60,000 < 80,000                          | 12051.0                             | 93.3  | 3.8     | 1.1     | 0.5     | 1.4  | 100.0 |
| 80,000 < 100,000                         | 10959.0                             | 94.8  | 2.6     | 0.5     | 0.7     | 1.4  | 100.0 |
| 100,000 < 150,000                        | 17723.0                             | 95.8  | 2.3     | 0.6     | 0.2     | 1.0  | 100.0 |
| 150,000 < 200,000                        | 6848.0                              | 94.1  | 3.7     | 0.5     | 0.5     | 1.1  | 100.0 |
| 200,000 < 300,000                        | 5384.0                              | 89.4  | 6.2     | 2.2     | 0.5     | 1.7  | 100.0 |
| 300,000 < 500,000                        | 3329.0                              | 84.8  | 10.2    | 1.5     | 1.5     | 2.0  | 100.0 |
| 500,000 < 1 MILLION                      | 1748.0                              | 76.5  | 17.7    | 2.7     | 1.0     | 2.0  | 100.0 |
| 1 MILLION+                               | 894.0                               | 63.2  | 26.6    | 4.9     | 1.9     | 3.4  | 100.0 |
| ALL RETURNS                              | 59929.0                             | 92.5  | 4.5     | 1.0     | 0.5     | 1.4  | 100.0 |
| SOME FARM OR NONCORP<br>BUSINESS ASSETS  |                                     |   |         |         |         |      |       |
| 1 < 60,000                               | 182.0                               | 61.5  | 13.7    | 5.5     | 2.7     | 16.5 | 100.0 |
| 60,000 < 80,000                          | 1788.0                              | 77.2  | 10.5    | 4.3     | 1.7     | 6.3  | 100.0 |
| 80,000 < 100,000                         | 1974.0                              | 81.2  | 10.0    | 2.3     | 1.8     | 4.6  | 100.0 |
| 100,000 < 150,000                        | 3747.0                              | 78.5  | 11.8    | 3.3     | 1.6     | 4.8  | 100.0 |
| 150,000 < 200,000                        | 1826.0                              | 80.3  | 11.2    | 4.5     | 1.3     | 2.6  | 100.0 |
| 200,000 < 300,000                        | 1958.0                              | 75.7  | 11.6    | 4.9     | 1.9     | 5.9  | 100.0 |
| 300,000 < 500,000                        | 1319.0                              | 61.6  | 19.5    | 6.6     | 3.0     | 9.3  | 100.0 |
| 500,000 < 1 MILLION                      | 809.0                               | 53.0  | 26.2    | 7.9     | 3.2     | 9.6  | 100.0 |
| 1 MILLION+                               | 485.0                               | 39.8  | 33.6    | 9.9     | 5.2     | 11.5 | 100.0 |
| ALL RETURNS                              | 14088.0                             | 74.0  | 13.6    | 4.5     | 2.0     | 5.9  | 100.0 |
| ALL RETURNS                              |                                     |   |         |         |         |      |       |
| 1 < 60,000                               | 1175.0                              | 80.2  | 10.0    | 3.1     | 0.9     | 6.0  | 100.0 |
| 60,000 < 80,000                          | 13839.0                             | 91.2  | 4.7     | 1.5     | 0.6     | 2.0  | 100.0 |
| 80,000 < 100,000                         | 12933.0                             | 92.7  | 3.8     | 0.8     | 0.9     | 1.9  | 100.0 |
| 100,000 < 150,000                        | 21470.0                             | 92.8  | 4.0     | 1.1     | 0.5     | 1.7  | 100.0 |
| 150,000 < 200,000                        | 8674.0                              | 91.2  | 5.3     | 1.4     | 0.7     | 1.5  | 100.0 |
| 200,000 < 300,000                        | 7342.0                              | 85.8  | 7.6     | 2.9     | 0.9     | 2.8  | 100.0 |
| 300,000 < 500,000                        | 4648.0                              | 78.2  | 12.8    | 2.9     | 1.9     | 4.1  | 100.0 |
| 500,000 < 1 MILLION                      | 2557.0                              | 69.1  | 20.4    | 4.4     | 1.7     | 4.4  | 100.0 |
| 1 MILLION+                               | 1379.0                              | 55.0  | 29.1    | 6.7     | 3.0     | 6.2  | 100.0 |
| ALL RETURNS                              | 74017.0                             | 89.0  | 6.3     | 1.7     | 0.8     | 2.3  | 100.0 |



We are not now in a position to provide the Committee with an insight regarding the liquidity problem faced by heirs other than the surviving spouse. Again, however, the data necessary to do this can be produced by the IRS. What is needed is a match of estate tax returns with the income tax returns of the heirs. Such a plan, I understand is in the offing, but it will not be implemented until 1980 or later. I once again offer to the Committee a willingness to analyze data from such a matched set of returns with all identifiers removed should the Committee wish to request the Treasury to provide the tapes. A relatively small sample of returns, if it were well designed, would suffice.

