REVISION OF FEDERAL ESTATE TAX LAW

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-FOURTH CONGRESS

SECOND SESSION

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REVISION OF FEDERAL ESTATE TAX LAW

MONDAY, MAY 17, 1976

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met at 9:30 a.m., pursuant to notice, in room 2221, Dirksen Senate Office Building, Hon. Walter F. Mondale, presiding.

Present: Senators Byrd, Jr., of Virginia, Mondale, Bentsen, Curtis, Hansen, and Dole.

Senator MONDALE. The committee will come to order.

I am very pleased to chair this hearing of the Finance Committee to consider reform of the Federal estate tax law. I wish to thank the committee's distinguished chairman, Senator Long, for his support in holding this hearing.

We shall have the opportunity today to hear from representatives from farm and small business organizations and experts in estate tax reform and to consider various legislative approaches that have been proposed. I welcome this opportunity to focus the attention of the committee on this most compelling issue.

The burden of the present estate tax law is unquestionably one of the most serious problems confronting America's farmers and small businessmen. The present estate tax exemption of $60,000 has remained unchanged since 1942. As a result, thousands of farms and small businesses are being sold because their heirs simply cannot afford the staggering costs of inheritance.

In 1950 there were 5.6 million farms in this country. By 1959 this number had decreased to 4 million. Today, only 2.8 million farms remain.

In 1942, the average value of land and buildings per farm was only $6,000. Even with equipment, the value of a farm was far below the exemption level of $60,000. Today the average value of land and buildings per farm is approximately $150,000. And farm experts have estimated that the investment in equipment required by today's highly sophisticated farming techniques is equal to that in real estate. This places the average farm investment near $300,000, some 20 times greater than that in 1942.

These figures do not portray the full dimensions of the estate tax problem facing farmers. We will have several witnesses today testifying to that effect.

The National Farmers Union has estimated that a farm valued at $320,000 typically produces family income of only $10,000 to $12,000 per year. Other funds are put back into farming operation. At this income level, it is small wonder that these farmers are unable to build up savings or other liquid assets over their lifetimes to cover the costs of passing their farms on to their families at their deaths.

The burden of the estate tax on small businessmen is similar to that facing the owners of family farms. Many have built their businesses up over their lifetimes through years of hard work. They have directed the earnings back into growth. These businesses are the sources of livelihood for them and their families, and one of their strongest desires is to see their efforts continued by their heirs.

Yet, in planning for their families' futures, they recognize the dangers in leaving them their businesses, with heavy estate tax obligations. Even families which have been willing to undertake the risks in attempting to continue these businesses are often simply unable to because of the inflexible structure of the existing law. The result in either event is that these small businesses are forced to be sold to larger concerns. This is one of the chief concerns that we have.

Certainly, nothing is more important and sacred to American life than the notion of family farming. The farm ought to remain in the hands of family ownership, and the same is true for small businesses. It is vital both to our economy and in terms of the competitive needs of this Nation and, also, to the social health of this Nation.

What we will be exploring today is a host of proposals and concerns directed toward what I hope will be an estate tax reform incorporated as an amendment to the pending Tax Reform Act.

[A press release announcing these hearings and a statement by Senator Dole follow:]

[Press release, Committee on Finance, May 12, 1976]

FINANCE COMMITTEE ANNOUNCES ADDITIONAL HEARINGS ON REVISION OF FEDERAL ESTATE TAX LAWS

The Honorable Russell B. Long (D., La.), Chairman of the Senate Committee on Finance, announced today that the Committee will hold additional hearings on revision of the Federal estate tax laws on *Monday, May 17, 1976*. These hearings will be chaired by Senator Walter F. Mondale (D., Minnesota) and will begin at *9:30 A.M. in Room 2221 of the Dirksen Senate Office Building.*

The following witnesses have been tentatively scheduled to appear on May 17: The Honorable Gaylord Nelson, Senator from Wisconsin; The Honorable Edward M. Kennedy, Senator from Massachusetts; Mr. Reuben L. Johnson, Director of Legislative Services, National Farmers Union; Mr. Carroll G. Wilson, President, Minnesota Farm Bureau Federation; Mr. William N. Kelly, Government Operations Task Force, National Conference of State Legislators; Mr. James P. Wicker, Small Business Council, Minneapolis and Saint Paul Chambers of Commerce; Mr. Paul F. Butler, American Bankers Association, accompanied by Mr. Richard Covey; and Mr. Frank S. Berall, Chairman, Committee on Estate and Gift Tax Reform, American College of Probate Counsel.

Written testimony.—Senator Long stated that the Committee would be pleased to receive written testimony from persons or organizations who wish to submit statements for the record. The Chairman noted that a number of people have already testified before the Committee or have submitted written statements on the subject of Federal estate and gift taxes in connection with the hearings that were held by the Committee on H.R. 10612. Those whose views already appear in the record of those hearings need not submit further testimony or written statements at this time.

Statements submitted for inclusion in the record should be typewritten, not more than twenty-five double-spaced pages in length, and mailed with five copies by Monday, May 31, 1976, to Michael Stern, Staff Director, Senate Finance Committee, 2227 Dirksen Senate Office Building, Washington, D.C. 20510.

STATEMENT OF SENATOR DOLE

Mr. Chairman, I appreciate this opportunity to restate to our Committee the urgent need for comprehensive reform of the Federal Estate Tax Laws.

No section of the Internal Revenue Code is in greater need of reform then the the estate provisions. Not since 1942 has Congress adjusted the Federal Estate

Tax exemption level. In that time, inflation has so eroded the value of the dollar that the $60,000 exemption in current law would have to be raised to well over $200,000 to afford the same degree of estate tax relief as was provided in 1942. Yet for years, Congress has stood idly by while the cruel tax of inflation takes a larger and larger bite out of the estates of farmers, small businessmen and women, and others in all sections of the nation.

I am deeply disappointed that our colleagues on the House Ways and Means Committee, a group dominated by so-called "Tax Reformers", chose to ignore the plight of the small businessman and farmer when it passed H.R. 10612 last year. For the House Bill not only overlooks one of the most flagrant instances of tax inequity in the Internal Revenue Code, it also fails to address a growing national problem—The serious inroads into our farmland base being made each year by increasing urbanization. I am pleased that some of the "Tax Reform" members of our Committee have, unlike their House counterparts, recognized these problems and have sponsored meritorious estate tax reform legislation.

NEED TO MAINTAIN OUR FARMLANDS

As our population increases, there is a rapidly expanding need to maintain our farmland base for production of food. The ever increasing urban sprawl is decreasing the availability of farmland, and it is only due to our increasing efficiency and technology that we have been able to meet expanding agricultural needs with a diminishing base. But we cannot continue this trend indefinitely. We must take steps to slow, if not reverse, this process of urban development of farmland to be able to meet our future food production needs.

Apart from the problem of a diminished agricultural base it is becoming increasingly difficult to reach or even find open or natural spaces near our urban areas. Land values near these areas become prohibitively high based on their *potential* for development. When a farm or other "Real Property" estate in such an area passes by inheritance into new ownership, current provisions of the Internal Revenue Code require that the estate tax be imposed on the "Market Value" of the property.

The most recent Department of Agriculture data indicates that rural land values in the year ended November 1, 1973, displayed the sharpest increase since 1920. As land values increase, the Federal Estate Tax increases even more due to the progressive rate structure. To alleviate this unfair tax burden on the family farm and to afford a similar degree of relief to others who might incur substantial tax liabilities in the future, I have introduced two bills and cosponsored another to increase the estate tax exemption level to $200,000 and to modify the system whereby land values are determined. These much needed reforms are based on the premise that all citizens should receive relief from the punitive impact of inflation operating through a fixed exemption in our estate tax law.

COMMEND PRESIDENT FORD

I commend President Ford for making similar proposals to provide relief from the unfair and inequitable Federal Estate Tax. Although I have not included it in my proposals, I believe the Administration's suggestion for a substantial liberalization of estate and gift tax marital deductions has great merit and should be seriously considered by the Committee.

The essential point is that we must act *now* to make these needed changes. The pending legislation in our Committee, H.R. 10612, provides an ideal opportunity for true "reform". If we adopt the proposals most of the members of our Committee seem to favor, we will assure that small farms and businesses will not be literally driven out of business because of excessive Federal taxation. No longer will children be forced to sell the farms and businesses their parents have worked a substantial portion of their lives to develop. That is surely a change in tax law worthy of the label "reform".

HOUSE CONCURRENT RESOLUTION NO. 5061

A CONCURRENT RESOLUTION memorializing the Congress of the United States to act on present legislation which increases the Federal Estate Tax Exemption from $60,000 to $200,000.

WHEREAS, The Federal Estate Tax, on transfers at death, is computed on a "taxable estate" after deduction of a $60,000 specific exemption; and

WHEREAS, Inflation, rising prices, and improved technology in recent years have pushed values of farm property upward. U.S. farm real estate values per acre in early 1975 averaged about eleven times higher than in 1940 and three

times higher than in 1960. Since 1940, the average size of farms has more than doubled. Consequently, many landowners find that the value of their real estate that would have escaped estate taxes a few years ago is now of such value as to incur major estate tax payments; and

WHEREAS, The estate tax has been a permanent part of the federal revenue system since 1916. The present $60,000 exemption has been in effect since 1942 and the present rate scale since 1941. Although all federal tax rates have been changed infrequently and have seriously lagged behind the general rate of inflation, only the gift tax has remained fixed for as long a time as the estate tax: and

WHEREAS, In recent years, changes in federal estate tax laws have been proposed. Bills carrying out federal estate tax reform have been introduced in both the House of Representatives and the Senate. Since the $60,000 exemption was established a generation ago, it is apparent that inflation has caused capricious changes in the original intent of Congress: Now, therefore,

Be it resolved by the House of Representatives of the State of Kansas, the Senate concurring therein: That the legislature of the state of Kansas respectfully petition the Congress of the United States to amend the federal estate tax law. As a minimum, these amendments should include (1) an increase in the standard estate tax exemption to reflect the effects of inflation since the present $60,000 exemption was set in 1942; and (2) provisions for basing the value of farmland and open spaces at levels reflecting their current use rather than their highest possible use. We ask that this issue be classified as a high priority so that the average farm family and every citizen will get relief from those revisions; and

Be it further resolved: That the secretary of state be directed to send enrolled copies of this resolution to the President of the United States Senate, the Speaker of the United States House of Representatives and to each member of the Kansas delegation in the Congress of the United States.

I hereby certify that the above CONCURRENT RESOLUTION originated in the HOUSE, and was adopted by that body
March 30, 1976.

D. S. MCGEIL,
Speaker of the House.
L. D. HAZEN,
Chief Clerk of the House.

Adopted by the Senate April 1, 1976.

ROSS O. DOGEN,
President of the Senate.
LEE KENNEY,
Secretary of the Senate.

Senator MONDALE. Our first witness is Senator Nelson, who is the Chairman of the Senate Select Committee on Small Business. He has done a great deal of work in this field and his committee has held hearings on this proposal. I look forward to hearing Senator Nelson testify.

STATEMENT OF HON. GAYLORD NELSON, A U.S. SENATOR FROM THE STATE OF WISCONSIN

Senator NELSON. Mr. Chairman, I have hearings starting that I am conducting in the Labor Committee on the Humphrey-Hawkins full employment bill, so if the chairman doesn't mind, I will submit my statement for the record and simply summarize briefly the principle that we are concerned about, which is really the main issue.

I note you have a very distinguished panel representing the various farm organizations in the country as well as the Smaller Manufacturers Council and Small Business Council of Minneapolis.

Mr. Chairman, the first question we deal with here is the question of whether there should be an estate tax exemption at all. If we agree—at least I do—that there should be, then what should the level of that exemption be?

Senator Packwood and I and our staffs have worked on this question along with others in the Small Business Committee. I am well aware that the Senator from Minnesota, Senator Mondale, has worked on proposals and conducted hearings in behalf of our Small Business Committee out in Minneapolis on this issue.

There are a number of proposals that have been introduced in both Houses of the Congress addressing themselves to this particular question.

The President, after the Small Business Committee hearings last fall, earlier this year endorsed an increase in the estate tax exemption. A number of bills, including those by members of the Small Business Committee and Finance have been introduced. The proposal that is being advanced by Senator Packwood and myself as well as others is to use a tax credit instead of an exemption.

Now, the first bill we introduced, as a number of us did last fall, was a bill that increased the exemption and did some other things. After evaluating over a period of time and having the economists on our staffs look at it, we have concluded that it would be more equitable to use a tax credit rather than an exemption. I think that is pretty clear when one looks at it.

If you have a $60,000 exemption, as you do now, and the taxpayer's estate is large enough so he is in the 70-percent bracket, then for every $1,000 exemption it is worth $700 to that taxpayer; whereas with the taxpayer in the 30-percent bracket, with every $1,000 exemption it is worth $300. The larger the estate, the greater the benefit per $1,000 of exemption. We think that that is regressive, it is more beneficial to the rich than those who are not, so we propose a credit.

Now, what level that credit should be will have to be determined by the Finance Committee on this side and the Ways and Means Committee on the other side as well as the debate on the floor of each House.

But, in any event, we are proposing a credit. It does two things: (1) It is more progressive; (2) it costs the Treasury less money. For example, if it was decided to increase the exemption from $60,000 to $147,000, that increase in the exemption from $60,000 to $147,000 would cost the Treasury $2,200 million.

On the other hand, if you give a credit of $35,000, which is equivalent to a $147,000 exemption—give a credit of $35,000, it would cost the Treasury not $2,200 million but $1,100 million. So it would be a little more than $1 billion less by using the tax credit.

The next principle that we incorporate in this proposal is the principle of phasing out the credit. Again we will have to decide, by discussion and debate on the merits, whether it should be phased out, as we think it should, and, if so, at what level.

We do not have the charts ready yet and I would ask the chairman permission to submit for the record later this week some charts showing the impact of a phaseout at various estate sizes.

In any event, we would propose roughly a starting at, say, $300,000 estate or thereabouts, phasing out the tax credit at the rate of $5,000 every $100,000—in other words, if you had a $40,000 credit, whatever it may be, at each succeeding $100,000 after $300,000, phase it down by $5,000 so that a $400,000 estate would have a $35,000 credit and a $500,000 a $30,000 and $600,000 a $25,000 credit. Wherever

you start, it doesn't matter. That is the principle and whatever the estate—$1 million, $1.2 million or $1.3 million—you would finally phase out the credit entirely.

Now, that introduces progressivity into the tax structure, it does not cost the Treasury as much and we need not worry as much with estates up in that level as we do those family-size farms and family enterprises that are worth $200,000 or $300,000 or $400,000.

Now, that summarizes the principles involved in the proposal that Senator Packwood and I and others will be introducing yet this week and on which we will be submitting to the Chair and to the committee our various statistics and charts showing the impact at each estate level. Thank you, Mr. Chairman.

Senator MONDALE. Thank you. We will include your full statement.

We will also include the very useful editorial in support of an estate tax reform appearing in The New York Times of May 10, 1976. And I would also ask the staff to find the article I put in the record on the bite of the estate tax on farming, showing the present tax driving between 200,000 and 400,000 farm families out of family farms a year. I would like that article to be included at this point in the record.

(An article and the charts referred to follow. The May 10 article appears at page 19 of this volume.)

[From the New York Times, Feb. 15, 1976]

DEATH TAXES COMPELLING HEIRS TO SELL FARM LAND

(By Roy Reed)

Springfield, Neb.—Lloyd Royal, 59 years old, drives a 7-year-old Chevrolet with 110,000 miles on it. He lives in an ordinary farmhouse next to a barn lot. If anyone called him rich, he would laugh.

But if he died his wife, Doris, would have to pay $32,000 to the Internal Revenue Service in Federal estate taxes. That's because their modest farm has quadrupled in value since they bought it, thanks to inflation and spiraling land prices. They have become "paper rich."

"There's an old saying that a farmer lives poor and dies rich," Mrs. Royal said this week. "If he died, I'd be in the job market and probably at the minimum wage, because the only thing I know anything about is farming."

Death taxes are making it increasingly difficult for farm families to keep their land. Children who inherit land usually pay even higher taxes than spouses. Just this week, a man near here had to sell his parents' 80-acre farm to pay the death taxes. He sold it to one of the largest landowners in the area—a pattern that has become familiar in the farm country here and elsewhere.

Farmers in New Jersey and on Long Island have also told of hardships because of the tax structure—and many are seeking change.

The inflated land prices that have caused death taxes to become a problem are also keeping young people from entering farming. It now takes at least $250,000 by many estimates to start farming after high equipment prices are added to high land prices.

From her kitchen table, Mrs. Royal has set out to change what she and many others regard as an absurdity in the tax law. She and a handful of friends have rounded up 70,000 petition signers in 42 states asking Congress to act on it.

This election year is apparently going to bring a new attack on the problems of death taxes and prohibitive start-up costs for farmers.

President Ford and several members of Congress have proposed legislation to make estate taxes more bearable for all small and middle-sized estates, including those of farmers. The proposals vary widely.

Senator George McGovern, the South Dakota Democrat, and 16 other Senators representing varied philosophies have introduced another bill to have the Federal Government buy and, lease it to young farmers, then sell it to them at a reduced price after seven years' labor.

The Young Farmers' Homestead Act, as the bill is called, has drawn favorable attention from such varied sources as the National Farmers Union and Progressive Farmer Magazine.

Progressive Farmer, a generally conservative publication, cited projections that 200,000 to 400,000 farms a year would disappear for the next 20 years if today's trend was not stopped.

The legislation faces up squarely to what probably has to be done if not rich but bright youngsters are really going to get into ranching or farming for themselves, it said in its January issue.

Estate taxes were no problem to farmers until a few years ago. Federal law exempts the first $60,000 of an estate from the death tax. Most farms were worth nowhere near that when that law was written in 1942.

W. Fred Woods, an economist with the Agriculture Department, estimates that the average value of farm assets in the United States was only $51,440 in 1960. By 1974 that had climbed to $169,744.

Farm values have continued to rise. Land prices in eastern Nebraska are going up more than 20 percent a year, according to observers.

TYPICAL ESTATE: $320,000

In 1960 the Royals paid $72,000 for their 240 acres—a small farm by Nebraska standards. Today, the land alone would cost close to $300,000. The Royals have become rich in the eyes of the Internal Revenue Service, even though they live little better than they did in 1960.

Gilbert Brody, president of the Wisconsin division of the National Farmers Union, says a farmer who earns $10,000 to $12,000 a year typically leaves an estate valued at about $320,000.

His widow pays a Federal estate tax of $20,200 on that, in addition to smaller state inheritance taxes.

When she dies, the children pay $83,190 in estate taxes, their share being larger because they do not receive the 50 percent marital deduction. According to Mr. Brody, the children probably will have to sell the farm to pay the death taxes.

President Ford has proposed delaying the payment of those taxes until five years after the death of the owner. Then the heirs could elect to pay the tax over 20 years, with the addition of 4 percent interest. Heirs may now stretch the payment over 10 years, but at an interest rate of 7 percent.

Mr. Ford's 20-year proposal would apply only to the first $300,000 of an estate. Descending benefits would be allowed up to $600,000, after which the present 10-year stretch-out provisions would apply.

$200,000 EXEMPTION PROPOSED

The Royals and their friends do not think much of the Ford proposal. They regard it simply as a postponement of an unjust debt.

"What on earth good is that when you don't have that kind of money in the first place?" a California woman said in a letter to Mrs. Royal.

At least 10 bills pending in the Senate would raise the $60,000 exemption to $200,000 on all estates, farmers' included.

Other bills would require the I.R.S. to assess farmland at its agricultural value and not at the "fair market value" it would bring if sold for some other use.

Land values here are being pushed up by the growth of Omaha, which is less than 25 miles from the Royals' farm. As the city pushes out, it absorbs farmland at dizzyingly inflated prices and converts it into housing developments and shopping centers.

Many argue that farmers would be less likely to sell to developers if their land was assessed at its value for farming and not for commercial or residential use.

Arthur H. West, president of the New Jersey Farm Bureau, said that Federal estate taxes, inflation and the system of appraising property had imposed unfair burdens on farmers. He added that many New Jersey farmers were actively supporting proposed legislation that would require that the assessment of a property be based on its value for farming.

Mr. Woods, the economist, warned in a recent interview in Washington that changes in the estate tax law should be made carefully if they are not to exacerbate the problem.

Assessing land at its value for farming or as open land instead of at fair market value could result in a low-tax device for the wealthy in passing their estates on to their heirs, he said.

"That would run up farmland prices and make it more difficult for producing farmers," he said.

LETTERS OF HARDSHIP

No one knows how many farmers have had to sell land to pay estate taxes, but there are indications that this is happening more often.

Thomas Pulaski, who used to own a 25-acre potato field near Riverhead on Long Island, says he sold his farm because of his tax bill. He drives a truck for a living.

Mr. Pulaski, who lives in Coram, L. I., said: "If I had decided to stay on my farm after my father's death, I'd have spent half my lifetime paying off loans through which my taxes would have been paid." He sold his property to a real-estate developer and made $6,000 profit—after taxes.

Suffolk County, New York State's largest agricultural county because of its potato and cauliflower crops, is trying to encourage farmers to stay by means of a farmland preservation program. In a $60-million project, the county is buying development rights—not the fee title—to the existing 57,000 acres of farmland. In effect, a farmer will get the market value of the property from the county and may keep the land. But he must agree not to use the land for any purpose other than agriculture.

More than half of 258 farmers surveyed last month by the Wisconsin division of the National Farmers Union said they had known farm families that had had to sell all or part of their farms to pay estate taxes.

Many of those who have written to Mrs. Royal have told of hardships caused by the tax. After her campaign was described by the Farm Journal last fall, the magazine received a letter from William Jones of Lakeport, Calif.

"Our orchard land has been in the family for over 100 years," he wrote, "and now because of this unfair tax in an inflationary period, the resources of the family [never more than provided a living for the family during the past 30 years] is now about to be confiscated by the Government for taxes."

Another Californian, William G. Cox of Capistrano Beach, wrote that his family had already lost its farm because of an exorbitant estate tax bill after his mother's death.

"The I.R.S. is killing the goose that lays the golden egg," Mr. Cox wrote. "The big corporations that are buying up the small farms will never pay another death tax on the land because a corporation never dies. Forming trusts and corporations within families seems to be the only way to go now."

Dixon G. Adams, a Springfield lawyer who is donating time to Mrs. Royal's campaign, estimates that 40 or 50 of Sarpy County's 600 farms have been incorporated in recent years to escape or lessen the impact of death taxes. But many farmers resent that alternative. They feel that incorporation would inpose more bookkeeping and "red tape" and would diminish their independence. Mr. Adams agrees.

"I don't want to construct a scheme where a farmer has to have a lawyer and a C.P.A. riding on the tractor with him," he said. "We are doing it though, because of necessity."

Many of the farm wives who write to Mrs. Royal complain of what they believe to be sex discrimination in the Federal tax law. These women dislike being treated in the same way as wives of city residents and millionaires.

Federal law allows a widow to deduct from her tax payment any financial contribution she has made to the family estate, but only if she can prove it with payroll check stubs or the like. Simply working shoulder to shoulder with her husband on the farm for 30 or 40 years is not enough for the I.R.S.

Resentment against that drew Mrs. Royal into her campaign. "I got started one day during the blizzard of 1975," she said. "I had been out in the snow all day helping get the cattle into the barn and then throwing hay to them and getting everything ready for the storm."

COMPARISON OF CREDIT AND EXEMPTION LEVELS

An estate tax credit of—	Would make net estates tax free up to—	Percentage of estates filing returns in 1973 that would be tax-free: Percent of all returns filed	Percentage of estates filing returns in 1973 that would be tax-free: Percent of returns with marital deduction
$20,700	$100,000 ($200,000 to spouse)	60	75
$26,700	$120,000 ($240,000 to spouse)	68	81
$50,700	$200,000 ($400,000 to spouse)	76	94

TABLE 1.—COMPARISON OF NET ESTATE EXEMPTION AND ESTATE TAX CREDIT IN BRINGING ABOUT SAME TAX RELIEF FOR RELATIVELY SMALLER TAXABLE NET ESTATES

An estate tax credit of	Achieves the same tax-free net estate as— A taxable estate exemption of—	Tax-free to spouse
$9,500	$60,000	$120,000
$20,700	100,000	200,000
$25,000	114,333	228,666
$26,700	120,000	240,000
$30,000	131,000	262,000
$35,700	150,000	300,000
$40,000	163,333	326,666
$50,700	200,000	400,000

TABLE 2.—COMPARISON OF REVENUE LOSSES FROM INCREASED EXEMPTION AND FROM REPLACING EXEMPTION WITH EQUIVALENT TAX CREDIT

[Fiscal year 1977 basis; revenue loss in billions]

Exemption	Revenue loss	Credit	Revenue loss
$100,000	$1.1	$20,700	$0.270
114,333	1.3	25,000	.550
120,000	1.4	26,700	.650
131,000	1.5	30,000	.840
150,000	1.9	35,700	1.1
163,333	2.0	40,000	1.4
197,667	2.3	50,000	1.7

Source: U.S. Department of Treasury (1975 estimates, projected to 1977 basis) and Congressional Research Service.

TABLE 3.—DISTRIBUTION OF ESTATE TAX RELIEF BETWEEN FAMILY-OPERATED FARMS AND SMALL BUSINESS AND ALL OTHER (LARGELY FINANCIAL ASSET) ESTATES

	Estimated 1977 revenue cost (millions)		
	Total cost	Benefit to family-operated farm or business	Benefit to all other estates
Estate tax credit:			
$20,700	$270	$40	$230
$25,000	550	80	470
$26,700	650	95	555
$30,000	840	130	710
$35,000	1,130	170	960
$40,000	1,420	210	1,210
$50,000	1,740	255	1,445

TABLE 4.—REVENUE COST OF "SPLIT CREDIT" PROPOSALS AND DISTRIBUTION OF BENEFIT TO FAMILY ENTERPRISE ESTATES AND OTHERS

	Estimated 1977 revenue cost (millions)		
	Total cost	Benefit to family-operated farm or business	Benefit to all other estates
"Split credit" of—			
$30,000 to farm and small business and $20,700 to all others	$360	$130	$230
$40,000 to farm and small business and $25,000 to all others	680	210	470
$50,700 to farm and small business and $26,700 to all others	810	255	555
$50,700 to farm and small business and $20,700 to all others	485	255	230

EFFECT OF REPLACING EXEMPTION WITH TAX CREDIT

[Credit of $20,700: Net estate tax-free up to $200,000 to spouse; net estate tax-free up to $100,000 to heirs]

Taxable estate				Net benefit to estate from substituting credit for exemption	
To spouse	To heirs	Tax payable with $60,000 exemption	Tax payable with above credit	Amount of tax reduction	As percent of present tax
$160,000	$80,000	$1,600	0	$1,600	100.0
$200,000	$100,000	4,800	0	4,800	100.0
$240,000	$120,000	9,500	$6,000	3,500	36.8
$300,000	$150,000	17,900	15,000	2,900	16.2
$400,000	$200,000	32,700	30,000	2,700	8.3
$600,000	$300,000	62,700	61,000	1,700	2.7
$800,000	$400,000	94,500	93,000	1,500	1.6
$1,000,000	$500,000	126,500	125,000	1,500	1.2
$2,000,000	$1,000,000	303,500	305,000	(−1,500)	(−.5)
$4,000,000	$2,000,000	726,000	732,500	(−6,300)	(−.9)

[Credit of $50,700: Net estate tax-free up to $400,000 to spouse; net estate tax-free up to $200,000 to heirs]

Taxable estate				Net benefit to estate from substituting credit for exemption	
To spouse	To heirs	Tax payable with $60,000 exemption	Tax payable with above credit	Amount of tax reduction	As percent of present tax
$160,000	$80,000	$1,600	0	$1,600	100.0
$200,000	$100,000	4,800	0	4,800	100.0
$240,000	$120,000	9,500	0	9,500	100.0
$300,000	$150,000	17,900	0	17,900	100.0
$400,000	$200,000	32,700	0	32,700	100.0
$600,000	$300,000	62,700	$31,000	31,700	50.6
$800,000	$400,000	94,500	63,000	31,500	33.3
$1,000,000	$500,000	126,500	95,000	31,500	24.9
$2,000,000	$1,000,000	303,500	275,000	28,500	9.4
$4,000,000	$2,000,000	726,200	702,500	23,700	3.3

TABLE 5.—ALL TAXABLE ESTATES, 1973, BY TYPE OF ASSET

Assets	Amount	Percen
Corporate stock	11.4	35.0)
Real estate	7.0	21.0
Cash	4.9	15.0
Bonds	2.8	8.0
Lifetime transfers	(2.5)	(7.0
Life insurance	1.5	5.0
Notes and mortgages	1.2	3.0
Household goods	1.1	3.0
Noncorporation business assets	.8	2.0
Annuities	.2	—
Total	33.3	100.0
Estimated family farm and small business assets:		
Noncorporation business assets	.754	[1] 2.3
Closed corporation stock (family-owned closely held corporations)	1,438	[1] 4.5
Farm real estate	[2] .750	[1] 2.3
Total family farm and small business assets	$3.0	[1] 9.1
Liquid and other marketable assets not including farm and small business assets:		
Corporate stock (other than stock of closely held corporations)	9.9	[1] 30.0
General real estate (excluding farm real estate)	6.2	[1] 19.0
Cash	4.9	[1] 15.0
Bonds, notes and mortgages	4.0	[1] 12.0
Total liquid assets and other nonsmall business marketable assets	25.0	[1] 75.0

[1] Percentage of all taxable estate assets.
[2] Estimate.

Source: U.S. Department of Treasury, "Statistics of Income: 1972—Estate Tax Returns" and "1965—Fiduciary, Gift & Estate Tax Returns," and estimates by Nelson staff.

TABLE 6.—BASIC DATA ON FEDERAL ESTATE TAX FROM RETURNS FILED IN 1973

Gross estate	Proportion of all returns filed (percent)	Proportion of all adult deaths in United States	Average net taxable estate	Total taxable Estate as percent of total gross Estate	Estate tax: Average per return filed	Estate tax: As percent of gross estate	Estate tax: As percent of taxable estate
$60,000 to $120,000 (average equals $86,849)..	50.0	4.4	$20,545	11.4	$977	1.1	9.9
$120,000 to $200,000 (average equals $151,877)............	25.7	2.3	50.147	27.8	7,044	4.6	16.7
$200,000 to $500,000 (average equals $296,260)............	17.8	1.6	144,997	46.9	30,956	10.4	22.3
Over $500,000 (average equals $1,343,951).....	6.5	.6	791,210	57.3	246,191	18.3	32.0
All returns (average equals $222,235)......	100.0	8.8	130,959	40.7	23,747	10.7	26.3

FINANCIAL SECURITIES HAVE "BUILT IN" AN ADJUSTMENT FOR INFLATION

The current rate of return or *annual yield on high-grade financial assets*, such as corporate stocks, corporate bonds and U.S. Treasury bonds, *has risen since the mid-1940s by more than enough to fully offset the inflationary erosion of the dollar.* (That, is the inflation occuring over the period has been fully "*built-in*" to the current market yields on good financial securities.)

	Current yield 1947	Current yield 1975
High-grade long-term securities:		
Corporate stock, dividends per share (Moody's composite, annual rate)............	2.38	10.52
AAA corporate bonds............	2.61	8.83
U.S. Treasury bonds............	2.25	6.98
Average yield............	2.4	8.8

Note: Increase in average yield, 1947-75—367 percent. Increase in general price index (GNP deflator) 1942-75—289 percent.

Source: U.S. Department of Commerce, Survey of Current Business.

$60,000 at 2.4% yielded $1.440 annual income in the mid-1940s. The equivalent 1975 "real income" is *$4,162* (*i.e.* $1,440 x 289% inflation since 1942—adjusting for inflation from 1947—present would give a lower figure).

At the current *8.8%* average return, it takes *$47,295* to yield an annual income of $4,162. Thus, *$47,295* of high-grade financial assets today, gives the *same "real yield"* (current yield *fully adjusted for inflation*) as *$60,000* of similar assets in the mid-1940s. Looked at the other way around: *$60,000 today* is equivalent to about *$76,000 in the mid-1940s.*

Senator NELSON. I neglected one point. If I may, in its final form we will also incorporate one additional principle. We will propose that the heirs of these estates not be required to pay anything on the principal for, say, 3 years—a period of time, 2 or 3 or 4 years; that they be required to pay the interest at the cost to the Government plus one-quarter of 1 percent, which is the charge for money borrowed through the Small Business Administration.

This grace period would give the heirs to this small business an opportunity to get their business in order; then we would give them perhaps 15 years to pay back the balance of that estate tax in equal payments over that period of time. Thank you, Mr. Chairman.

Senator MONDALE. Thank you very much for a most useful presentation.

[The prepared statement of Senator Nelson follows:]

STATEMENT OF SENATOR GAYLORD NELSON

Mr. Chairman, Members of the Committee, we appreciate this opportunity to open the Finance Committee's hearings on estate and gift tax revision with the presentation of our views on the significance of these changes for family farms and small enterprises.

PUBLIC OPINION PREPARED FOR CHANGES IN THE LAW

In my view, the initiatives taken by the Congress and particularly the Senate in this area have made it possible to enact an estate and gift tax revision bill during this session of Congress. On April 27, the lead story in the Wall Street Journal was devoted to a thorough presentation of competing arguments on the chief questions in the estate and gift tax areas.

On May 10, the New York Times, in a thoughtful editorial, concluded that: "Consensus on a moderate reform of the estate tax is possible this year. The chance for it ought not to be missed."

These two articles, which reflect informed public opinion on these matters, are attached as appendices to my statement for the Committee's information.

HISTORY OF SENATE INVESTIGATION OF ISSUES

Mr. Chairman, a commendation is in order for your leadership in co-chairing our combined Small Business Committee-Joint Economic Committee's hearings on the estate tax area on August 26, 1975. Subsequently, the Small Business Committee and Finance Committee joined in estate tax hearings in Washington on September 25, 1975, and three further field hearings of the Small Business Committee to gather testimony on this subject during the summer and autumn of last year.

These serious inquiries produced a series of estate and gift tax revision bills, such as the Mondale-Nelson bill (S. 2394), the Nelson-Mondale-Humphrey "Small Business Estate and Gift Tax Reform Act" (S. 2819), and the Nelson-Packwood bills proposing a credit mechanism as an alternative to the exemption (S. 3139, S. 3140). In my view, these efforts laid the basis for Administration proposals in 1976 which put the estate tax issue on the front pages and thereby improved the likelihood of legislative action.