Finally, let me urge upon the Committee that it give serious consideration to undertaking a study of the inheritance tax as an alternative to our present system of death taxes. The functions of the estate tax would be better served and equity would be more easily achieved if heirs were taxed on the basis of their existing wealth plus the value of their inheritance. The tax rate schedules could be structured so that the point where one entered it was dependent upon his existing wealth. There are many problems which one would need to address, but I suggest that the Committee undertake such work so that the next time that estate tax reform is considered, an adequate body of data will be available to it.



STATEMENT by EDWARD C. HALBACH, JR.

before

THE HOUSE COMMITTEE ON WAYS AND MEANS  
Tuesday, March 23, 1976

ON THE SUBJECT OF ESTATE AND GIFT TAX REFORM

Most of the currently important ideas for revision of the estate and gift taxes have been before this Committee for a number of years. The major problems under the present law and the pros and cons of major proposals have been discussed and debated at length, with divergent viewpoints and varied perspectives quite well represented in the available literature. I shall therefore try in this statement to go over old territory as little as possible in presenting my observations.

I am greatly concerned that current proposals, particularly for an increased exemption and an enlarged marital deduction, may be adopted without regard to more general issues that need to be addressed in this field.\* Also I hope these proposals do not reflect a broadly shared inclination to de-emphasize the role of transfer taxes in our overall tax structure. Otherwise, I would not be troubled generally over appropriate measures to expand exemptions for inter-spousal transfers or for the purpose of lessening the number of modest estates affected by these taxes. In fact, I think that both exemptions and procedures should be so designed as to avoid "contact" with estates that are not important to revenue raising and other objectives of taxes on wealth transmission. (The revenue consequences of such steps can be confined by simply eliminating bottom brackets and beginning the tax at higher rates on estates in excess of the specific exemption.) Enacted in isolation, however, such measures would not only seriously detract from the importance of the transfer taxes but may prematurely diminish interest in more general and fundamental revisions. At least the resulting revenue losses would tend to deter modifications involving possible revenue loss.

In short, I believe consideration of the objectives underlying these recent proposals should take place in the context of serious deliberations about broader reform, or at least be deferred until a decision is reached one way or another on the merits of proposals that have been more or less a part of this Committee's agenda since 1969.

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\*I am concerned as well over suggestions of preferential treatment of small businesses and family farms if this might take the form of lower tax liability. This concern does not necessarily extend to realistic special valuation rules for land committed to special uses, and it certainly does not extend to the adoption of more liberal rules for paying taxes in installments, especially softening executor liability features.



A Unified Transfer Tax. I personally hope the Committee will carefully consider or obtain further study of an accessions tax (discussed below) before taking definitive action in this field. Serious attention must be given, however, to the type of less fundamental revision represented not only by the 1969 Treasury Studies but also by the analogous recommendations of the American Law Institute (1969) and the American Bankers Association (1972). Central to all of these proposals is the replacement of the present dual system of separate estate and gift taxes with a unified transfer tax. For a variety of reasons, unification is essential to an efficient, equitable system of taxing succession and gifts. The now familiar arguments range from the revenue loss under the present dual system and its disparate treatment of taxpayers who are similarly situated, to the opportunities offered by a single integrated system to minimize the whole area of line drawing between -- and litigation concerning -- transfers that are "complete" during life and those that "take effect" at death. In addition to the intrinsic merits of a unified tax, such a system provides a better background against which to handle an enlarged or total exemption of transfers between spouses, about which I will have some specific comments and suggestions later.

Dependent Children. Before turning to marital deduction questions, I wish to urge that some special provisions be made either to defer taxation or to grant a limited exemption for transfers to or for certain dependent children of a decedent, as in the orphans deduction (\$3,000 per year under age 21) suggested in the 1969 Treasury Studies. The reasons for something of this sort are self-evident and the costs negligible. In choosing the basic approach to be taken, the conceptual appeal and flexibility of deferral (in determining the amount of the taxable transfer as well as in payment of the tax) must be weighed against the simplicity of an ascertainable-amount deduction. Whether and in what terms a deduction or deferral privilege should apply to the estate of a decedent who leaves a surviving spouse depends on the extent to which interspousal gifts are exempted.

Interspousal Transfers: Exemption. Despite earlier reservations about a 100% marital deduction, I have come to believe that the complete exemption of interspousal transfers -- essentially as recommended by the 1969 Treasury Studies -- is highly desirable and to be preferred either to the present 50% deduction or even to the inviting variations employing a specific dollar amount. No other approach solves as well the troublesome problems concerning interspousal transfers. Even concern over a temporary revenue loss can and should be put aside. This minor loss is a small price to pay for long-range improvement of our transfer tax system.