For a generation, family farms and small businesses had experienced a typical problem of neglect in this area. Over the past 34 years, the country experienced an inflation of 289% but farmland and business assets increased in value fivefold or even tenfold in some cases. Thus, problems involving widows and children continuing the business have become increasingly acute, but lawmakers would not take them seriously.

Part of the neglect of the very real problem facing farm families and small business owners has stemmed from the fact that these family enterprise situations only account for about one-tenth of all taxable estates. For the remaining majority of taxable estates, consisting substantially of corporate securities and other financial assets, the problem has not been acute. Indeed, the long-run rise in rates of return on financial assets has largely offset for these estates the long-run inflationary impact that has been so devastating to the farm and small business estates. It is the farm and small business enterprise where the family wants to "keep the business in the family" that has suffered.

ESTATE TAXES MOW DOWN FAMILY AND INDEPENDENT ENTERPRISES

Because of this inaction, our hearings sketched the picture of tax-free mergers on one side and the threat of a progressive estate tax up to 77 percent on the other, operating like the twin blades of a giant scissors to cut down family ownership of farms and small business at the end of one generation.

Because of this tax structure, waves of mergers periodically sweep through the economy, as illustrated by the following statistics on the acquisitions:

Year	Acquisitions
1970	6, 123
1971	4, 645
1972	4, 804
1973	[1] 4, 040

[1] Source: W. T. Grimm Co., Chicago, Ill. Reprinted in "Small Business Tax Reform, 1970-74," Select Committee on Small Business, U.S. Senate, Committee Print, July 25, 1974, p. 321.

The totals were somewhat lower during the past two years.

The merger movement is most pronounced in the growth band of the economy. A special study by the Federal Trade Commission revealed that in the two decades prior to 1967, almost one-third of all the companies owning between $10 million and $100 million in assets disappeared through mergers.[1]

INCREASING COSTS OF ENTRY ELIMINATING FAMILY SMALL BUSINESS FROM IMPORTANT AREAS OF THE ECONOMY

At the same time, increasing capital requirements at the point of entry are making it more difficult for many independent firms to go into important segments of our economy. Farming is a prime example: A University of Minnesota study reportedly estimated that starting up a farm operation would take almost $250,000 in capital.

The Chairman is aware of similar testimony in our Small Business Committee hearings in the area of independent communications media,[2] manufacturing, and distribution business.[3]

CURRENT RECOMMENDATIONS

In an effort to help reach a consensus on an action plan this year, the Small Business Committee has been working to develop the soundest and most effective possible legislative recommendations. They are summarized briefly as follows:

1. *Substitution of a credit for the exemption.*—The evidence, including detailed revenue estimates, indicates that a credit mechanism appears superior to an exemption on grounds of both equity for moderate-sized estate and revenue impact.

For example, the following table gives a comparison of revenue losses produced by exemptions and equivalent credits:

Comparison of revenue losses between exemption and equivalent credit (fiscal year 1977 basis)

Exemption:	Revenue loss	Credit:	Revenue loss
$100,000	$1,300,000,000	$20,700	$270,000,000
114,333	1,600,000,000	25,000	550,000,000
131,000	1,800,000,000	30,000	840,000,000
147,667	2,200,000,000	35,000	1,100,000,000
163,333	2,300,000,000	40,000	1,400,000,000
197,667	2,700,000,000	50,000	1,700,000,000

Source: U.S. Department of the Treasury, 1977 projections by staffs of Senators Nelson and Packwood.

In my view, we could reduce the revenue impact still further by phasing the credit down pro-rata by something in the neighborhood of $5,000 per hundred thousand of taxable estate. I am drafting a proposal along these lines to submit this week for the Committee's evaluation.

Our goal should be a level of relief adequate for continuation of family farms and modest-sized commercial businesses, while not giving windfall benefits to owners of property which is not directly productive of employment and wealth in this manner. Some measure of relief should be provided to those moderate-sized estates consisting largely of personal and financial assets. But it is clear that the urgent problem to be addressed is an adequate level of relief for the the independent family farm and small business enterprise.

2. *Equivalent relief in the area of lifetime giving* to reopen the alternative of a gift of farm or business assets while the parents are still alive to assist the younger generation through transitional problems. This could be accomplished through a combined use of the estate and gift tax exemptions/credits (see S. 2819), or by a unified transfer tax exemption which could have the virtue of added simplicity.

3. *Relief for the surviving spouse.*—If the farm or business wife survives, as is typical, there is a great inequity from taxing the entire estate to the husband,

[1] Studies by the staff of the Cabinet Committee on Price Stability, January 1969, "Industrial Structure and Computation Policy," p. 74.

[2] Statement of Jared How, Joint Hearing before the Select Committee on Small Business and the Joint Economic Committee, U.S. Senate, 94th Cong., 1st Sess., "The Impact of Federal Estate and Gift Taxes on Small Businessmen and Farmers," Aug. 26, 1975, pp. 38–45.

[3] Statement of John C. Davis III, Joint Hearings before the Select Committee on Small Business and the Subcommittee on Financial Markets of the Committee on Finance, U.S. Senate, 94th Cong., 1st Sess., "Small Business Tax Reform, Sept. 23, 24, 25 and Nov. 13, 1975, pp. 1336–1356.

particularly when the wife has worked side by side with the husband to build up the value of the farm or business.

We have therefore recommended that increasing the marital deductions to 100 percent up to somewhere between $100,000 and $250,000, with a possible phasing down or phasing out of this deduction on a graduated basis.

4. *Deferral of estate tax payments.*—Our bill, S. 2819, and the President's January 5 proposal recommend deferral of the estate tax payments when the immediate imposition of the total tax on a closely held business could destroy it.

Our testimony to the Ways and Means Committee and here is that there be allowed up to a 15-year deferral, with payments of interest only for the first 3 years at the cost of money to the Federal Government plus ¼ of 1 percent. That formula is presently used in the Small Business Act.[4]

We have also recommended that the executor of the estate be relieved of personal liability, while protecting the government through an ample security interest in the property, so that deferral under Section 6166 can again become a practical possibility.

5. *Valuation.*—Our December proposal offers an alternative to so-called "use valuation" because many observers feel that use valuation raises many administrative problems. Our proposal would permit the farmer or small businessman to restrict the use of the property by means of an enforceable covenant limiting it to the desired use. This covenant could then be valued actuarily. Such a covenant would also be amenable to the environmental uses described by THE NEW YORK TIMES editorial and other thoughtful Members of Congress and of the nation's bar associations.

6. *Technical provisions.*—There should be a cleanup of several technical provisions, including Section 6166 and Section 303 stock redemptions, as recommended by our prior proposals.

7. *A study of the social and economic consequences of the effect of death taxes* by way of causing mergers and concentration, including absentee ownership of farms and businesses and the impact upon the economy, and social and community institutions.

CONTRIBUTION OF SMALL BUSINESS TO THE NATION

The new, family, local, small and independent businesses of America are of great and proven value to this nation. They provide 52% of all private employment, 43% of the business output, ⅓ of the Gross National Product; and over half of all innovation, including major industrial changes in petroleum refining, aluminum manufacture, copying and computer miniaturization.

Beyond the statistics, however, the worth of small and family enterprises to our community and national life is immeasurable.

Studies have proven that locally owned businesses are stronger supporters of local, social, and charitable institutions in the cities and towns where the owners reside and have their roots. Self-reliance in economics goes hand in hand with independence of thought and action, the foundation of our democratic form of government, as Thomas Jefferson perceived 200 years ago.

REVISION IS LONG OVERDUE AND SHOULD BE ACCOMPLISHED NOW

For a generation now, our Federal estate tax laws have been a key factor in the elimination of family farms and small businesses. The laws have been destructive of our most cherished values and traditions. Moreover, these laws have been concentrating wealth in fewer hands, largely in conglomerate corporations. This is a result exactly opposite to what many of us feel the estate taxes were designed to achieve. We feel that the revision which the Committee has undertaken is long overdue and we would be pleased to cooperate in any way possible in the Committee's work toward this revision.

[From the Congressional Record, Senate, Apr. 29, 1976]

APPENDIX A

DEATH TAX BURDENS OF SMALL AND FAMILY FARMS AND BUSINESSES RECOGNIZED BY THE WALL STREET JOURNAL

Mr. NELSON. Mr. President, I would like to invite attention to an article entitled "Death and Taxes" which appears in today's Wall Street Journal, and ask

[4] See Section 7(b)5, Public Law 85-536, as amended, the so-called "Economic disaster" sections of the Act.

unanimous consent that it be printed in the RECORD for the information of all concerned. It is a good summary of the issues involved in the arguments surrounding some of these questions.

There being no objection, the article was ordered to be printed in the RECORD, as follows:

[From the Wall Street Journal, Apr. 27, 1976, as reprinted in the Congressional Record, Apr. 29, 1976]

DEATH AND TAXES—BIDS TO EASE BURDEN OF ESTATE, GIFT LEVIES LIKELY TO STIR DISPUTE; CONGRESS MAY ACT IN 1976, BUT SOME LIBERALS SEEK TO TIGHTEN TAXES INSTEAD; IS THE TAIL WAGGING THE DOG?

(By John Pierson)

WASHINGTON.—Some angry, some plaintive, the letters are pouring into congressional offices these days. A farmwife in Polo, Ill., writes: "We have mortgages on two farms in Ogle County. My husband is a cardiac, diabetes and dialysis patient. The increase in land value has horrified me and my children with the estate taxes as they now stand. It will mean we will have to sell—which we didn't want to do."

In this election year, there is a good chance that Congress will grant some sort of relief from the burden of federal estate and gift taxes. President Ford's promise to propose such a break for family farms and businesses earned him a loud round of applause from Senators and Representatives assembled to hear his State of the Union address.

The House Ways and Means Committee has completed hearings on the matter and will soon start drafting a bill. And Russell Long of Louisiana, chairman of the Senate Finance Committee, says he may try to tie estate-tax relief to a bill extending the income-tax cuts that now are due to expire June 30.

But complications lie ahead. Some liberals think the estate tax should be tightened rather than loosened. For every farmwife facing a forced sale to pay her husband's death taxes, they see a rich family taking advantage of "loopholes" in the present laws to pass along vast wealth from generation to generation.

A BREWING CONTROVERSY

Attempts to plug the loopholes will stir great controversy, which could doom efforts to ease the burden on the farmwife in Polo, Ill., and other not-so-rich Americans for whom the estate tax poses a genuine hardship.

"Even those who want to do something are fearful they might open the door to taxing capital gains at death," says Rep. Joe Waggonner, a Louisiana Democrat and leader of the Ways and Means Committee's conservative bloc. Under current law, gains on capital assets that aren't cashed in during life escape income taxation (but not escape taxation) when passed along at death—a situation that liberals deplore.

This there is some possibility that in the few months of work time left in this election-year Congress, lawmakers may not reach any agreement on estate and gift taxes. Yet the cry for estate-tax revision is so strong that even if nothing gets done this year, Congress will almost certainly change the law within the next two years.

HOW THE TAX WORKS

The federal estate tax works this way. When you die, the Internal Revenue Service totes up everything you own. Deductions are allowed for lawyers fees and other administrative costs, funeral expenses, unpaid debts, and casualty and theft losses incurred during settlement of your estate. Half of what's left may go tax-free to your spouse, further allowances are made for charitable bequests and $60,000 of the rest is exempt from tax.

Whatever remains is subject to the estate tax, with the rate rising in steps from 3% on the first $50,000 to 77% on the amount exceeding $10 million.

But before paying the IRS, your executor can take a credit for state death taxes, federal taxes on gifts you made within three years of your death estate taxes paid on bequests you received within the preceding 10 years, and foreign death taxes.

The federal gift tax is designed to prevent you from avoiding the estate tax by giving away your property while you're still living. You can give $3,000 each year to anyone tax-free and an additional $30,000 tax-free to anyone during your lifetime. Gifts to charity escape the gift tax, as does half the value of anything you

give your spouse. Beyond that, gifts are subject to taxation at rates ranging from 2.25% on the first $5,000 to 57.75% on amounts over $10 million.

EFFECT ON FAMILY FORTUNES

Estate and gift taxes were originally imposed to raise revenue. But the two levies bring in only about $5 billion a year, less than 2% of today's federal revenue.

Recently they have been viewed as a way of preventing the continuation of large family fortunes, generation after generation. But, with inflation driving up land and other values many relatively modest estates, which would have escaped taxation in years past, now are obliged to pay. In 1945, only 1% of all estates had to pay any federal tax; in 1975, tax was due from the estates of 150,000 Americans, 7.7% of those who died last year.

The problem has become especially acute for farmers whose estates consist largely of illiquid assets such as land, buildings and machinery. Near large cities, in particular, the market value of farmland has shot up, leaving many farmers' estates with a big tax due and little cash to pay it with. Thus, some farm widows and children have been obliged to sell part or all of the farm to satisfy the IRS.

Smaller farms are often sold to large farming corporations. Therefore, it is argued, the estate tax is bringing about the very concentration of wealth it was meant to prevent. The same holds true, to a lesser degree, for small, family-owned businesses.

Some liberals maintain, however, that the extent of forced sales has been exaggerated. For the relatively few genuine hardship cases, Congress can provide some narrow relief, they say.

Liberals maintain that by subjecting more and more estates to tax, inflation simply has been making the estate levy hit where it should. The 7% of Americans who pay some tax are still the richest 7%, they say. Most plans for easing taxes on small estates would ease them even more for large estates. And with the government currently running huge deficits, now is no time to be cutting taxes, liberals add.

"To employ an increase in the estate-tax exemption to solve liquidity problems of deceased farmers is to let the tail wag the dog," declares Sen. Edward Kennedy, the leader of the Senate's liberal tax "reformers." "The ultimate thrust of tax reform should be to broaden the scope of the estate tax, not restrict it," the Massachusetts Democrat says.

But Congress is hearing a lot more noise from those who want to lighten the estate-tax burden. Here are some of their proposals:

EXEMPTION

Farm groups and others would raise the estate-tax exemption as high as $200,000 from its present $60,000. That would restore the tax to roughly its 1942 status as a levy on large estates, but it would also cost the Treasury $2 billion a year. To narrow the revenue loss, President Ford wants to raise the exemption only to $150,000 in equal steps over five years.

But liberals say the government has no business giving those Americans who accumulate more than $60,000 during their lifetime a tax break at the expense of those who don't. "We seem to be moving back to an era of 'entailed' and perpetuated wealth, which Thomas Jefferson deplored in 1776," says Rep. Charles Vanik, an Ohio Democrat.

Besides, liberals say, a farmer can avoid the estate tax by incorporating his farm and giving away shares each year to his wife or children. And he can take out life insurance to pay his estate tax.

But liberals recognize the enormous pressure for relief. If some must be granted, they say, better through a credit against tax due than through a higher exemption. A credit gives everyone an equal dollar break, while an exemption favors those in higher brackets. A $35,700 credit would permit an estate of $150,000 to escape tax, just as would a $150,000 exemption; but it would cost the Treasury far less when applied to all estates, big and small.

MARITAL DEDUCTION

Almost everyone, liberals included, feels that this tax-free allowance should be increased from its present 50% to better reflect the contributions that the husband and the wife make to the family's wealth. Farmwives, who often labor alongside their husbands from dawn to dusk, are particularly incensed at the government's taxing part of what they feel is rightfully theirs already.

President Ford has proposed that husbands and wives be permitted to give or leave their spouses as much as they like, tax-free. The IRS would have to wait until the property passed to the next generation before getting its share.

LAND VALUATION

If a farmer's wife or children want to keep farming after his death, it is proposed, the IRS should value the farm as a farm and not as a potential housing development. Under various bills in Congress, open spaces near cities, timberland and historic sites would also be taxed at their "current-use" value rather than their fair market value. Some of the measures provide that if, within five years, the heirs sell the farm for development, the government "recaptures" the lost estate tax.

But some critics warn that even with such a recapture provision, current-use valuation would lure many wealthy individuals and speculators into farmland. One solution: Let a person leave his land's "development rights" to the government or a charity to satisfy the higher estate tax that would be due if the land were given its fair market value. If the heirs later wanted to sell the land for development, they could do so only after purchasing back the development rights.

TAX DEFERRAL

President Ford wants to give estates of farmers and small businessmen more time to pay. Under his proposal, they wouldn't have to pay any tax for five years. Then they would have 20 years, instead of the present 10, to pay what is owed. Interest on the unpaid balance would be at 4% instead of the present 7%. These benefits would be phased out for estates valued between $300,000 and $600,000.

Opponents argue that this Ford plan amounts to a 45% reduction in estate taxes equal to the amount of interest that could be earned on the unpaid balance.

RATES

Some groups favor lower estate-tax rates instead of, or in addition to, a higher exemption. Others say the rates should be restructured to switch more of the burden to the higher brackets. To ease the revenue loss from his proposed higher exemption, Mr. Ford would start taxing estates above his proposed $150,000 exemption at 30%, thus eliminating the lower rates that now apply to estates between $60,000 and $150,000.

GIFT TAXES

There are a number of proposals for easing the gift-tax bite. Some would increase the $3,000 annual exclusion, others the $30,000 lifetime exemption, others the 50% marital deduction. Still others would allow a taxpayer to credit the unused portion of lifetime gift-tax exclusions against his estate tax.

Congressional liberals, however, are resisting plans for softening both gifts and estate taxes; instead, they want to tighten up.

GAINS AT DEATH

If you sell a share of stock while you're alive, you pay income tax—at half your usual rate—on any gain over your purchase price. If you leave that share to someone, it is subject to estate taxes but not to income tax on the unrealized gain. What's more, your death permanently wipes out your original purchase price as the basis for taxing the gain. Instead, your heir receives a "stepped-up" basis, the stock's fair market value at the time of your death. Thus, if he ever sells, he will pay tax only on the amount of gain since you died.

Thomas Reese, legislative director of Taxation With Representation, a lobby group, says that failure to tax capital gains at death "is one of the key elements perpetuating the aristocracy of wealth that arose in this country after the Civil War." Mr. Reese, Sen. Kennedy and others want to tax capital gains on assets passed along at death just as if they had been sold during life. This change would bring the Treasury $2 billion a year, they figure.

Taxing capital gains at death could easily wipe out the benefit from a higher estate-tax exemption and would, the Treasury says, fall especially hard on small farms and small businesses.

TRUSTS

When Nelson Rockefeller was being considered for Vice President, he disclosed that he had received $38 million, 83% of his taxable income, from family trusts during one 10-year period. Under present law, an individual can leave his assets "in trust" to his grandchildren, with the income from the property going to his children.

The transfer is taxed once, not twice, as it would be if the property were passed from parent to child each time. "Generation-skipping" trusts can escape taxation in as many as three successive generations.

Some liberals would subject generation-skipping bequests or gifts to a surtax that would more or less equal the taxes due if no generation or generations had been skipped.

FOUNDATIONS

When Ailsa Mellon Bruce died in 1969, a tax of less than 1% was paid on her $570 million estate because she left most of it to the Mellon Foundation. According to some critics, private foundations sometimes perpetuate private control of wealth giving little to legitimate charities. These critics would limit the estate-tax deductions for contributions to private foundations, a step that educational institutions and other charities fear would drastically reduce their income.

Thus, while almost everyone acknowledges you can't take it with you, there's little agreement on what should happen to it when you leave it behind.

SENATE CONCERN WITH THE PROBLEM

Mr. NELSON. Mr. President, the article mentions Senator Russell Long, chairman of the Senate Finance Committee, and should have noted that he has authorized a public hearing on estate and gift tax revision in the Senate Finance Committee on May 17, with the Senator from Minnesota (Mr. Mondale) as chairman.

As chairman of the Senate Small Business Committee, as well as a member of the Finance Committee, I would like to point out that Senator Mondale served as cochairman of a joint Small Business Committee public hearing on estate tax problems of family farms and small businesses on August 26, 1976, along with the chairman of the Joint Economic Committee (Mr. Humphrey). This was followed by additional public hearings held by the Small Business Committee on September 25, 1975, and extensive committee research on this subject, which resulted in the introduction of the following bills:

S. 2394, sponsored by Senator Mondale, myself, and others;

A comprehensive Small Business Estate and Gift Tax Act, S. 2819, introduced by myself, Senator Mondale, Senator Humphrey, and others on December 18, 1975; and

Most recently, S. 3139 and S. 3140, introducted by myself and Senator Packwood, advancing the credit mechanism as an alternative to the exemption in providing relief.

It might be further observed that a delegation of Small Business Committee Senators, including Senator Packwood, Republican of Oregon, and Senator Haskell, Democrat of Colorado, and myself, appeared before the Ways and Means Committee on March 16 to argue for action during this Congress. We feel that our committee's work helped to crystallize the problems of the family farmer and the small business and encouraged the interest in the executive branch, which led President Ford to advance a set of proposals in January and March of this year. Now, at last, these issues, which are critical to the preservation of small businesses and family farm, and which had been buried for the past 3 decades, have finally emerged to the front pages of the Nation's respected business publications.

IMPACT ON FAMILY FARMS

It is just in time for a substantial portion of the Nation's farm and business families. Testimony in Small Business Committee hearings revealed that farmers had purchased their land 30 or 40 years ago at prices ranging from $50 to $100 an acre. Now the average is $354 an acre nationally, while it has reached $1,000 an acre in six States and is between $600 and $1,000 per acre in nine others.

Although not as well documented, the situation with business plants and equipment is similar.

Because of this, it is impossible in a growing number of cases to pay the Federal and State death taxes and still keep the farm or business in family operation.

We are finding that farms are being broken up and independent companies are being merged or sold to absentee corporations.

Our Small Business Committee investigation found that the estate taxes are literally mowing down independent businesses at the end of every generation. When these are gone, it becomes increasingly difficult to replace them. University studies show that it takes about $200,000 to go into farming, and, for most manufacturing operations, the capital needs are probably the same or larger. Thus, over time, we are eliminating small or independent enterprises from large and vital areas of the American economy.

TIME FOR ACTION

The evidence about the detrimental effects of estate taxes has come in, and it is time to examine the many pending legislative proposals and take action. The Ways and Means Committee hearings in March, under the chairmanship of the Congressman from Oregon (Mr. ULLMAN), have done that, and I am pleased that the Finance Committee hearings of May 17 will serve this function. I expect to participate in those hearings, to advocate the viewpoint of the family farm and smaller business, and hope that meaningful action will be taken in this Congress to update these laws, to restore the congressional intent of past years, and to, preserve a climate where small, family, and independent enterprise can be founded, can grow, and can be continued in local and independent ownership from one generation to another.

[From the Congressional Record, Senate, May 11, 1976]

APPENDIX B

NEW YORK TIMES ADVOCATES ESTATE TAX REFORM THIS YEAR

Mr. NELSON. Mr. President, as chairman of the Senate Small Business Committee, I am pleased to report that one of the Nation's leading newspapers, the New York Times, has concluded that:

"Consensus on a moderate reform of the estate tax is possible this year. The chance for it ought not to be missed."

This judgment was contained in an editorial of May 10, 1976, entitled, "Estate Tax Reform" which cited the many advantages to our economy, ecology, and lifestyle of revising the 34-year-old limitations of the estate and gift tax statutes. I ask unanimous consent that the editorial be printed in the RECORD at the conclusion of my remarks for the information of the many Senators and members of the public who are interested in this vital matter.

The PRESIDING OFFICER. Without objection, it is so ordered.

(See exhibit 1.)

Mr. NELSON. The Congress has been in the forefront of the effort to gain estate tax reform, notably with the joint hearings of the Small Business Committee, the Joint Economic Committee, and the Finance Committee on August 26 and September 25, 1975. These inquiries and the consequent legislative recommendations, including the Small Business Estate and Gift Tax Reform Act (S. 2819) and the bills offering a tax credit as an alternative to the exemption (S. 3139 and 3140) did much, in our view, to lay a foundation for the administration proposals of 1976 in this area.

The House Ways and Means Committee held a series of hearings during the spring of this year to evaluate the many pending proposals. The Senate Finance Committee will hold similar hearings on May 17.

I would hope that the "consensus" described by the New York Times can result in meaningful reform of the estate and gift tax laws during this session of Congress.

EXHIBIT 1

[From the New York Times, May 10, 1976, as reprinted in the Congressional Record, May 11, 1976]

ESTATE TAX REFORM

Because inflation has destroyed the meaning of exemptions and limits established by Congress back in 1942, the tax-writing committees have under consideration a major revision of the estate tax. Under existing law, a person may leave one-half of his estate tax-free to his spouse and on the other half, there is an exemption

from taxes of the first $60,000. In effect, therefore, the ordinary estate is taxed if its net worth exceeds $120,000.

Although this was an impressive sum when the law was written at the beginning of World War II, inflation has brought an ever-widening number of middle-class people within the tax collector's net.

President Ford has joined numerous Congressmen in both parties in calling attention to the particular hardship that the estate tax inflicts on farmers and ranchers—a concern that has been echoed by New York State legislative leaders. Because most of their assets consist of land, buildings, and machinery, their heirs may be forced to sell in order to obtain the capital to pay the tax.

Sophisticated farmers incorporate their operations and donate shares each year within gift tax limits. But many smaller farmers and ranchers fail to do so, and the result is to accelerate the steady decline in the number of family farms.

The needs of the environment also argue in favor of estate tax reform. As farm lands go on the market and become converted to non-farm uses, the open space that once surrounded cities, big and small, disappears. It is replaced by mile after dreary mile of low density, semi-suburban fringe development—a disaster in terms of ecological balance and human reaction and refreshment. In theory, strict zoning could control this kind of development and preserve natural greenbelts. Important as zoning is, however, experience has shown that by itself it is often insufficient to preserve open spaces. Economic incentives are also needed.

Of the many possible variations in the tax code, three changes seem desirable. The marital deduction could be increased from 50 percent to 100 percent, postponing the tax bite until the estate passes to the next generation. Second and more important, farms—and timberlands, wetlands, and historic sites as well—could be valued for tax purposes on the basis of their current use and not at their potential market value if they were developed into housing or shopping centers. Third, the present low exemption of $60,000 could be adjusted to reflect inflation by giving a tax credit as well. This would be preferable to increasing the exemption because a tax credit gives everyone the same relief while exemptions are more valuable to those in the higher brackets.

Tax reformers are understandably dubious of dealing separately with the estate tax problem when the entire tax code is in need of a thorough-going revision. But comprehensive tax reform is manifestly impossible in an election year and, indeed, will continue to be so as long as the Presidency and the Congress are controlled by opposing parties and opposing philosophies. Meanwhile, consensus on a moderate reform of the estate tax is possible this year. The chance for it ought not to be missed.

Senator MONDALE. I understand that Senator Kennedy is on his way.

Senator BENTSEN. Mr. Chairman, I believe that, unless we take some kind of action in substantially increasing this estate tax exemption, you are going to see over the next 20 years some 400,000 family farms and ranches go out of business.

The Department of Agriculture tells me that approximately 25 percent of the farms and ranches being sold today are being sold to settle taxes. So what you are seeing is the small family farm, the small family ranch, the small business, going out of existence. You are seeing the big corporate ranch and big corporate farmer and big corporation coming in and taking them over.

I had a newsman that was with me as I was making a comment about this before a group and he said: For a moment I thought that was kind of a rip-off for the rich; then I got to thinking about a sister of mine who had worked for her husband to build a farm and loved it as much as he did and yet when he died they weren't able to keep it and they had to sell it for tax purposes.

If you are talking about making $15,000 on a farm today you are talking about a farm that has to have a value of something over $200,000. Then you have the problem of somebody coming out and trying to buy an acre for a house and then seeing the IRS come in and

try to value the whole ranch based on what the purchase price was of that one particular acre. And that is wrong and I don't think this is the way it ought to be.

I received a letter from a friend of mine in Texas who is 73 years of age. He sat down and wrote the letter about how important it was to raise the estate tax exemption and how it might have been appropriate 30-some years ago but wasn't today, and now he would like to see his children be able to carry on that farm.

Then he decided to lie down and take a nap. This was last month. He told his wife he was going to have to rewrite this letter because he had misspelled the word "agriculture" and he had done it by hand and written it to me. He never awakened from that nap.

I would like to bring that letter and introduce it into the record as something that I think is important to what we are talking about today, and I very strongly support those who are here and are talking about raising this exemption substantially, talking about ways of easing the burden of paying that tax and give them time to do it and certainly trying to evaluate farms and ranches based on their economic return rather than some speculative value put on by a group of promoters with a syndication who might be buying stuff up in the general area.

We have seen in the last year or two some of these syndications collapse and go through three or four levels, and yet we have seen the IRS trying to use those sales to buy them on interest for only a period of 5 years or 2-percent down, "I will catch you later for the balance," calling that a true market value.

Senator MONDALE. That point is very well taken. You know, if you have a farm anywhere near a growth area, a major industry or even many of our secondary-size cities of 10,000 or 15,000 or more and they are growing, there is a good chance under the present law that the appraisers will come out at the time of estate tax settlement and say: "We are going to value this land for its value as a supermarket or as an industrial site." Instead of bearing a price for agricultural purposes, it will bear a price many times more—$10,000 an acre—absolutely prohibiting any chance that that land will stay in agriculture. I think that has significance not only for agriculture but for the environment because that encourages the chewing up of this land.

Senator HANSEN. Let me add my voice to that of the distinguished Senator from Texas in saying that people I have heard from—and that includes folks from one end of the country to the other—recognize precisely the accuracy of what Senator Bentsen has said.

Senator MONDALE. That provision is rather uniformly found in all of the bills. It is in mine and Senator Nelson's.

Senator BENTSEN. Yes.

Senator MONDALE. You have to do that.

Senator HANSEN. I don't go so far as some do, and there are some who think that maybe it is almost a perpetual requirement, but it would seem to me in order to simplify the tax law there ought to be a termination date some place. I don't know, I am not saying where it should be. Five years have been recommended. Maybe that isn't enough. But I think that if there was a time certain that it would start to apply that at least you would have accomplished an important goal.

Senator MONDALE. We are pleased to hear from our next witness, Senator Kennedy.

STATEMENT OF HON. EDWARD M. KENNEDY, A U.S. SENATOR FROM THE STATE OF MASSACHUSETTS

Senator KENNEDY. Thank you very much, Mr. Chairman, members of the committee.

I would like to file the complete statement in the record and then just summarize it. It will take about 12 or 15 minutes——

Senator MONDALE. It will be placed in the record as though read.

Senator KENNEDY [continuing]. If that is agreeable with the members of the committee.

Mr. Chairman, I appreciate this opportunity to appear before the Senate Finance Committee to present my views on the action necessary to reform the Federal estate and gift tax laws. There has been no thoroughgoing revision of this important segment of the Federal tax system since 1942. Estate and gift tax reform is, therefore, clearly overdue.

In order to evaluate proposals in this area, it is important to review the role that the taxation of the transfers of wealth has played in American political and social thought. It is also important to survey the actual operation of the present estate and gift tax laws to see how well—or how poorly—they are fulfilling their role in our overall tax system.

This analysis leads me to conclude that there are serious problems with our present system of taxing wealth transfers. In my remarks today, I will try to identify the most important of these problems, and offer proposals to correct the defects.

I believe that estate and gift taxes can and should be an important instrument for achieving economic and social justice in the United States. But the present system—largely a product of the 1920's and 1930's—is a weak and ineffective tool for a vastly different America entering the final quarter of this century.

My proposals for estate and gift tax reform are, therefore, intended to lay the necessary foundations for a truly fair and effective system of taxing transfers of accumulated wealth.

Estate and gift taxes thus perform a crucial role in the total Federal tax system. They impose a tax on a significant source of "ability to pay" that would otherwise fall outside the Federal tax structure. Strengthening the taxes on transfers of accumulated wealth thus strengthens the fairness of the total Federal tax system.

Conversely, weakening those taxes—as recommended by the Ford administration—is a step in the direction of greater social and economic injustice, a step toward greater concentration of wealth and power in the hands of a privileged few.

In considering proposed changes in the estate and gift tax system, it is important to understand how the system is operating at present. A few facts put the issue in perspective:

Only 7 percent of decedents dying each year pay any Federal estate tax; 93 percent do not. By definition, anyone who pays an estate tax is, therefore, in the top 7 percent of wealth with respect to those estates.

In 1977 the individual income tax will bring in $160 billion, the corporate income tax will bring in $60 billion and social security taxes will bring in $107 billion. These other taxes are already notorious for the heavy burdens they impose on individuals and corporations. Only the estate and gift taxes fail to pay their way.

The first chart I have attached to my testimony makes the point dramatically.

Up here you see on these charts exactly what the situation is. This chart here points out that 24 percent of Americans, when they die, have an estate of a value of less than $100; 56 percent have less than $5,000; 93 percent have less than the present $60,000 exemption.

So what we are really talking about is the top 7 percent of the population.

Now if you accept the Ford administration proposal, you will raise this figure to 98 percent of the American people who will pay no estate tax. You are effectively reducing the input of estate taxes to an even smaller number of the wealthy.

Now there are two broad sources for the present weakness in our system——

Senator MONDALE. Would you yield there for a minute?

Senator KENNEDY. Yes.

Senator MONDALE. We estimate that if a Minnesota farm is worth, say, $300,000, it will bring an income to those farmers of about $10,000 to $12,000 a year. Now I think we would all agree someone making that kind of money is not rich yet they would come within this——

Senator KENNEDY. I am going to come to that directly.

Senator MONDALE. These people are really very modest income people.

Senator KENNEDY. I will come to that and talk specifically about that particular problem, how we are trying to deal with that. I have some specific recommendations in that area which I know is of special interest to the members of this committee.

There are two broad sources for the present weakness in our system of taxing transfers of accumulated wealth:

The presence of substantial tax expenditures in the estate and gift taxes.

The presence of substantial defects in the structure of the present tax system.

As a result of the Budget Reform Act, Congress is now thoroughly familiar with the tax expenditure concept in the context of the Federal income tax system. It has proved a valuable tool in our efforts to control and rationalize Federal spending.

Tax experts and economists have long recognized that the concept is equally applicable to other taxes, including the estate and gift tax. The chairman of the Senate Budget Committee, Senator Muskie, has noted on the Senate floor the desirability of developing a tax expenditure budget for estate and gift taxes.

I am firmly of the view that it is time to add estate and gift tax expenditures to the tax expenditure budget, so that this avenue of Federal spending will be subject to the same scrutiny and control as other tax and direct spending by the Federal Government.

I am presenting today, for the first time, a tax expenditure budget for Federal estate and gift taxes. The analysis was developed by Professor Stanley S. Surrey of Harvard Law School and Professor Paul R. McDaniel of Boston College Law School. Its outline is given in the second chart attached to my testimony. And I am pleased to be able to make it available to the committee.