Assuming integration of the transfer taxes, the temporary revenue loss should be modest, almost compensated for by the gains on the unification itself, and soon recouped anyway. The advantages of deferral of a donative transfer tax (unlike an income tax) have generally been exaggerated, and this will be particularly true under a unified system. The advantages and disadvantages of deferral until the death of the second spouse must be considered realistically by policy makers and cautiously by estate planners. There is an obvious disadvantage of deferral (i.e., of marital deduction) beyond the amount that will



bring about equalization of the spouses' estates (which, of course, is already allowed): that is, the disadvantage of subjecting the excess transfers (exempted at the first death) eventually to a higher rate of tax under the progressive rate structure. The usually stated advantages to the taxpayer of deferral via marital deduction are as follows: (1) property that would have been needed to pay the amount of tax that is postponed is preserved and produces income until the survivor's death (but this "benefit" is wiped out later because the tax is then based on an estate that is directly or indirectly enlarged not only by that "extra" income but by the earnings and capital appreciation on all of the initially untaxed property); (2) the deferral period allows an opportunity to deplete the survivor's estate through gifts (but unification of the taxes will remove the savings that now result under the dual system, except those flowing from the annual exclusion); and (3) the deferral allows a period for consumption of the survivor's estate (but, unless this reduces the estate below the size of the first so that lower rates apply, there will be a net benefit only if and to the extent actual consumption increases because the spouse owns the property outright rather than receiving its benefits in trust; thus, such advantages are pretty well confined to modest estates). Deferral here, then, is not like an interest-free loan as it is in the income tax; the government, in effect, gets its tax-share of the property by a proportionate sharing in the property's fruits until the tax is finally collected. This larger tax base at the later time compensates fully for the deferral, and may even overcompensate due to rate progression. Thus, it will rarely be desirable under a graduated, unified transfer tax (whether in the form of an accessions tax or in the traditional form of a tax focusing on the donor or estate) for property owners to plan for more than the estate splitting allowed by present law.

Among the most troublesome practical problems of the gift tax is that which arises when the independent property of one spouse is treated as "ours" or is converted to jointly owned (especially joint tenancy or community) property. The problem results from the marital deduction being limited to 50% of the property given inter vivos. Of course, the 100% marital deduction would resolve this problem. If a complete interspousal exemption is not adopted other steps should be taken to remove the often difficult, harsh problems of unintended gifts and unrecognized, sporadically enforced tax liabilities resulting from quite natural and generally tax-neutral behavior. (The present so-called 50% marital deduction at death is really an exemption of 100% for all transfers up to a maximum of 50% of the entire adjusted gross estate, whereas the gift tax deduction is more limited, being allowed for only 50 % of the property actually given, regardless of how small that amount may be in relation to a donor's total property holdings; therefore the goal of a change would be to permit a full deduction, possibly within some overall limit, for interspousal gifts during life comparable to the deduction allowed at death.) Certainly a large, flat marital deduction allowance (ranging from \$100,000 in some proposals to \$250,000 in others) would moot most of these problems. A more complete solution, absent a 100% deduction, may require some innovation. A number of possibilities can be imagined and should be examined. One method, for example, might be to extend the present nonrecognition-of-gift rule for joint tenancy and tenancy by the entirety land (IRC §2515) to other forms of co-ownership by husband and wife, and to personalty as well as realty, so long as the ownership form allows neither spouse alone to withdraw or take more than his own share of the property.



(The results of this rule must then be appropriately reflected and sorted out in whatever marital deduction rule is retained or adopted for transfers at death. Such a proposal is discussed in an unpublished report of the Committee on Estate and Gift Tax Changes of the ABA Section of Real Property, Probate and Trust Law.)

Interspousal Transfers: The Non-Marital Share and the Unfortunate Need for Tax-Avoidance Trusts. The reverse side of the marital deduction or interspousal exemption coin is the handling of transfers to or for the spouse that exceed the allowable deduction or for which an allowable deduction or exemption is not taken -- that is, transfers of property already subjected to tax in the first spouse's estate. Here, my concern is the effect the tax law has in pressuring the property owner to use the trust to provide for his spouse in order to avoid a second tax on the non-marital deduction share. It is an ironically inverted variant of the generation-skipping problem; but here, to avoid a double tax in a single generation, a tax-bypass trust is practically required by present law. The limited (10-year) and declining (20% every 2 years) credit for property previously taxed is not an adequate safeguard against double taxation. (Incidentally, thought should be given to whether the present property-previously-taxed credit under IRC §2013 is justified at all as applied to estates of transferees who are of "lower" generations than the decedent. I believe it is not.)

Trusts should be used or not for tax-neutral reasons. The pressure under the present Code to use the trust for tax reasons can and should be eliminated. In the case of non-marital deduction bequests to a spouse, for any property taxed in the first spouse's estate and received in normally "taxable" form by the survivor in excess of the allowable marital deduction (or over the amount of the elected deduction in the case of a new 100% marital deduction), the survivor's estate can (1) be allowed a deduction for the value of such inheritance valued as of the first decedent's death, or (2) if elected by the survivor at the time of the inheritance (i.e., not on the basis of hindsight), be allowed alternatively to exclude such property from the later estate with a tracing burden imposed upon the taxpayer. (On the latter as the sole method in analogous situations under a 100% marital-deduction rule, see 1969 Treasury Studies at 379.)