That is the second chart, Mr. Chairman. This has never really been developed before. It has been done for income taxes, and we have tried to develop it for estate and gift taxes.

Senator MONDALE. You don't have the marital deductions?

Senator KENNEDY. According to the experts, the marital deduction is not a tax expenditure. It is a structural feature of the estate tax, like the personal exemption in the income tax, which is also not a tax expenditure.

This initial tax expenditure budget provides dramatic evidence as to why these taxes are at present so ineffective in reaching those who have the greatest ability to pay. The Federal Government expends almost $3.5 billion through the transfer tax system—or 60 percent of the amount of revenue actually raised by estate and gift taxes. The comparable figure for the income tax system is only 48 percent. Thus, tax expenditures play an even larger proportional role in the estate tax than they do in the income tax.

There are two tax expenditures that have no place in our present transfer tax system: The exclusion for generation skipping transfers, which permits some wealth to be passed on for 100 years or longer, without ever incurring an estate or gift tax, and—the preferential treatment accorded lifetime gifts, which permits the very rich to transfer wealth to their children and grandchildren, while paying transfer taxes far less than those who transfer their property at death.

Together these two tax expenditures will cost the Federal Government over $1.5 billion in fiscal year 1977. And the entire benefit of these tax expenditures is available only to the wealthiest families in the country.

I urge the committee to take the following five actions to insure a fairer and more effective method of taxing transfers of accumulated wealth.

In order to terminate the present preferential treatment for lifetime giving as compared to transfers at death, the present dual estate and gift tax structure should be replaced by a single, unified transfer tax system.

Senator BENTSEN. I am having trouble following your testimony.

Senator KENNEDY. I am on page 5. This would be point 1. I am going through these five areas very quickly.

Under a unified transfer tax, there would be a single exemption and a single set of rates, applicable to all gifts and bequests of accumulated wealth, whether made during life or at death. Thus, the transfer tax would be a neutral factor in individuals' decisions as to whether to transfer property during life or at death. The same transfer tax liability would result in either case.

Generation-skipping transfers should be taxed. The abuse whereby wealthy families may transfer property through several generations without incurring any estate or gift tax must be ended. This abuse is accomplished by highly sophisticated and complex trusts, carefully

drafted by the expensive legal advisers of the rich, who enable their clients to "skip" estate and gift taxes for 100 years or more.

An effective transfer tax must tax transfers of wealth at least once each generation. Such a tax would follow the normal pattern of devolution of property in this country. Yet, present tax rules provide artificial incentives to the wealthy to follow this pattern in economic reality, but escape the payment of any estate or gift tax in the process.

Various techniques have been devised to end the abuse of generation-skipping trusts. The most satisfactory method is that recommended by the Treasury Department in 1969. It would impose a special additional tax on such arrangements to insure that the total tax burden is the same as if the transfer had followed the usual pattern from parent to child to grandchild.

The present marital deduction should be changed from a 50-percent to a 100-percent deduction for transfers between spouses.

This unlimited marital deduction will insure that the Federal transfer tax operates in conformity with the understanding of most married couples that the property they acquire during marriage is the result of their joint efforts.

A single transfer tax rate schedule should be provided. It should be designed to produce more rational progressivity than is true of the present rate schedules. And it should, of course, produce the revenues that Congress deems appropriate. At the least, I would urge the committee to set the initial rate at 14 percent.

A single $60,000 exemption should be provided for all lifetime and death transfers. The exemption can be used at any time by transferors with their estates entitled to the unused balance at their death.

In addition, the committee should give serious consideration to substituting a tax credit for the present exemption. If the committee takes this course, the level of the credit should be no higher than about $9,500, which is the level required to replace the $60,000 exemption. The revenues gained from this shift can be used to offset other changes or as a net gain to the Treasury. But there is no justification for using the shift to the credit as a pretext for conferring unwarranted relief on estates over $60,000.

A good deal of attention has focused in recent months on liquidity problems encountered by estates owning family farms or small businesses.

I think we all agree that it is undesirable to have a tax system that forces estates to sell a family farm or a family business in order to pay estate taxes. But I think we also agree that provisions to avoid this result should not produce windfalls for estates that do not have such problems.

In conjunction with my testimony today, I would like to submit for the record a statement I made last week, containing an analysis of studies on the liquidity problems encountered by estates owning family farms and of proposals to deal with those problems. These studies have convinced me that the Senate must be extremely cautious to tailor relief for farm estates in a way that solves the liquidity problems of the deserving few, without raising more serious problems for all legitimate farmers in the process.

[The material referred to follows:]

Statement of Senator Edward M. Kennedy

ESTATE TAX RELIEF FOR FAMILY FARMS: MAKING SURE THE SOLUTION IS NOT WORSE THAN THE PROBLEM, MAY 13, 1976

One of the major tax issues confronting this Congress is the liquidity problems that farm owners, especially the owners of small family farms, reportedly encounter when required to pay federal estate taxes. A number of bills have been introduced in the Senate and the House to provide various forms of estate tax relief to deal with this problem. And a great deal of testimony urging estate tax relief for farmers was presented to the House Ways and Means Committee in its recent hearings on estate and gift taxation.

Similar estate tax liquidity problems also confront the owners of small businesses, and in the near future I plan to discuss this question as well. But the purpose of my remarks today is to deal with issues affecting farms.

I am very sympathetic to the need to preserve farm land and open spaces as one of the nation's most important long run priorities. To that end, I submitted to the Senate Finance Committee in March a proposal designed to achieve this objective without impairing the equity or effectiveness of the estate tax system. I am pleased to have received a number of expressions of support for the proposal from those who share my interest in the preservation of family farms and open spaces.

My own continuing investigation into this issue has convinced me that Congress should be very careful in the type of estate tax relief that it provides for farm operations. It appears quite likely that most of the proposals that have been presented to Congress so far will achieve exactly the opposite results from those intended by their sponsors. That is, in the name of providing estate tax relief for farmers, many of these proposals will have the actual result of hastening the demise of the small family farm.

The purpose of my remarks today is to present the data that agricultural experts have developed on the liquidity issue and their analyses of the likely effects on the agricultural sector of various tax relief proposals. When this evidence is objectively analyzed, I hope that Congress will agree with me on the need for carefully targeted legislation in this area.

WHAT IS THE EXTENT OF THE LIQUIDITY PROBLEM?

The push for estate tax relief for farm estates has arisen from occasional reports that owners of family farms are forced to sell all or parts of the farm in order to obtain funds to pay federal estate taxes. Until recently, there has been general agreement—but little systematic analysis—that estates owning farms have faced liquidity problems significantly more severe than estates with other types of assets.

But recent studies indicate that serious liquidity problems are actually encountered by only very few estates owning farms. The staff of the Iowa Law Review recently conducted an extensive survey and analysis of estate planning and tax problems encountered by farm estates. With respect to the liquidity issue, the study reached some important conclusions that are worth quoting here in detail.[1]

"Insufficient liquidity can be defined as an excess of total probate taxes and costs over total liquid assets—a phenomenon which can have serious consequences for estate beneficiaries. Many authorities have commented on the liquidity problems commonly thought to be associated with farm estates. According to the hypothesis, while the level of liquid assets in most estates remains relatively constant, rising land values and fixed death tax exemptions, coupled with estate tax rates which have either remained constant or increased, all combine to cause a widening gap between probate taxes and costs on the one hand and the pool of liquid assets available for their payment on the other.

"The findings of this study fail to bear out the existence of the liquidity problem postulated by these authorities—at least among the 64 probate estates which were examined. There was a potential liquidity problem among living farmers,

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[1] Contemporary Studies Project: Large Farm Estate Planning and Probate in Iowa, 59 Iowa Law Review 794, 928–930 (1974) (footnotes omitted). The farm estates studied had federal estate tax gross estates of $250,000 or more. With the utilization of the marital deduction, the deductions for debts and administrative expenses, and the present $60,000 exemption, the taxable estates studied generally would have ranged from $40,000 and up. Thus, these are the estates that would benefit from most current proposals for estate tax relief.

however. But rather than indicating any pervasive dissimilarity between the two groups, this difference in liquidity appears to show merely that farm operations generally acquire greater amounts of liquid assets between retirement and death.

"For purposes of this study, estate liquidity was determined by comparing ordinary debts of the estate, and actual (or prospective) taxes and estate settlement costs with the amount of cash or readily convertible assets included in the estate. The respective liquidity conditions of living farmers and probate estates did not compare favorably. Probate estates had an average of $48,600 in total probate expenses and $54,800 in total liquid assets. Stated differently, probate expenses averaged 22% of the average appraised gross estate (AAGE) and liquid assets averaged 25% of AAGE. Living farmers, on the other hand, had an average of $61,900 in liquid assets or 9.5% of their average gross estate. Even if it is assumed that living farmers, upon their death, will suffer total probate expenses only in like proportion to those encountered by probate estates—22%—the extent of the *apparent* liquidity gap is clear.

"Even so, certain mitigating factors evidently operate to relieve this liquidity squeeze over time, a fact which is established beyond doubt by the sufficiency of liquidity found among *probate* estates. Whatever these factors may be—partial liquidation upon retirement and the greater degree of financial maturity which accompanies age being two possibilities—something occurs between the average ages of 51 and 75 years to ease the kind of liquidity squeeze which is perhaps merely symptomatic of that middle stage of the family farm cycle in which most of the subject-farmers found themselves at the time of this study. In any event, the conclusion seems inescapable that whatever liquidity problems were observed among living farmers, they constitute only a temporary condition which either tends to cure itself with the passage of time or is solved by the affirmative actions of the client or his attorney at some point prior to his death."

The Iowa Study thus requires revision of the generally accepted view of widespread liquidity problems in farm estates:

First, the liquidity problem generally is a temporary one encountered by living farmers.

Second, the overwhelming majority of farmers take steps prior to death to solve this problem and insure liquidity for their estates.

Third, only about 20% of the farm owners even have a potential liquidity problem.

These conclusions were verified in testimony presented by James D. Smith, Professor of Economics at Pennsylvania State University during the House Ways and Means Committee Estate and Gift Tax Hearings this year.

Professor Smith approached the liquidity problem by asking a simple question: What percentage of an estate's liquid assets—cash, stocks, bonds, life insurance—are required to pay estate taxes and probate costs? Obviously, if an estate has liquid assets in excess of its estate taxes and probate costs, it has no liquidity problem.

Professor Smith's findings, based on 1973 estate tax returns, are instructive. In analyzing estates with farm or noncorporate businesses, the only estates found with significant liquidity problems were those with less than $60,000 in assets—23% of these estates incurred probate costs and estate taxes (presumably state taxes) in excess of liquid assets. But the present $60,000 estate tax exemption already eliminates any federal estate taxes for this group. No changes in the federal estate tax deduction would help these estates.

On the other hand, 75% of the estates incurred estate taxes and probate costs in an amount that was *less than one-half* of the liquid assets owned by the estate. In other words, in three-fourths of the estates owning farms or non-corporate businesses in 1973, not only was the estate not required to sell these assets to pay estate taxes, but the estate was also passed on to the heirs with substantial liquid assets as well.

In only 9 to 14% of the larger estates studied did estate taxes plus probate costs equal or exceed liquid assets. Only in these estates was there even a possibility that the farm would have to be sold to pay estate taxes.

The following table summarizes Professor Smith's findings:

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

Type of return and economic estate	Number of returns (thousands)	Ratio of (tax plus costs) to (liquid assets minus debts)					
		0 to 0.25	0.25 to 0.50	0.50 to 0.75	0.75 to 1.0	1.0-plus	All
Some farm or noncorp business assets:							
$1 to $60,000	596	44.3	19.0	6.0	7.7	23.0	100
$60,000 to $80,000	3,482	65.5	15.8	5.5	3.6	9.6	100
$80,000 to $100,000	3,485	63.3	17.2	6.6	2.9	9.9	100
$100,000 to $150,000	6,156	57.2	19.0	8.4	3.3	12.0	100
$150,000 to $200,000	3,152	51.4	23.2	8.9	4.6	11.8	100
$200,000 to $300,000	3,420	46.2	26.2	8.2	6.0	13.5	100
$300,000 to $500,000	2,251	37.1	33.2	10.4	5.0	14.3	100
$500,000 to $1,000,000	1,473	35.3	34.8	11.2	4.8	13.9	100
$1,000,000 plus	878	31.8	40.1	11.6	5.0	11.5	100
All returns	24,843	52.7	22.8	8.2	4.2	12.1	100

Nor did Professor Smith's study find any significant liquidity problems where the estate passed to the surviving spouse. Some 57% of these estates with assets from $60,000–$100,000 paid no federal estate taxes at all under present rules. Almost half of the estates with assets from $100,000–$150,000 paid no estate tax. Obviously, an increase in the estate tax exemption will not help these estates at all.

These studies indicate that the great majority of farm estates encounter no significant liquidity problems.

On the other hand, a small percentage of farm estates do face quite significant liquidity shortages, and are therefore deserving of relief. We must be sure, however, that provisions intended to help these deserving cases do not provide windfalls to those who do not require federal financial assistance.

ARE PRESENT DEATH TAXES DIVERTING LAND FROM FARM USE

Another relevant factor is whether present federal estate and gift taxes are operating to reduce the amount of land devoted to farm and open spaces. According to a 1974 publication by the U.S. Department of Agriculture, 95% of the farm acreage transferred in 1973 remained in agriculture, forestry or recreation use. In 1974, the figure was 93%.[2]

Thus, even when farm land is transferred, it is almost always to someone who is going to farm the land also. This data led W. Fred Woods, an agricultural economist with the Department of Agriculture, to conclude that "we cannot say that farmland is presently being diverted from agricultural use on any substantial scale as a result of death tax burdens.[3]

THE IMPACT OF ESTATE TAXES ON THE FAMILY FARM

Although the data show that significant liquidity problems are confined to small estates, it is important to ask whether the family farm is faced with disproportionately difficult problems so that the existence of this vital institution is jeopardized. Here again, studies indicate that even when one considers preservation of the family farm as a primary goal, estate taxes have little impact.

Neil E. Harl, Professor of Economics at Iowa State University, examined the role of federal estate tax rules in preserving small family farms. His study concluded:[4]

"Can agriculture make a compelling case for special [estate tax] treatment? The big argument is the adverse effect on the family farm. But let's look at that argument carefully.

"The great majority of the farm businesses don't continue into the next generation anyway. For some, the children are all grown and live off the farm, and their's no one in sight to assume ownership and management of the farm

[2] Farm Real Estate Market Developments (CD-79), Economic Research Service, U.S. Dept. of Agriculture, (July, 1974) at p. 40.

[3] Woods, "Death Tax Policy: Implications for Rural Land Use," Paper presented to the Conference on Rural Land-Use Policy in the Northeast, Atlantic City, New Jersey (Oct. 3, 1974) at p. 14.

[4] Harl, Some Reflections on Federal Estate Tax Reform (Feb. 9, 1976).

business. For some others, there may be a farming son, but he's running his own independent operation by the time the parents die. He may have been helped earlier by the parents before he spun off in his own economic orbit. In some cases, he may have been the parent's tenant. But the key point is that in a high percentage of the cases, *the son's farm business is well established by the time the parents die.*

"For this entire group of farmers— and it may total 70% to 80% of the total, maybe more—the death tax burden certainly affects the amount of capital to pass to the heirs. But it doesn't have a great impact on the farm business."

Thus, the problem of preserving the "family" farm is confined to a small percentage of farm estates. Again, the lesson is that estate tax relief for liquidity problems must be carefully structured.

THE EFFECT ON AGRICULTURE OF INCREASING THE ESTATE TAX EXEMPTION

Many of us have noted the serious adverse effects that a general increase in the estate tax exemption would have. These problems are outlined in the letter and fact sheet at the conclusion of my remarks.

But would a general increase in the $60,000 estate tax exemption be a desirable step for the agricultural sector of our economy? As well-meaning as advocates of an increased exemption are in this respect, agricultural economists who have examined the matter have found that increasing the estate tax exemption can be expected to produce significant adverse effects for family farm owners.

In September 1975, the Cooperative Extension Service of the College of Agriculture of the University of Illinois at Champaign-Urbana issued an analysis by a number of distinguished agricultural economists, both in and out of government, entitled "Death and Taxes: Policy Issues Affecting Farm Property Transfers." The studies examined the impact on agriculture of various estate and gift tax changes. Three significant agricultural criteria were employed to evaluate the various proposed changes: Farmland buying opportunities, effect on farm size, and effect on amount of farm land ownership by non-farmers.

According to the studies, a general increase in the estate tax exemption would produce adverse effects for small farmers under all three criteria.

1. *An increased estate tax exemption could reduce farmland buying opportunities.* Applying the first test, the study concluded: "High exemption or low taxes on death transfer of farm property give an advantage to the heirs of the farmer over all other people, including young persons who would like to buy farmland. So the equality of opportunity principle is violated.

"Furthermore, if it is true that young farmers can more readily enter farming on a holding somewhat smaller than many retiring farmers have built up, some division of large holdings at the time of transfer may particularly improve equality of opportunity. The aspiring young farmers would then find it easier to buy a modest-sized farm."

2. *An increased estate tax exemption may hasten the trend to larger and larger farms in the U.S.*

One argument advanced by the Administration and others for a $150,000 estate tax exemption it that it will help preserve the small farm. In fact, the study concluded, the opposite may result:

"A higher death tax exemption or lower rates could lead to larger farms in the United States, as there would be less pressure for selling all or part of a large farm estate in order to pay taxes. However, larger farms kept intact following death might be operated more frequently by tenants than by owners. Frequently the heirs will not be operating farmers."

3. *A higher estate tax exemption will tend to produce more farm land ownership by non-farmers.*

The study concluded here:

"Low death tax exemptions and relatively high rates have some tendency to preserve an agriculture where operators own at least part of their land. Higher exemptions and lower rates have an opposite effect. They facilitate moving toward a financially elite landholding class in agriculture, and landholding by other than farm operators."

THE EFFECT ON AGRICULTURE OF PREFERENTIAL ESTATE TAX TREATMENT FOR FARMS

In contrast to the across-the-board increase in the estate tax exemption favored by the Administration, two general types of bills have been introduced in Congress to provide preferential estate tax treatment for farms without providing

windfalls to non-farmers: Bills which allow preferential valuation of farms for estate tax purposes; bills which provide an additional exemption or credit for farms.

Can these approaches to the farm liquidity problem be expected to produce more favorable results for agriculture than a general exemption increase? Unfortunately, there is evidence that these "solutions" may actually be worse for agriculture than the present problem.

The studies published by the University of Illinois also examined the effects of these proposals under the same criteria. The studies found:

1. *Preferential estate tax treatment for farms will reduce farm land buying opportunities, especially for young farmers.*

2. *Preferential treatment for farms would result in larger farm operations.*

3. *Most important, preferential treatment for farms will substantially increase ownership of farm land by non-farmers.* Here, the study concluded, "Selective concessions for agricultural estates could attract investments of well-to-do non-farmers in farm land and tend toward transfer of ownership and control out of the hands of operating farmers."

". . . The proposal that is most certain to move agriculture toward a system of nonfarm-landholding with more farm tenancy would be an increased death tax exemption for farm estates only. Such selective preferential treatment would also be highly inequitable."

In sum, the most serious danger in proposals for preferential estate tax treatment for farms is that it may simply create a new form of "tax shelter" involving purchases of farm land by wealthy outside investors to shield their assets from estate taxes.

In the study cited earlier, Fred Woods of the Department of Agriculture warned: "Thus, such legislation could contribute further to the attractiveness of qualifying types of rural land as vehicles for wealthy individuals to employ in passing more of their assets to their heirs. Consequently, such legislation might well increase the demand for these types of land and contribute to further inflationary land price increases."

Professor Harl of Iowa State University, whose study was also cited earlier, has made the same point: "We've learned that agriculture's unique cash method of accounting has been a major factor attracting outside capital in the past into numerous farming ventures. It's taken years of legislative effort to close off areas of abuse by outside investors. A federal estate tax break for agriculture alone could face the same kinds of problems."

NEEDED: A REAL PRESCRIPTION FOR THE PROBLEM, NOT A QUICK FIX

The only substantial evidence that I have been able to uncover leads me to believe that the Congress must act very carefully in fashioning a solution to the genuine liquidity problems faced by some estates owning small family farms. Failure to provide carefully targeted relief may well produce more serious problems for agriculture in the future than problems we are trying to solve today.

I believe that the proposal I have submitted to the Senate Finance Committee meets this criterion. Under my proposal, a family farm will be valued for federal estate tax purposes at its value for farm use if either if the following conditions are met:

1. The decedent in his or her will, or the decedent's estate within the period of time for filing a federal estate tax return, transfers the development rights with respect to the property to a state or local government (or to an instrumentality thereof), or to an organization described in section 501 (c)(3) of the Code, the exempt function of which is to preserve land and open spaces. The decedent, of course, may have taken this action prior to death, and thus guaranteed valuation at the value for farm purposes.

2. Alternatively, the decedent or the decedent's estate may transfer such development rights to the Secretary of Agriculture.

Either of these transfers will constitute satisfaction of the federal estate tax liability for the tax that otherwise would be attributable to the difference between the value of the land at its highest and best use and its value as farm property.

"Development rights" are actually negative easements. They do not give the holder of the rights the power to take any action with respect to the land covered by the development rights except the right to prevent commercial or residential development on the land. Thus, the use of the farm property as farm property by the heirs and beneficiaries of the decedent will not in any way be impaired by possession of the development rights by a state or local government, for example.

This proposal will insure that federal estate taxes will be forgiven only in those situations in which there is assurance that the farm property will in fact continue to be used as farm property. If at some later date, the owners of the farm desire to develop it, or to sell it to a purchaser who wants to develop the land, they can do so and they (or the purchaser) can acquire the development rights from the state or local government, charitable organization, or the Secretary of Agriculture, as the case may be, by paying to the holder of the rights the estate taxes foregone by the federal government, plus interest.

This proposal offers several advantages over other proposals that have been advanced to solve the liquidity problem for owners of farm operations:

It confines the federal estate tax relief to farm operations and to those farm families who are serious in thier desire to continue operating as a family farm.

It does not involve any interference in the family farm operation by federal, state or local government.

If it subsequently becomes desirable to utilize the farm land in commercial or residential development, it will be possible to do so, but at no financial loss to the federal government, in the case of development rights held by the Secretary of Agriculture. In the case of rights held by state or local governments, the proposal can be seen as a form of revenue sharing.

The proposal takes advantage of the most innovative of the techniques presently being utilized for conservation of open spaces and thus encourages use of these progressive land use techniques.

I am pleased that this proposal is receiving a favorable reaction and is being studied by those sharing my concern to preserve farm lands and open spaces.

Included at the end of my remarks, for example, is a letter from Mr. Robert O. Binnewies, Executive Direc[illegible] of the Maine Coast Heritage Trust, a privately funded conservation organization in Maine, urging adoption of my proposal.

If the Senate feels we should go further and provide some form of preferential estate tax treatment for farm estates, then two steps must be taken to avoid the serious problems I have outlined above:

1. The measure initially must be effective for a limited period of time so that Congress may study the results of the provision in terms of costs and benefits, equity, effectiveness and other factors. I would suggest a 10-year initial period to give adequate time for evaluation.

2. Congress must require, after a period of 8 years, the preparation and submission of a report on the effects of the program, including recommendations as to whether it should be terminated, continued, or modified. The study should be conducted by the Congressional Budget Office in cooperation with the Joint Committee on Internal Revenue Taxation, the House and Senate Agriculture Committees, the Department of Agriculture and the Treasury Department.

In conclusion, I am convinced that there are certain owners of small family farms who need relief from the burden of federal estate taxes. But the evidence is also convincing that the problem is confined to a small percentage of farm estates and that the relief must be specifically directed to these deserving farm owners. I hope that the suggestions I have outlined will help Congress to achieve this goal.

Senator KENNEDY. Equally cautious solutions are needed to solve the liquidity problems of estates owning small businesses. The data in the analysis indicate that serious liquidity problems are again confined to about 10 percent of estates owning small noncorporate businesses. Further, we must be careful, in defining "small business," that we do not provide unjustifiable tax relief for the wealthy.

The most significant reform to alleviate t[illegible] liquidity problems for deserving estates owning farms and small businesses is the unlimited marital deduction. Testimony before the House Ways and Means Committee in its recent estate and gift tax hearings indicated that the most serious problems were being encountered in estates where the surviving spouse inherited the farm or small business.

My proposal for an unlimited marital deduction will eliminate all liquidity problems for estates with farms and family businesses where the surviving spouse receives the property.

To solve the liquidity problems encountered where a farm or small business passes to the next generation, I propose a special family farm and small business tax credit.

This tax credit would contain the following four elements:

One: The credit would be established at an amount which, when added to the basic $60,000 exemption, would exempt from the estate tax family farms and small businesses, up to $175,000 in value. This relief, larger than the relief in the Ford administration proposal for such estates, would have only a modest cost because it would be available only for farms and small businesses.

Two: The credit would be available only to estates owning farms and small businesses which stay in the family.

Three: If the farm or small business for which an additional credit has been granted is subsequently transferred outside the family, the amount of the additional credit should be repaid to the Treasury.

Four: The special tax credit should carry a termination provision effective 10 years from the date of its enactment. This will insure that Congress must evaluate the cost, the benefit, the equity, and the effectiveness of the credit. After 8 years, Congress should require a report on the effects of the program, including recommendations as to whether it should be terminated, continued, or modified. The study should be conducted by the Congressional Budget Office in cooperation with the staff of the Joint Committee on Internal Revenue Taxation, the House and Senate Agriculture and Small Business Committees, the Department of Agriculture, the Small Business Administration, and the Treasury Department.

Farmers and owners of environmentally valuable open spaces should be permitted to transfer development rights on the property to local governments, to charities, or to the Department of Agriculture or the Department of the Interior. Such transfers will insure that the farmlands or open spaces will be valued for estate tax purposes only at farm or open space value. The value attributable to development potential would thus be exempted from estate tax, as long as the land continued to be a farm or open space. This special treatment would be available even if the recipient of the land was not a member of the decedent's family.

Finally, I also hope that Congress will act as promptly as possible to close what I believe is the most notorious single loophole in the tax laws, the failure to tax capital gains at death. I regard this issue as part of income tax reform. I have previously submitted my proposals to the committee in this area for consideration as part of H.R. 10612, the House-passed income tax reform bill now being considered by the committee.

Comprehensive estate and gift tax reform is urgently needed in the United States, because a system of effective taxation of the transfer of accumulated wealth is vital to the achievement of our national goals of economic and social justice. I beleive that the proposals I have offered today represent constructive steps to achieve that goal. I look forward to working with this committee in the months ahead, as we work to make the long-promised goal of estate and gift tax reform a reality.

Mr. Chairman, I know that Senator Nelson testified earlier today in terms of his proposals. We are not very far apart, although I would hope that in any extension of the credit, we would still maintain the

level of $60,000. The effect of his credit would be to raise that level significantly. Therefore, it would benefit a number of different groups in the highest income brackets. I don't think the case has been made for an increase in the $60,000 exemption.

Senator MONDALE. I believe the Senator Nelson proposal would eliminate the $60,000 exemption and substitute the credit.

Senator KENNEDY. But the effect of that credit in place of the exemption will be to increase the $6,000 exemption.

Senator MONDALE. Then he has a phase out, the credit phases out at the upper level.

Senator KENNEDY. The principal question is how we are going to target the relief to reach the family farm and the small business in such a way that we will not be creating windfalls for those who don't deserve them. By creating an extra benefit for family farms, we may open up a new loophole that will be used by those with large accumulations of wealth to avoid paying estate taxes. In effect, they may bid up the price of farms and drive family farmers off their land.

I would sincerely hope that in fashioning a solution to meet this legitimate objective, which I strongly support, it can be done in such a way that we are not going to be creating a new kind of loophole.

Senator MONDALE. Thank you very much, Senator, for a most useful statement.

Senator Bentsen.

Senator BENTSEN. Yes.

Senator Kennedy, when you talk about a 10-year payment, of course you have the 35-percent limitation now, you say you have liberalized it to the extent of reducing that to 25-percent. To give them the credit for doing that, as I recall, they have also changed it to now make them reflect something in a much higher interest rate than we previously had. As I recall, it was about 4-percent and now it is something that is geared to prime, which is substantially higher than that.

Even with a 10-year period of time to do it, if you keep the exemption as low as $6,000, you are talking about a farm that is valued at today, with your equipment and the speculative value that has come to farms, you are talking about something that certainly is valued at $200,000 to $300,000 and has an income of $10,000 to $15,000.

So if you are talking about those people trying to pay off that estate tax, and paying that kind of interest charge already, if you have got a market value of some $300,000 and you are having to pay a 7-percent rate on that, you are talking about your paying about a 6-percent rate, you are talking about $18,000 there.

So you are finding yourself in a position of having to go through a partial liquidation and that is a very difficult thing to accomplish in trying to sell off part of a farm. I think what they finally end up doing is selling the entire thing.

So that is why I think that you are in a position where if you are going to continue family farms in this country, and the estimate is that over the next 20 years some 400,000 of them are going to go out of existence, with the primary cause of it being trying to pay off these taxes, as someone dies and the kids try to carry it and find they can't do it, so I think basically you have to raise the exemption in order to bring that about.

Even though it is a relatively small number of people percentage-wise, I still don't see any reason for them to try to bring that kind of inequity to them and I think it is a social objective and economic objective and in the national interest to try to keep these small farms and these small ranches in existence.

Senator KENNEDY. Senator, I agree with you and that is why, in my suggestion, I would raise the exemption to $175,000. We are going beyond the administration. What we are trying to do is target the relief on the farms or small businesses themselves.

I have tried to suggest a proposition to deal effectively with the problems of the family farm or small business, but not written so broadly or so generally that anyone who just owns any stock is going to receive a windfall.

What concerns me is that by raising the exemption for carryover, you are going to be providing that kind of windfall to a great number of Americans who have absolutely no interest in the family farm.

Senator BENTSEN. Let's deal with another point, then, that you have also brought up, and one that is a very popular point raised in some schools of thought, and that again is that capital gains escape any kind of a tax on death. What you are finding, I think, in this kind of a situation is a couple of situations developing. You are finding a very substantial increase in the capital gains tax that has been taking place. It has been raised to 35 percent and then you get a preference tax on top of that, so you get up to about 37 percent. Then if you are in an area like New York, California, they have another 5 percent that is added on to it.

So this is one of the things that has been forcing people to make a tax decision and not economic decisions and not transferring properties. It is a voluntary thing, this transfer of property.

I, frankly, think that we ought to see a substantial reduction in the capital gains tax on assets that have been held over a long period of time. I am for taxing profits but not for taxing illusory profits, and I think this is what you are finding in a lot of these situations where something has been held and owned 15, 20, 25 years and inflation has taken place and much of that gain is not really there.

And to say in effect we are going to have a double tax. I hold very much to the contrary point of view that what people are talking about is trying to tax it twice on death.

Senator KENNEDY. Well, Senator, I know that there are differing views on this. I would put the reduction of the capital gains tax very low in my list of priorities.

There are, obviously, questions about capital formation and other issues. I have suggested at other times to the committee, that in terms of tax expenditures, we ought to apply three tests. One is, is there a sound public policy purpose for either a direct expenditure or a tax expenditure? If we can say yes there is, then the question is, is it better to have a tax expenditure and direct appropriation.

We may say with regard to some areas, it is much better to act through a tax expenditure rather than through a direct appropriation. Then, the third test comes, if you are going to provide a tax expenditure, are we devising the best means to carry out the purpose. I would much rather provide in the area of, say, oil, a greater incentive for investment to the person really taking the risk, rather than create a tax loophole for the rich and wealthy.

We have to try and define these goals and apply these tests. What I tried to do in the earlier presentation is to apply them in the areas of income tax. Here, I have tried to do it in the area of the estate tax.

In the case of capital gains, I think eventually you have to ask yourselves whether this is really the most effective way of encouraging capital formation. This committee has to study that issue.

I think a good many businessmen and economists would disagree, but it is a major issue.

Senator BENTSEN. No one can quarrel with the objectives you are talking about. I think we both share it. The question is how we measure those and how people react to these kinds of taxes and what actions they take. And my point is if you have someone, for example, who has built a small business, reaches the age they want to retire, and they get ready to sell it and find they are, themselves, facing in California or New York something like a 40 percent tax, then they make themselves a tax decision and not an economic decision.

The sale is a voluntary thing so they decide not to sell it and so you find capital immobilized in that kind of situation.

So, I feel over a long period of time where you have allowed for an inflation factor, in effect, that you are actually probably going to pick up more taxes by more transactions being made rather than finding it frozen, and from the surveys we have made we have in general found that kind of reaction coming back.

I must agree that that is a judgmental thing and they can be argued on either side as to how the public would finally react on it.

Senator KENNEDY. I would say, Senator, that there are those who make a strong case that capital is frozen now because of the advantages of holding assets until death. A sliding scale for capital gains tax would raise similar problems, because people would hold their assets longer to get the lower tax rates. This is the lock-in effect that bothers me.

Senator BENTSEN. What that fellow does, he merges his company, that is what he does, instead of selling it and not getting the diversification, he ends up taking a tax free merger and merging it into a wicket corporation which he never wanted in the first place.

Senator HANSEN. I join with the others on the committee, Senator Kennedy, in thanking you for your appearance this morning and for the very interesting presentation that you have made.

I want to study it so that I may understand it better than I do now, but I would like to just follow along, though I think it has been fairly well explored by Senator Bentsen.

You speak about capital gains at death. I know there are those of us in the Congress who attach great moment to social programs and we come down on different sides of them. I am not as intrigued with Government's participation in trying to achieve certain social objectives as are some.

I was visiting with a member of Parliament a couple of weeks ago and he said the British are totally bankrupt on social program ideas. Every idea that can be suggested to enhance the social well being of Britishers has been adopted. And he said they are just about at the end of their rope, they don't know what more to offer.

I suppose different people, historians, likely, will take a look at England and they may be able, given the advantage of objectivity, which I admit I do not now have, because it is pretty hard to look

at a situation right today and to be objective about it—it seems to me that what the trend in England certainly was—was to deny more and more the responsibility and obligation of individuals to do for themselves those things that they can and I think can do best, and to transfer this role more and more to Government.

In this regard, I come back to the point on capital gains. In order to achieve the social objectives we have done violence to the value of the dollar, and that is what we are talking about, because when we are talking about taxes or capital gains or whatever, we are talking about the value of a dollar, we aren't talking about a bushel of wheat or a pound of corn, or acre of land, we are talking about dollars.