Interspousal Transfers: The Terminable Interest Rule. The 1969 Treasury Studies and others have recognized that the present terminable interest rule is largely unnecessary. Because it is complex, treacherous and often unduly harsh, it should be changed. There is no reason to further the demand for sophisticated counsel or to create excessive risks for non-specialists and their clients, whether in the context of a 50% or 100% marital-deduction rule. (At present, just to note one set of examples, many general powers of appointment cause inclusion in a survivor's gross estate under §2041 but yet will not qualify a trust for the marital deduction in the first spouse's estate under §2056.) Where a survivor receives only a life interest or certain other limited interests in property, the deduction should be allowed for that property in the first estate if the survivor consents to later taxation to him or to his estate when his interest ends, with the increased tax (at the estate's marginal rather than average rates) to be borne entirely from the property involved. A similar provision was suggested in the 1969 Treasury Studies. In short, the present terminable interest rule, with all of its complexities for the IRS and taxpayers alike, need not be continued.



A combination of such a simple new rule to replace the present terminable interest rule and a rule (as mentioned above) to eliminate the need for tax-avoidance trusts in non-marital deduction provisions would result in a tax law far less intrusive into private decisions and planning than the present law. Absent tax policy considerations to the contrary, an ideal state of affairs would allow a property owner to provide for a spouse as he sees fit, without tax consequences either influencing or depending on his specific decision. I believe this type of neutrality is largely achievable throughout the interspousal transfer area.

Generation Skipping. Much has been spoken and written in recent years about the problem of generation skipping. While I do not wish here to repeat what is contained in the rather full debates on that subject, I do wish to say that I believe it is necessary and possible for any attack that is to be made on generation skipping transfers to avoid unnecessary complexity, the need or opportunity for avoidance by sophisticated planning and the danger of fortuitously but dramatically different treatment of taxpayers who are similarly situated.

Having examined the various proposals in the area, I am satisfied that the most satisfactory solution lies in the use of a proper form of an accessions tax. I believe that, more than any other, this approach will enable whatever generation-skipping policy is settled upon to be effectively implemented. That is, I think it creates a capacity to make such policy workable.

The Accessions Tax. I am among those who have become convinced that the accessions tax approach could produce a distinctly better transfer tax than can be produced through any modification of the present system or any version of a unified transfer tax focusing on transferors rather than transferees. Most of the arguments that have regularly been made for such a tax and some that have not seem to me to make a strong case. Most of the arguments on the merits against such a tax seem to be of dubious validity, to relate to earlier accessions-tax schemes or at least to have less force than has generally been believed. The strengths of the accessions tax are both in basic concept and in technical detail -- i.e., in its ability to cope with problems that have tended to plague other systems. Because I believe the accessions tax can offer an array of those disadvantages summarily referred to as simplicity, efficiency, neutrality and equity, I hope it is not a tax "whose time has not yet come". I therefore hope it will receive full consideration before the burdensome and costly (probably once-in-a-lifetime) process is undertaken of introducing, implementing and working out in experience the inevitable adjustments to a new system, which ought to be the best system presently foreseeable for the long run.

The essence of the accessions tax is that the tax is to be collected from and determined on the basis of the circumstances of recipients rather than donors and estates. It differs from an inheritance tax in various details and particularly in that it would be based on the cumulative accessions from all sources over the lifetime of each recipient and would be graduated accordingly. In addition, an effective form of the tax generally taxes funds or assets as they reach the recipient, not when those beneficiaries' interests are created in some future-interest or uncertain form. I will not attempt here to discuss



further the structure and specifics of such a tax but would like to focus on its problems and advantages. Fortunately, however, the superb work of Professor William B. Andrews already provides for anyone interested a full discussion and a carefully worked out version of the appropriate type of model for such a tax. See American Law Institute Federal Estate & Gift Tax Project (1969); Andrews, "The Accessions Tax Proposal," 22 TAX L. REV. 589 (1969).

The basic, traditional (but hardly trivial) argument for the accessions tax is one of fairness and equity -- its preferable allocation of burdens among those who in a realistic sense bear the tax. Even its critics or doubters tend to concede this. Under present systems and others oriented toward transferors (i.e., donors and estates), the tax on any given amount of receipts is greater for a recipient who takes from a single transferor than it is for one who receives property from several. Also, one who inherits a particular amount as one of several successors to an estate is taxed more heavily than a recipient of the very same amount would be as the sole beneficiary of an estate. Under an accessions tax persons whose total accessions are similar will be taxed similarly. This is so regardless of differences either in the number of sources or in the number of persons with whom estates are shared.

Similarly important but more technical are the distinct advantages an accessions tax has in eliminating or coping with the persistent, unresolved problems inherent in taxes imposed on donors and estates. Ironically, some critics (no doubt assuming a form of accessions tax that is more like an inheritance tax) assert that this tax has the traditional problems of an estate tax plus those of inheritance taxes. On the contrary, a proper accessions tax will cope cleanly with some of these problems and tend to build others out of the system rather than, as taxes on transferors do, to build them in and then attempt to cope with them in ways that complicate the system and its administration.