And one of the reasons that I am so intrigued with Senator Bentsen's idea on graduating downward capital gains is that it does recognize that when we speak about capital gains having occurred, what we are really talking about is that there has been a hell of a lot of inflation.

I think U.S. News had a little editorial maybe a couple of months ago on a person who sells a home that in 1950 cost him $50,000, he gets $100,000 for it today. I suppose most of us, if we didn't stop to think, would think that is a pretty good deal, it is a good time to sell.

According to the U.S. News and World Report story it would be a very poor time to sell because the value of a dollar today as compared with the dollar at the time the home was purchased would buy only 48 cents, so you wouldn't come out even on that basis.

Now, my question to you is, don't you think that some recognition ought to be given in examining any changes that may be suggested in capital gains taxes to what has been the result of the erosive effects of inflation upon our dollar?

Senator KENNEDY. Well, I think they could be and should be, Senator. I do feel that we are talking about the totality of growth of tax expenditures, which has enormous importance in terms of our economy generally, increasingly so. We debate at length the size of our budget. the defense budget, yet we see tax expenditures increasing much faster than our total budget. I think it has direct economic implications that ought to be examined by this committee. I think there are serious questions of the implications of that growth that should be examined.

The problem is clear, for example, in the area of tax shelters. You can't find in the Internal Revenue Code tax shelters for moving pictures of azalea plants or real estate or any of the other factors. But they have grown up, and we ought to be constantly asking ourselves these questions about these abuses.

In the area of new capital formation, I think it is a very legitimate issue that ought to be considered in great detail by the members of this committee.

I, myself, feel that in the areas which you have outlined there is a variety of different factors at work, including the continued escalation of inflationary pressures on our economy, which have caused a deterioration of the value of the dollar.

The same problem exists in other areas. It clearly exists in health care. We have mandated additional spending programs without increasing the supply of services, and costs are going right out of sight.

The Congressional Budget Office has estimated that by 1981, there will be $250 billion in total health care spending unless we come to grips with inflation.

These are broad questions that could be debated and discussed and I appreciate with you the need for such a discussion and debate.

They hit the people in my State on fixed incomes as they do in Wyoming. They are as common to your State in Casper and Cheyenne as they are to Chicapee and New Bedford and Falls River in Massachusetts.

But I think that the proposals here meet the criteria we have mentioned with respect to the efficiency and equity of tax expenditures.

Senator BENTSEN. I know the Senator has another committee he has to chair.

Senator HANSEN. If I could, I just want to make one statement.

I am glad you mentioned the points you have and I appreciate it. I appreciate the intense interest you have taken in this area and in so many areas.

I would say this: Defense, despite what people may think about it, 10 years ago accounted for a little bit less than 4 percent of the total budget; 10 years later it is a little over 24 percent. HEW, a Department of Government that wasn't even in existence 20 years ago, represents nearly one-third of it. And one thing that disturbs me about so many social programs is that when the Government starts picking up the tab a lot of things happen.

I am not talking about denying poor people, people unable to buy necessary medical aids, the sort of treatment that they need. We have two hospitals that are not tax supported in Wyoming, one of the two happens to be in my hometown, but as soon as the Government starts picking up the tab you know you want to go in for every little ache and pain that you may have, and the doctors, we have found this out, as we have examined medicare and medicaid, have taken advantage of an opportunity to really gouge the taxpayer, and I have to believe, Mr. Chairman, that we have, if we look around and see how the other countries have handled these programs, there certainly isn't all pluses to be said for Government participation.

Senator KENNEDY. I would have to have 1 minute to comment just on the health.

Senator MONDALE [presiding]. Maybe we could hold these health hearings some other time.

Senator KENNEDY. Just to this point.

Senator MONDALE. One minute.

Senator KENNEDY. Yes. You will find both the HEW studies and congressional research studies have shown it generally isn't the people in the poorer areas and the unserved areas that abuse and overutilize services. It is generally the suburban areas. This might not be as true in communities in Wyoming, but the health economics studies reflect that fact. The capacity of the suburbs to overutilize health care services and swallow up specialists is virtually unlimited. I agree with your point on that. We are trying to alter or change that.

Senator MONDALE. Senator Dole.

Senator DOLE. I will be very brief.

Is there a definition in the legislation of small business "family" farm? Is that defined somewhere?

Senator KENNEDY. Yes, it is defined in existing law. Perhaps the definition can be improved.

Senator DOLE. It certainly will be defined and I think it is necessary, because "small business" and "family farm" are catch words.

Senator KENNEDY. Yes.

Senator DOLE. I was on the Family Farm Subcommittee in the House. We never met but it had great appeal. So, it has a good ring, and I think if it is properly defined we could have even greater benefits than suggested by the administration.

Senator KENNEDY. I think the Senator is quite correct, there are definitions which exist in law. They ought to be tightened.

Senator DOLE. I think I agree. I think Secretary Simon indicated they would be sending up legislation on some areas. Increasing the marital deduction makes a great deal of sense. But doesn't that just delay the tax impact, assuming that the wife survives 4 or 5 years? Does it in any way discourage more effective estate planning if you give them an out as far as taxes are concerned? Are they just going to wait until the survivor passes on and then be hit with a larger tax?

Senator KENNEDY. Well, they will still do the planning, I imagine, Senator, in terms of the best way to meet their family objectives or personal desires.

Senator DOLE. I think the same can be said of your comments concerning generation-skipping transfers. That seems to be an area that needs some attention because it really is designed to avoid tax and is used largely by the wealthy. I think you said that taxes can be avoided for several decades.

Senator KENNEDY. Well, in some instances it can be at least two or three generations.

Senator DOLE. If you made gift transfers in your lifetime of $60,000, I understand you couple those together and that would have no exemption at death; is that correct?

Senator KENNEDY. Yes, the Senator is correct.

Senator DOLE. And with reference to the question raised by Senator Mondale, you have this rather large investment.

Senator KENNEDY. You would still be able under the existing law to give away $3,000, a year. This is basically an administrative factor. Individuals may want to give away during their life. They may want to hold until death. It ought to be left to the individual, but the tax implication should not be a factor.

Senator DOLE. Finally, in the area Senator Mondale and Senator Bentsen referred to an investment of, say, $300,000 in a farm or a small business may produce an income of $10,000 to $15,000. Would that be considered a family farm or small business, or does that exceed what the definition might set forth?

Senator KENNEDY. With the unlimited marital deduction, I favor, it will go to the wife without any tax.

Senator MONDALE. When she dies under these tables I have seen, that estate would pay $65,000 in estate taxes.

Senator KENNEDY. They would have a $175,000 exemption.

Senator MONDALE. I am talking about under the present law.

Senator BENTSEN. May I ask, the Senator in his prepared statement calls it tax credit. He has just referred to it as an exemption. He has obviously given a great deal of thought to this. I think some of it I could find myself very much in agreement with. But I am trying to find out what the difference is between a tax credit and exemption, if you mean them as two different things?

Senator KENNEDY. They are different, but it is easier for the purpose of discussion to translate the credit into a corresponding exemption. A $9,500 credit is equivalent to a $60,000 exemption. For farms, I would favor a credit equal to a $175,000 exemption.

Senator BENTSEN. It is a credit rather than an exemption, you meant to say?

Senator KENNEDY. Yes. It is generally the credit that has more of a value to lower income, middle income people than the exemption.

Senator MONDALE. Thank you very much for your useful contribution.

[The prepared statement of Senator Kennedy follows:]

PREPARED STATEMENT OF SENATOR EDWARD M. KENNEDY

I appreciate this opportunity to appear before the Senate Finance Committee to present my views on the action necessary to reform the Federal Estate and Gift Tax laws. There has been no thoroughgoing revision of this important segment of the Federal tax system since 1942. Estate and gift tax reform is therefore clearly overdue.

In order to evaluate proposals in this area, it is important to review the role that the taxation of transfers of wealth has played in American political and social thought. It is also important to survey the actual operation of the present estate and gift tax laws to see how well—or how poorly—they are fulfilling their role in our overall tax system.

This analysis leads me to conclude that there are serious problems with our present system of taxing wealth transfers. In my remarks today, I will try to identify the most important of these problems, and offer proposals to correct the defects.

I believe that estate and gift taxes can and should be an important instrument for achieving economic and social justice in the United States. But the present system—largely a product of the 1920s and 1930s—is a weak and ineffective tool for a vastly different America entering the final quarter of this century.

My proposals for estate and gift tax reform are therefore intended to lay the necessary foundations for a truly fair and effective system of taxing transfers of accumulated wealth.

I. THE ROLE OF ESTATE AND GIFT TAXES

Our country early recognized the problems created by excessive accumulations of wealth. Indeed, taxation of wealth transfers has a much longer history in the United States than does income taxation. The first form of transfer tax was adopted in the United States in 1798, while the first form of income tax did not appear until the Civil War.

Over the years, the taxation of accumulated wealth has been recognized as a central element in a fair system of taxation. President Theodore Roosevelt, a vigorous advocate of transfer taxation as an instrument for social and economic justice, strongly supported a highly progressive transfer tax as a means of decreasing the concentration of wealth.

And President Franklin Roosevelt reflected these views in forcefully advocating a strengthened and improved transfer tax structure: "The desire to provide security for one's self and one's family is natural and wholesome, but it is adequately served by a reasonable inheritance. Great accumulations cannot be justified on the basis of personal and family security. In the last analysis, such accumulations amount to the perpetuation of great and undesirable concentrations of control in a relatively few individuals over the employment and welfare of many, many others."

Out of this background of political, economic and social pressure for an effective system of taxation of wealth transfers emerged the present estate and gift tax system. It achieved its present form in most important respects by 1942. Some changes were made in the marital deductions in 1948—largely though as an adjunct to income tax changes. Basically, we enter the last quarter of the twentieth century with a wealth transfer system designed to meet the needs of America in the 1920's and 1930's.

What should be the modern role of the federal estate and gift tax system? In essence, I believe that these taxes are best understood as filling a significant gap in the "ability to a pay" concept on which our federal tax system is fundamentally grounded.

The "ability to pay" principle is basic to our understanding of the role of taxes in a free and democratic society. The more economic benefits one has derived from our free enterprise system, the greater is his responsibility to contribute to the society from which he has derived so much. That is already the basis of our progressive federal income tax structure.

But the income tax is not sufficient fully to carry out the "ability to pay" principle. It is based on "income". Under present rules, gifts and bequests do not constitute income subject to tax. Therefore, vast amounts of accumulated wealth can be transferred from generation to generation outside the scope of the income tax. But it is obvious that an individual with $500,000 in inherited wealth has as much "ability to pay" as any corporate executive who has earned $500,000 through his salary.

It is therefore the function of the estate and gift taxes to insure that this source of "ability to pay"--accumulated wealth--in fact makes some contribution to the Federal Government. In the absence of a significant tax on the transfer of wealth, great accumulations of economic power could pass from generation to generation, without ever making their fair contribution to the cost of our common government.

Estate and gift taxes thus perform a crucial role in the total federal tax system. They impose a tax on a significant source of "ability to pay" that would otherwise fall outside the federal tax structure. Strengthening the taxes on transfers of accumulated wealth thus strengthens the fairness of the total federal tax system.

Conversely, weakening those taxes as recommended by the Ford Administration- is a step in the direction of greater social and economic injustice, a step toward greater concentration of wealth and power in the hands of a privileged few.

II. THE OPERATION OF THE ESTATE AND GIFT TAXES

In considering proposed changes in the estate and gift tax system, it is important to understand how the system is operating at present. A few facts put the issue in perspective.

Only 7% of decedents dying each year pays any federal estate tax, 93% do not. By definition, anyone who pats an estate tax is therefore in the top 7% of wealth with respect to those estates.

Only about one-fourth of the total wealth transferred in a year incurs the burden of estate and gift taxation. The remaining transfers are tax exempt.

Estate and gift taxes have for some thirty years produced about 2% of total federal revenues, although the absolute yield has risen from about $450 million in 1943, to an estimated $6 billion for fiscal 1977. By contrast, it is estimated that in 1977, the individual income tax will bring in $160 billion, the corporate income tax will bring in $60 billion and social security taxes will bring in $107 billion. These other taxes are already notorious for the heavy burdens they impose on individuals and corporations. Only the estate and gift taxes fail to pay their way.

Although the estate tax rate rises to a nominal 77%, in fact the effective rate of tax on net economic wealth transferred at death never rises higher than about 34%. For the wealthiest estates—those over $20 million—the effective estate tax rate is only about 23%.

The import of this fact is clear. Present transfer taxes are falling far short of contributing significantly to the nation's "ability to pay" tax system. By their default, the burden of other federal taxes is higher than it ought to be.

As this Committee and the Senate consider estate and gift tax reform, we shall hear a great deal about "small" estates, the "average" estate, "small" farms, "small" businesses and the problems created by estate taxes for these "small, average Americans".

But Congress cannot lose sight of the fact that the "small" taxpayer in the context of estate tax changes is not the same "small" taxpayer we are concerned about in the income tax.

Some 80% of adult individuals pay income tax each year. In this context, "small" taxpayers really do exist. But each year, only 7% of decedents pay any estate tax. Thus, when we talk of those who pay estate taxes, we are talking about the most elite and the most powerful group of potential taxpayers in America. In the context of the present estate tax, the "small" taxpayer is one who possesses wealth beyond the reach of over 90% of our citizens.

A chart I have attached to my testimony makes this point dramatically. 24% of the persons in the nation have a net worth of less than $100. Another 32% have wealth between $100 and $5,000. For over half our citizens, the wealth they own can be measured in terms of a few thousand dollars at most, and probably much less.

Let me illustrate the point in a different way. In 1972, those with net wealth over $60,000 constituted only 5% of the decedents in that year. Yet, this 5% owned 43% of the total net wealth in the country—a staggering $1.5 trillion in net worth.

Further evidence of the problem this Committee faces can be seen by looking at the share of the national wealth held by the richest 0.5% of individuals in the country.

In 1953, the richest 0.5% controlled 22% of the wealth—$221 billion. In 1972, the share was essentially unchanged—20.4%. But the total wealth had increased to $722 billion.

When we realize that in 1972 only $4 billion of estate taxes were collected, we can see how inadequate the present estate and gift taxes are in fulfilling the basic principle of "ability to pay" in American taxation.

III. SOURCES OF WEAKNESS IN THE ESTATE AND GIFT TAXES

There are two broad sources for the present weakness in our system of taxing transfers of accumulated wealth:

—The presence of substantial tax expenditures in the estate and gift taxes.

—The presence of substantial defects in the structure of the present transfer tax system.

A. A tax expenditure budget for estate and gift taxes

As a result of the Budget Reform Act, Congress is now thoroughly familiar with the tax expenditure concept in the context of the federal income tax system. It has proved a valuable tool in our efforts to control and rationalize federal spending.

Tax experts and economists have long recognized that the concept is equally applicable to other taxes, including the estate and gift tax. The Chairman of the Senate Budget Committee, Senator Muskie, has noted on the Senate floor the desirability of developing a tax expenditure budget for estate and gift taxes.

I am firmly of the view that it is time to add estate and gift tax expenditures to the tax expenditure budget, so that this avenue of federal spending will be subject to the same scrutiny and control as other tax and direct spending by the federal government.

I am presenting today, for the first time, a tax expenditure budget for federal estate and gift taxes. The analysis was developed by Professor Stanley S. Surrey of Harvard Law School and Professor Paul R. McDaniel of Boston College Law School. Its outline is given in the second chart attached to my testimony. And I am pleased to be able to make it available to the Committee.

As with the early income tax expenditure analysis, this initial estate and gift tax expenditure budget should be regarded as a starting point for more intensive definition and analysis of federal spending through the estate and gift tax system. Refinements in the budget will undoubtedly be made as attention begins to focus on its significance.

But this initial tax expenditure budget provides dramatic evidence of an obvious reason why these taxes are at present so ineffective in reaching those who have the greatest ability to pay. The Federal Government expends almost $3.5 billion through the transfer tax system—60% of the amount of revenue actually raised by estate and gift taxes. The comparable figure for the income tax is only 48%. Thus, tax expenditures play an even larger proportional role in the estate tax than they do in the income tax.

As in the income tax system, listing the specific estate and gift tax expenditures does not mean that the purposes for which the federal funds are spent are wrong. The list does require, however, that Congress analyze these federal spending programs as part of the total federal budget and evaluate them in the same terms of need, efficiency, and rationality that we apply to other federal spending programs.

When that examination is made, Congress may desire to continue or to modify some of the present tax expenditures. But others should be repealed outright—and immediately.

There are two tax expenditures that have no place in our present transfer tax system: The exclusion for generation skipping transfers, which permits some wealth to be passed on for 100 years or longer, without ever incurring an estate or gift tax, and the preferential treatment accorded lifetime gifts, which permits the very rich to transfer wealth to their children and grandchildren, while paying transfer taxes far less than those who transfer their property at death.

Together these two tax expenditures will cost the federal government over $1.5 billion in fiscal 1977. And the entire benefit of these tax expenditures is available only to the wealthiest families in the country.

B. Structural defects in estate and gift taxes.

In addition to the weaknesses in the transfer tax system created by tax expenditures, the present system badly needs a thoroughgoing revision of three specific structural elements.

First, the two taxes should be unified into a single transfer tax, not only to eliminate the inequities caused by the present dual tax structure, but also to simplify the tax treatment of many transfers.