In one instance in which an existing problem is eased, a counterpart problem arises but is not as difficult to handle. Estate and gift splitting or shifting between married donors is for nearly all purposes no longer a problem (for the tax depends on the recipient's total accessions and not the number or size of the estates he takes from). The resulting neutrality lessens one broad area of possible inequity among taxpayers and of major burdens in planning for a "split" on one side and in enforcement on the other. There is, however, an inverted counterpart in the form of what might be called interspousal "accession splitting" through planning that would divide the normal inheritance of a particular recipient between himself and his spouse. This problem is readily handled, however, by aggregating such split accessions in the spouse who is related to the transferor. Fairly simple provisions will also cover the problem of further accessions after the death of one of the married recipients.

In most normal dispositive patterns, accession "splitting" among other recipients is both proper and contemplated by the rate structure. It is, in fact, the very object of an accessions tax system and is directly related to



its equitable allocation of burdens. Furthermore, even the abnormal, consciously planned dispersion of estates among numerous recipients in several generations is largely counteracted by cumulation, which catches up over a lifetime, and by differential rates to handle the generation-skipping element that is present. (See second paragraph below.) Planned dispersion and an associated element of deferral, however, are probably the greatest real problem of the accessions tax. Nevertheless, the extent of this problem can be and has been exaggerated, for as the descendants multiply when generations are jumped (instead of two children, e.g., there are likely to be four grandchildren) so do the number of ancestors from whom accessions are received and cumulated over life (e.g., each such grandchild has four grandparents instead of two parents).

Other problems, however, virtually disappear. This is true of difficulties relating to the qualification and valuation of both marital and charitable deduction transfers. This is also true of the problem of line drawing between transfers during life and those effective at death. (Although unification in the form of a tax on transferors will go a long ways toward removing this irritant, questions of "completeness" -- i.e., when to tax -- and of how to handle uncertain reversionary interests remain; even these are eliminated under the accessions approach.)

In addition, the serious problem of generation skipping, and especially the complexities of dealing with the multi-beneficiary discretionary trust, are difficult to deal with under any tax levied on donors and estates. On the other hand, once policy objectives are decided upon, the matter of effectuating these policies is strikingly simplified by a proper form of accessions tax. It will afford an efficient, clean handling of these matters in a way which is natural to the system and which both protects revenues and is fair to the beneficiaries. It thus becomes uninviting and unnecessary for planners to attempt to exploit the system. (The essence of the solution is found in the fact that (a) the system does not require immediate identification of the recipients and interests to be taxed and (b) the problem of tax deferral is compensated for by including in the eventual tax base income and appreciation of the deferral period -- values that would not have been included in the initial amount of the accession had there been no deferral. Because of progressive rates, this enlargement of the tax base may even result in a modest "penalty" for deferral, and the 1969 ALI study also proposed something akin to a withholding tax -- the "extra estate tax" -- to be credited against the later taxes on trust distributions. This suggestion may involve overcompensation\*.) The problem of generation skipping itself is expressly dealt with through the rate structure in the ALI model but is otherwise handled naturally and without elaborate special provisions. This is because it is the very nature and approach of this accessions tax that, basically, it is imposed on actual receipts and distributions as and when they reach the recipient. Thus, it does not have to handle future and contingent interests that are hard to value in the form in which they are originally created by a transferor.

In addition to a certain amount of "magic" in solving or eliminating tax problems, the accessions tax has important potential for facilitating other improvements in the legal system, especially in the wealth transmission process.

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\*This is especially so in light of the rather harsh treatment of accumulation distributions in the almost certain-to-be-enacted new throwback rule (§677(e)) of §701(a) of H.R. 10612 (no refunds).



This tax will require different procedures and mechanisms for its administration, analogous to or even partially integrated with the income tax. Ironically, this has been a source of concern to some commentators, probably attributable to a natural tendency to confuse novelty with complexity. (Even from the viewpoint of public enforcement and taxpayer compliance, this change may have advantages to the tax system -- e.g., procedural convenience and the benefit of having transfers reported by recipients rather than by executors who may have to deal with prior acts and information that was known only to the decedent.) By the very nature of the accessions tax (in this respect, like the income tax), the responsibility centers on the recipient. This could significantly facilitate development of new and simplified succession procedures under state law. In fact, I am satisfied systems can be developed involving not simplified estate administration but succession without administration, patterned after Civil Law systems in Europe. (See Halbach, "Reducing the Need and Cost of Legal Services Through Simplification of the Legal System", ch. 11 in LAW AND THE AMERICAN FUTURE (American Assembly, Schwartz ed. 1975).) A principal obstacle to such probate reform now is the need to cope with the estate tax format of the federal law. (Thus, Continental systems rely on inheritance taxes, which in this respect are much like the accessions tax.) I realize it is not the role of this Committee to concern itself directly with probate reform, but I think such related considerations are properly relevant to the making of tax policy. After all, probate costs often exceed tax levies even in quite substantial estates. Such costs not only erode the tax base but in fact compete with taxes in terms of the overall financial burdens borne by estates as they pass from generation to generation.

For the reasons I have mentioned, steps should be taken to unify our transfer taxes and I believe the most promising approach can be found in the accessions tax. The opportunity for fundamental tax reform comes only rarely, for the burdens of starting anew are considerable. They should therefore be made worthwhile by the end result. That being so, it seems to me important at least to give serious consideration to the accessions tax in deciding whether to enact major revisions in forms that might prove less satisfactory in the long run.



Oral Statement  
by  
Gerald R. Jantscher\*  
before the  
House Committee on Ways and Means  
March 23, 1976

Mr. Chairman and members of the committee:

I am pleased to appear here today and take part in a panel discussion of estate and gift tax reform. The topics for the panel are unification of the estate and gift taxes, the proper treatment of generation skipping transfers, and the taxation of transfers between husbands and wives. I have something to say about all three topics, but with your permission I would like to concentrate on unification and generation skipping, since I feel that I have more to say about them than about the taxation of interspousal transfers.

I. Unification.

Proposals to unify the federal estate and gift taxes have been made recurrently for at least three decades. The subject has been studied and restudied; draft legislation has even been prepared to make the two taxes one. Nearly every major group that has spoken on the subject since the Second World War has favored unification. Practically all analyses of the shortcomings of the current estate and gift tax structure begin with the fact that the taxes are not unified.

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Unification is not a novel idea. Quite apart from the numerous studies that have been made supporting unification, examples of a unified transfer tax structure can be found in the tax systems of other nations. There are many countries that have unified their taxes on gifts and bequests, either wholly or partially.

Unification would put an end to the favorable tax treatment accorded to gifts. Under the present regime of separate gift and estate taxes, men of wealth are able to reduce their taxes substantially by giving property away during their lives instead of passing it through their estates. No matter that the property is given to the same persons who would have received it anyway--the fact that it is given rather than bequeathed means a very sizable reduction in taxes.

Let me offer a few examples to show how large these tax savings can be:

- . A millionaire can divide a gift of \$100,000 among his three children at a cost in gift taxes of just \$915. If he had kept the property and bequeathed it to them instead, the estate tax cost would have been \$16,000.
- . A husband and wife who own \$5 million can pass the property on to their children by a combination of gifts and bequests at a total tax cost of a little more than \$1 million. If they cannot or will not make gifts, however, and must pass all the property through their estates, the tax cost will be nearly \$2 million.

Both of these are hypothetical examples, not actual ones. We know from studies that few persons make as much use of gifts as tax considerations alone would dictate they should. But this fact only emphasizes the unfairness of the present tax structure. Some persons make large gifts and obtain



sizable tax savings. Others who are either poorly counseled or fearful of parting with much of their wealth and risking later dependency upon their children or who are concerned about making their children wealthy too soon must forgo those tax savings.

The 1974 hearings on the nomination of Nelson Rockefeller to be Vice President of the United States afforded the public an uncommon opportunity to examine the finances of one very wealthy man. Mr Rockefeller disclosed that between 1964 and 1973 he and Mrs. Rockefeller paid nearly \$4 million in federal gift taxes. It is possible to calculate that by 1973 he must therefore have made noncharitable gifts of at least \$10 million-- and this is a minimum figure; he may have given away much more. If instead he had kept \$14 million of gifts and gift tax and passed them on through his estate, the tax on the total would have been \$10-3/4 million. The difference between an estate tax of \$10-3/4 million and a gift tax of \$4 million is what unification is all about.

It is difficult to think of arguments in favor of keeping the estate and gift taxes separate. A unified transfer tax structure would not be a radical departure from present law. The federal gift tax is now a cumulative, lifetime tax, and unification would add to it only the feature that dispositions at death would be treated as the decedent's final gifts. I think that few practitioners would find the change puzzling.

Some opponents of unification believe that the tax laws should encourage lifetime giving and that therefore the current system of separate estate and gift taxes, which provides such generous savings for gifts, should be retained. I have never been persuaded that society at large benefits when wealthy parents advance the date when their children accede to wealth, particularly when, as is so often the case, the gift is made in trust. In



my opinion the tax laws ought to be neutral between transfers during life and transfers at death and should neither encourage one nor discourage the other.

But if Congress believes that gifts ought to be encouraged, you can devise more sensible incentives within the framework of a unified tax system than are provided now by the dual tax structure. The present incentives can only be called irrational. The largest incentives are reserved for the persons with the greatest wealth--precisely the ones who are most able and willing to make gifts anyway. I mentioned the example of a millionaire who divides a gift of \$100,000 among his three children and now saves more than \$15,000 in taxes. If a man who owns just a quarter-million dollars of wealth were able to make such a gift, his tax savings would only amount to \$9,000. But if a man with \$10 million makes the same gift, his tax savings are more than \$30,000.

The proper way of giving a neutral tax incentive for gifts within a unified tax structure is to offer a rate discount on lifetime transfers. Let the rate of tax on gifts up to some modest limit be one-half or two-thirds or three-quarters of the corresponding tax rate on bequests--but require the gifts plus gift tax to be included without exception in the cumulation base. In this manner all donors, regardless of their wealth, would be offered the same tax savings for making the same total of gifts. And put a limit on the amount of gifts that could qualify for the discount. Restrict the discount to, say, the first \$500,000 of gifts. Then it would be impossible for anyone to save millions of dollars, as some donors now do, by giving away wealth during his life.

I have a few remarks to make on the subject of "grossing up:" the practice of including a tax on lifetime gifts in the base of the tax. Even



some supporters of unification allege that grossing up the tax on gifts would be an unnecessary refinement and can safely be omitted. I want to emphasize in the strongest way I know how the importance of grossing up the tax on gifts in a unified system. If the tax is not grossed up, persons who make gifts will continue to be rewarded with very sizable tax savings. Consider a widow who owns \$5 million. Under a fully unified system with the current estate tax rates, taxes of a little more than \$2,430,000 would have to be paid when the property passed to her children, regardless of how she divided her transfers between gifts and bequests. But if the tax on gifts were not grossed up and she made net gifts to her children of \$2 million, her taxes would be reduced by more than \$375,000. The savings she can achieve today by making the same gifts total around \$930,000; so in this example a unified system that did not require grossing up would go only a little more than half-way toward eliminating the rewards that are now given to those who make gifts.

## II. Generation Skipping.

The question of what to do about generation skipping transfers is an exceptionally thorny one. Not only is one confronted by a severe technical problem of designing effective legislation, one must also squarely face some hard choices requiring a reconsideration of the very purpose of a tax on transfers.

I assume that the primary reason why we impose estate and gift taxes in the last quarter of the twentieth century is to diminish concentrations of inherited wealth. Never mind that the taxes are not as well designed for this purpose as some possible substitutes--notably the accessions tax. They serve well enough, and would serve better if some



substantial but not fundamental changes were made.

I do not believe that the estate and gift taxes are adequate substitutes for a periodic tax on capital--a wealth tax. Their coverage is far too limited. They never reach property that is accumulated and consumed in the course of one person's lifetime. Accordingly, I do not believe that the effectiveness of the taxes ought to be appraised by measuring them against a hypothetical tax that would reach property exactly once every generation. I am unpersuaded that the taxes should be modified to provide for a surtax on transfers to grandchildren or more remote descendants.

In fact, I would find it easier to argue for rate discrimination in favor of grandchildren than for discrimination against them. Normally a man needs no urging to leave property to his wife and children. It is his grandchildren and more distant relations whom he is apt to overlook. If the purpose of the death tax is to promote a wider distribution of wealth, its effectiveness might be enhanced by imposing lower rates of tax on property passing to more distant kin.

I do not favor such rate discrimination in the federal estate and gift taxes. The taxes are ill suited for the purpose of promoting gifts and bequests to specific recipients, since they are graduated according to the circumstances of the donor instead of those of the donee.

The term "generation skipping" is normally used to describe certain dispositions in trust that remove property from the estate tax base for at least one generation. The most prominent example of these is a trust that gives the settlor's children income interests for life, with remainder to grandchildren. Often the children are given limited powers to make withdrawals from principal, as well as powers to decide who should enjoy the property after them. Despite the fact that the property has been put at



their service for all of their lives, no estate tax is charged on it when the children die.

As a result, one would expect wealthy persons to leave much of their property to their children in trust rather than outright, in order to save the tax that would otherwise be imposed on its next transfer. Many do so. The Rockefeller nomination hearings that I referred to before provide an ideal illustration. In 1934 and 1952 Mr. John D. Rockefeller, Jr. created trusts of the kind I have just described for the benefit of his children and grandchildren. The value of the two trusts of which Vice President Rockefeller is the life beneficiary was \$116.5 million in August 1974--substantially more than the value of all the property that he owns outright. The property that he owns outright will be included in full in his gross estate for estate tax purposes; but no part of the trusts will be.

I might add that although we know very little about the holdings of other members of the Rockefeller family, we do know that the value of the assets in all the trusts that Mr. John D., Jr. created for his descendants in 1934 and 1952 totaled nearly three-quarters of a billion dollars a year and a half ago. If they were all generation skipping trusts, as seems likely, it is a safe bet that most of the property they contain will not be subject to gift and estate taxes again until some time in the 21st century.

Like the tax advantages of making gifts, the tax savings that can be obtained by creating long-lived trusts are not available to everyone. Many persons--even some who are quite wealthy--are unable to place large amounts of property in trust. To keep the property out of the life beneficiary's estate, the powers that he or she may be given must be limited. Many families feel that the restrictions that are required are too high



a price to pay for the tax savings that such trusts promise. In practice generation skipping trusts can only be established by persons of substantial wealth.

The job of devising legislation to bring generation skipping trusts within the reach of the estate tax is not a simple one. A number of attempts have been made, both in this country and abroad, but on the whole they have not been very satisfactory. The fundamental problem is that the trust is a very flexible instrument and that the interests given to beneficiaries can be very large--nearly the equivalent of full ownership of the property--or very small. Any attempt to tailor the tax to reflect the extent of the beneficiary's interest is apt to require some highly complicated legislative language. Nevertheless, I believe it can be done and I encourage this committee to do it. This is no place to go into details, but I would like to offer a few suggestions here.

First, I believe you can deal generously with trusts that are due to fall in to the creator's spouse or children. These are not generation skipping trusts as the term is normally used. By exempting them from an additional tax, you will spare most of the trusts that are created in the United States and confine the tax to only a minority.

Second, after you have exempted trusts in the previous category, you can deal strictly with those that remain. A few additional exemptions may be warranted: a trust, for example, for the benefit of a young person, provided that he is certain to receive the principal no later, say, than his 30th birthday. But such trusts as those in which the children of the settlor receive income for life, remainder to the settlor's grandchildren, deserve no favors. Many of them were only created to avoid estate and gift taxes, and nothing would be lost by withdrawing the incentive.



Third, whatever additional tax is imposed on generation skipping trusts, it would be a mistake to confine it to trusts that skip two or more generations, while exempting those that skip only one. In the first place, there are very few trusts created to skip two generations. Few settlors appear to be willing to tie up property past the lives of their grandchildren. More important, however, it is the skipping of the first generation that most severely erodes the base of the estate tax and blunts its effectiveness. The skipping of a second generation is much less important.

To understand why, consider a family in which property passes from father to son to grandson in an orderly succession. An estate tax would be collected in each generation. Now imagine that the family's property is tied up in a trust that skips one generation, and that the trust is reestablished every other generation. Then estate tax collections fall by one-half. Finally, imagine that the family could tie up its property in a perpetual trust. In that case estate tax collections fall to zero.

Observe that a succession of trusts that skip one generation reduces the estate tax by half as much as a perpetual trust that skips all generations. To put it another way, skipping one generation is just as effective by itself as skipping all remaining generations.

In view of the significance of skipping the first generation and the probable complexity of any legislative remedy directed against generation skipping, I doubt whether it would be worthwhile enacting legislation that was directed only against trusts that skipped two or more generations.



### III. Marital Deduction.

Discussions about the future of the marital deduction focus on whether the deduction should be expanded or kept as it is now. To my knowledge, no one advocates curtailing it. Among those who favor an increase, opinion divides between those who favor an unlimited deduction and others who favor retaining some limit, though a higher one than now.

Several of the arguments for an unlimited marital deduction are chiefly based on the supposed simplification of the law that such a change would accomplish. It is said that an unlimited deduction would greatly reduce the record-keeping requirements of families, and would accord better with the common attitude of many couples who regard the family property as owned jointly by the husband and wife, regardless of whether legal title resides in only one of them. Certainly these points have much merit, although I do not think that by themselves they are decisive.

The principal objection to an unlimited marital deduction is that it would cost revenue and thereby make the estate tax a somewhat less effective instrument for diminishing concentrations of inherited wealth. Perhaps the revenue loss would not be severe. At the highest wealth levels it would generally be to the children's disadvantage for their parents to concentrate all of the family's wealth in the hands of the surviving spouse. Taxes are usually minimized in the long run by transferring at least some property directly to children from the estate of the first spouse to die. At lower wealth levels, however, an unlimited marital deduction might very well reduce revenues substantially. And while the reduction in tax might initially benefit the surviving spouse, it would ultimately be reflected in an increase in the total amount of property received by children.

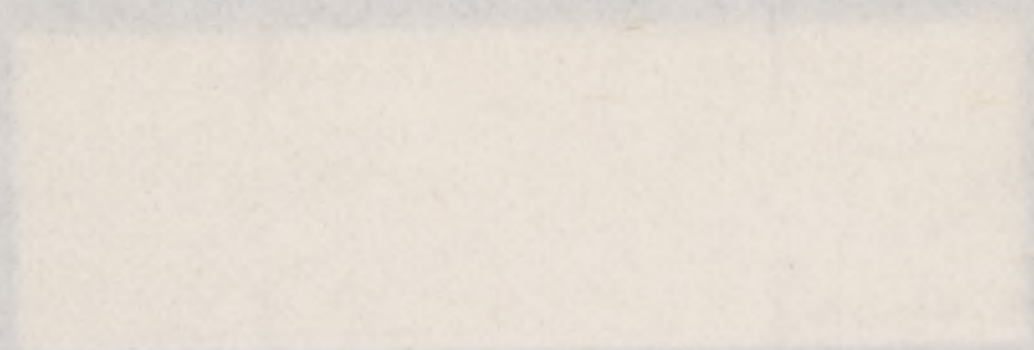


Of course, any reduction in revenue could be offset by an increase in rates or a reduction in the exemption. The net effect of all these changes would then be slight, at least in the long run. The tax burden on transfers from the estates of single or divorced decedents would rise. The taxes paid by the estates of widowed decedents would also be increased, but the increase would largely be offset by a reduction in the tax paid by the estates of the first spouse to die. In the short run, however, there would be no such offset, and so perhaps it would be desirable to phase in the increase in rates over a period of several years.

Perhaps a case can be made for increasing the marital deduction at the very lowest wealth levels, in order to give some tax relief to the spouses of persons of modest wealth. This could easily be done by amending current law to provide for a marital deduction equal to the larger of, say, \$250,000 or one-half of the decedent's adjusted gross estate. If Congress should enact an increase in the current exemption of \$60,000, however, the need for any increase in the marital deduction will be reduced.











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