Second, it is imperative that we adjust the marital deduction. The marital deduction is the method by which the family unit is defined in the case of married couples. A transfer tax should only be imposed on transfers out of a taxable unit. It is therefore important to define the unit properly, lest the tax operate unfairly.

The present 50% marital deduction follows the community property model of ownership, where each spouse is deemed to become the owner of one half of each piece of property as the property is acquired.

But this model is neither an adequate nor an accurate reflection of what really happens in a family when most married couples view property as "ours" not half "his" and half "hers". And this is realistic, because the efforts of both contribute to the accumulation of the property—whether both spouses work outside the home, or one works inside and the other works outside. The federal transfer tax definition of a taxable unit needs to be revised to reflect this fact.

Third, the rates and exemptions are also in need of major revision. Is it not ludicrous, for example, that the starting tax rate for the accumulated wealth of the richest 7% of the decedents is only 3%, when a 14% rate applies to the first dollar of taxable income that the poorest worker in the country earns? Substantial changes should also be made in the upper transfer tax rates to provide more uniform and rational progressivity in these rates.

IV. PROPOSALS FOR REFORM

I urge the Committee to take the following five actions to insure a fairer and more effective method of taxing transfers of accumulated wealth.

1. Unification of estate and gift taxes

In order to terminate the present preferential treatment for lifetime giving as compared to transfers at death, the present dual estate and gift tax structure should be replaced by a single, unified transfer tax system.

Under a unified transfer tax, there would be a single exemption and a single set of rates, applicable to all gifts and bequests of accumulated wealth, whether made during life or at death. Thus, the transfer tax would be a neutral factor in individuals' decisions as to whether to transfer property during life or at death. The same transfer tax liability would result in either case.

A properly structured unified tax will eliminate the three major inequities that presently favor the wealthy few who can afford to transfer property during life:

It will end the preferential rates for gifts which are now one-fourth lower than estate tax rates.

It will end the ability to make gifts during life under one rate schedule, and then at death start over again at the bottom of a different rate schedule.

It will eliminate what is in effect a deduction for gift taxes if property is transferred during life, although no deduction is given for federal estate taxes if property is transferred at death.

This change ultimately would increase federal revenues by approximately $800 million at fiscal 1977 levels.

2. Taxation of generation skipping transfers

The abuse whereby wealthy families may transfer property through several generations without incurring any estate or gift tax must be ended. This result is accomplished by highly sophisticated and complex trusts, carefully drafted by the expensive legal advisers of the rich, who enable their clients to "skip" estate and gift taxes for 100 years or more.

An effective transfer tax must tax transfers of wealth at least once each generation. Such a tax would follow the normal pattern of devolution of property in this country. Yet, present tax rules provide artificial incentives to the wealthy to follow this pattern in economic reality, but escape the payment of any estate or gift tax in the process.

Various techniques have been devised to end the abuse of generation-skipping trusts. The most satisfactory method is that recommended by the Treasury Department in 1969. It would impose a special additional tax on such arrangements to insure that the total tax burden is the same as if the transfer had followed the usual pattern from parent to child to grandchild.

It should be emphasized that a tax on generation-skipping transfers does not prevent a donor from making such a transfer. It simply removes the present tax reward for making transfers in this form.

Elimination of the generation-skipping abuse would ultimately increase revenues by an estimated $700 million at 1977 levels.

3. Unlimited marital deduction

The present marital deduction should be changed from a 50% to a 100% deduction for transfers between spouses. This unlimited marital deduction will insure that the federal transfer tax operates in conformity with the understanding of most married couples that the property they acquire during marriage is the result of their joint efforts. They cannot understand why a gift tax is imposed under present rules when one spouse transfers technical legal title in property to the other.

And they are right. Technical legal ownership may be placed in one spouse for good non-tax reasons, but generally both spouses have contributed in some measure to acquiring the asset, and no tax should be imposed on the transfer of title in the property to the other spouse, whether during life or after death.

The change to an unlimited marital deduction would reduce revenues by an estimated $700 million at fiscal 1977 levels.

4. Rate of tax

A single transfer tax rate schedule should be provided. It should be designed to produce more rational progressivity than is true of the present rate schedules. And it should of course, produce the revenues that Congress deems appropriate. At the least, I would urge the Committee to set the initial rate at 14%.

5. Level of exemption

A single $60,000 exemption should be provided for all lifetime and death transfers. The exemption can be used at any time by transferors with their estates entitled to the unused balance at their death.

In addition, the Committee should give serious consideration to substituting a tax credit for the present exemption. If the Committee takes this course, the level of the credit should be no higher than about $9500, which is the level required to replace the $60,000 exemption. The revenues gained from this shift can be used to offset other changes or as a net gain to the Treasury. But there is no justification for using the shift to the credit as a pretext for conferring unwarranted relief on estates over $60,000.

The previous discussion of the key changes necessary to create a fair and effective transfer tax system indicates why it is imperative for Congress to reject President Ford's proposal to increase the present $60,000 estate tax exemption to $150,000. The appropriate exemption level should be established in light of other fundamental decisions concerning the structure of the transfer tax.

Increasing the exemption to $150,000 would take the heart out of the estate tax, reducing its coverage by 70% and its revenue by 33%. Congress must first reform the basic structure of the transfer tax before it can intelligently resolve the issue of the appropriate exemption level. Clearly, however, it should not take a premature step at this time that would have the effect of destroying the estate tax for the future.

6. Special problems of estates owning farms and small businesses

A good deal of attention has focused in recent months on liquidity problems encountered by estates owning family farms or small businesses.

I think we all agree that it is undesirable to have a tax system that forces estates to sell a family farm or a family business in order to pay estate taxes. But I think we also agree that provisions to avoid this result should not produce windfalls for estates that do not have such problems.

As to farms, a number of recent studies have concluded that liquidity problems are faced by, at most, only 10% of estates owning farm assets. It is essential that we provide relief for these estates from their serious liquidity problems. But, it is equally essential that we not create new tax shelters for non-farmers and unjustifiable windfalls for the wealthy in the process.

In conjunction with my testimony today, I am submitting an analysis of studies that have been made of the liquidity problems encountered by estates owning family farms and of proposals to deal with those problems. These studies have convinced me that the Senate must be extremely cautious to tailor relief for farm estates in a way that solves liquidity problems of the deserving few, without raising the more serious problems for all legitimate farmers in the process.

Equally cautious solutions are needed to solve the liquidity problems of estates owning small businesses. The data in the attached statement indicate that serious liquidity problems are again confined to about 10% of estates owning small non-corporate businesses. Further, we must be careful, in defining "small business", that we not provide unjustifiable tax relief for the wealthy.

One study has revealed that the top 20% of income recipients in the country control over 98% of all income from Subchapter 5 corporations, 69% of all income from partnerships, and 51% of all income from sole proprietorships. These high income individuals are the same ones who control the accumulated wealth that is properly subject to a transfer tax.

Therefore, estate tax relief for "small business" must be targeted to those small business persons who genuinely need help—not to the very wealthy who happen to have part of their wealth set aside in "small" family corporations or partnerships.

The most significant reform to alleviate the liquidity problems for deserving estates owning farms and small businesses is the unlimited marital deduction. Testimony before the House Ways and Means Committee in its recent estate and gift tax hearings indicated that the most serious problems were being encountered in estates where the surviving spouse inherited the farm or small business.

My proposal for an unlimited marital deduction will eliminate all liquidity problems for estates with farms and family businesses where the surviving spouse receives the property.

To solve the liquidity problems encountered where a farm or small business passes to the next generation, I propose a special family farm and small business tax credit.

This tax credit would contain the following four elements:

1. The credit would be established at an amount which, when added to the basic $60,000 exemption, would exempt from the estate tax family farms and small businesses, up to $175,000 in value. This relief, larger than the relief in the Ford Administration proposal for such estates, would have only a modest cost because it would be available only for farms and small businesses.

2. The credit would be available only to estates owning farms and small businesses which stay in the family. The farm or small business must have been owned by the decedent or the decedent's spouse for five years prior to the decedent's death and it must pass to lineal descendants. In addition, to insure that the credit is available only to estates with liquidity problems, the value of the farm or small business must equal at least 25% of the taxable estate of the decedent.

3. If the farm or small business for which an additional credit has been granted is subsequently transferred outside the family, the amount of the additional credit should be repaid to the Treasury. The credit subject to repayment should also bear interest for ten years at reasonable market rates set by the Secretary of the Treasury.

4. The special tax credit should carry a termination provision effective ten years from the date of its enactment. This will insure that Congress must evaluate the cost, the benefit, the equity, and the effectiveness of the credit. After a period of eight years, Congress should require a report on the effects of the program, including recommendations as to whether it should be terminated, continued or modified. The study should be conducted by the Congressional Budget Office in cooperation with the staff of the Joint Committee on Internal Revenue Taxation, the House and Senate Agriculture and Small Business Committees, the Department of Agriculture, the Small Business Administration and the Treasury Department.

5. The following liberalized estate tax payment rules should also be enacted:

The election to pay estate taxes over a ten year period should be permitted if the value of an interest in a farm or small business exceeds 25% of the taxable

estate of the decedent. This reform would replace the requirement in present law limiting such relief to cases where the value of the farm or small business exceeds either 35% of the gross estate or 50% of the taxable estate.

The requirement that an executor post a bond as a precondition to the granting of an extension of time to pay estate taxes should be eliminated. The extension should be granted simply upon entering into a satisfactory security arrangement with the local district director of the Internal Revenue Service.

Where extensions of time have been granted under the above conditions, the executor should be relieved of personal liability for subsequent deficiencies.

The special rules for redemptions of stock in closely held corporations in order to pay death taxes or funeral or administrative expenses should be liberalized. Such special treatment should be available where the value of the stock exceeds 25% of the taxable estate of the decedent, and should be permitted to extend over a period of ten years. Present rules limit this treatment to larger business interests.

Farmers and owners of environmentally valuable open spaces should be permitted to transfer the development rights on the property to local governments, to charities, or to the Department of Agriculture or the Department of the Interior. Such transfers will insure that the farmlands or open spaces will be valued for estate tax purposes only at farm or open space value. The value attributable to development potential would thus be exempted from estate tax, as long as the land continued to be a farm or open space. This special treatment would be available even if the recipient of the land was not a member of the decedent's family.

I believe this series of proposals will completely solve the genuine liquidity problems encountered by estates owning farms or small businesses. At the same time, however, the proposals are carefully circumscribed to insure that the integrity of the transfer tax system is maintained and that its utility as a tax based on ability to pay will not be undermined.

VI. CAPITAL GAINS AT DEATH

Finally, I also hope that Congress will act as promptly as possible to close what I believe is the most notorious single loophole in the tax laws, the failure to tax capital gains at death. I regard this issue as part of income tax reform. I have previously submitted my proposals to the Committee in this area, for consideration as part of H.R. 10612, the House-passed income tax reform bill now being considered by the Committee.

CONCLUSION

Comprehensive estate and gift tax reform is urgently needed in the United States, because a system of effective taxation of the transfer of accumulated wealth is vital to the achievement of our national goals of economic and social justice. I believe that the proposals I have offered today represent constructive steps to achieve that goal. I look forward to working with this Committee in the months ahead, as we work to make the long-promised goal of estate and gift tax reform a reality.

Tax expenditure budget for estate and gift taxes, fiscal year 1977

	Millions
Agriculture: Deferral of estate tax payment for farms	$50
Commerce and transportation: Deferral of estate tax payments for small business	50
Education, training, employment and social services:	
Charitable contribution deduction/education	275
Charitable contribution deduction social services	500
Health: Charitable contribution deduction/health	125
Income security:	
Exclusion for annuities for qualified employee benefit plans	200
Exclusion for general skipping transfers	700
Exclusion for life insurance proceeds on which decedent paid premium	150
Preferential treatment for lifetime gifts:	
Dual rate base	300
Deduction for gift taxes paid	300
Preferential rates	225
General government: Exclusion for gifts to political organizations	10
Revenue sharing: Credit for State death taxes	600
Total tax expenditures	3,485
Total tax receipts	5,800

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Senator MONDALE. Our next witnesses consist of a panel representing the National Farmers Union, Reuben L. Johnson, director of legislation; Minnesota Farm Bureau, President Carl Wilson; Texas and Southwest Cattle Raisers Association, Mr. James Whittenburg; and the National Conference of State Legislatures, representing them is William N. Kelly, chairman of the Minnesota House Tax Committee and a member of the Government Operations Task Force.

I am particularly pleased to have our Minnesota representatives here today and wish especially to greet Bill Kelly, the able chairman of the House Tax Committee, and Mr. Carl Wilson, the president of the Minnesota Farm Bureau.

I believe we will hear from the panel in the order that I called them—first, Mr. Reuben Johnson.

May I say we are going to have to hurry to get this hearing done in time to pass the law. I would like to ask that if possible, you keep your opening statements to about 5 minutes and then it will give the Senators a better chance to question you.

STATEMENT OF REUBEN L. JOHNSON, DIRECTOR OF LEGISLATIVE SERVICES, NATIONAL FARMERS UNION, ACCOMPANIED BY DAVID M. WEIMAN

Mr. JOHNSON. Thank you. I will try to be brief.

The National Farmers Union appreciates the opportunity to present its views before this committee on a matter that is very important to each and every member of the Farmers Union—reform of estate and gift taxes.

Delegates to our recent national convention held last March, adopted the following as a special order of business with regard to reforming the estate tax provisions of the law:

> The Federal Estate and Gift Tax Laws should be amended to include the following: (1) Raising the exemption from $60,000 to $270,000; (2) raising the gift tax exemption from $30,000 to $60,000 per person; (3) utilizing use value taxation basis in determining the value of a farming estate; (4) increasing the annual gift tax exemption from $3,000 to $6,000 per person; (5) allowing transfer of the first $240,000 of farm business and related property to a surviving spouse, tax free, at the time of death.
>
> Since 1972 delegates to each succeeding Farmers Union Convention have adopted a policy calling for a change in the Federal estate codes. We, therefore, urge that the Congress act promptly.

While we directed our attention to the farmer community and policy direction, we obviously understand the need to make some adjustments in it. We do not look for any particular special treatment or advantage in agriculture. We extend the same recommendations to the small business community.

Present law establishing a $60,000 deduction was adopted in 1942, raising it from the $50,000 level which had prevailed since 1916. The present tax table was established in 1941 and the marital deduction was enacted in 1948. In short, we are dealing with a taxing structure dating back three decades or more.

Thus, the family farm that passed from one generation to the next just a few years ago will today face a sizable estate tax. The land is the same. The farmhouse is the same. In short, the farming unit remains unchanged, until the Federal Government comes around to collect the estate tax. Only then is the same unit considerably "larger".

I might say, Mr. Chairman, the point about the inflation, and much of that has come in recent years and cannot be overstressed in terms of the land value, equipment and so forth; as has already been pointed out here, and I want to make that point again.

Liquid assets are generally a small percentege of the enterprise. Therefore, there is great difficulty in paying the taxes due on the estate. According to a 1973 USDA economic research service report, "70 to 90 percent of total farm assets are in the form of fixed assets—land and buildings." Thus, to pay the tax, either part or all of the farm must be sold. When that happens, then family farming is disrupted. The continuity of passing the land from one generation to another is destroyed.

In that context it is very difficult to try to protect the family farm, and the system that we have we feel serves our Nation best in the production of our food supply.

Another inequity in this policy is the treatment of the farm wife after the death of the husband. Her contribution, often equal to the husband, is unrecognized. The tax penalty is severe—and grossly unfair. Many farm wives sit on tractors, work in the barn, and tend to the same chores as their "farmer-husbands." Frequently, they actively assist in the management of the farm by keeping the books, ordering supplies, and assisting with marketing responsibilities. A quick trip through almost any farming community would confirm this. However, that "partnership" is unrecognized for estate tax purposes. That must be changed.

It is this provision—the marital deduction—that is particularly offending to many of our members. To a farm wife, her unrecognized contribution is intolerable. To combat this problem, one farm wife recently told us how her son and daughter-in-law were handling the situation. To establish that the wife owned and contributed to the farm, each had his own bank account and everything for the farm is purchased with two checks—one in each name. The last major purchase, a large tractor, was paid for with two separate checks.

Senator MONDALE. I just heard a bell.

Mr. JOHNSON. I heard the bell, Mr. Chairman, and I would like to come to the last line of my statement, if I may. Let us keep the family on the farm and the farm in the family.

Mr. Chairman, the editorial you referred to earlier that you inserted in the record, we have available to the staff if they would check with us following the hearing.

Senator MONDALE. Very well, thank you very much. Mr. Johnson, for a very fine statement.

[The editorial referred to above follows:]

[From the New York Times, Jan. 8, 1976]

THE FAMILY FARM ESTATE TAX

Since 1959, the number of family-owned and operated farms has fallen from more than 4 million to 2,820,000 and the precipitous decline continues. In part, this reflects the abandonment of marginal, inefficient farms but often the disappearance has been due simply to an inequitable tax situation.

Under Federal law, all land including farm land is valued for estate-tax purposes at the "fair market value" that it might have if put to its most lucrative use. Land used for growing potatoes, hay, or even soybeans may be worth much more if sold for development as a shopping center, housing tract, or factory site. On that basis, the estate tax on a farm may be crushing in terms of the income that the farm

produces and thereby leave the farmer's heirs with no alternative but to sell to a developer in order to get the ready cash to pay the tax.

The disappearance of a family farm into the suburban sprawl can be more than a private disappointment. Tilled fields, pasturage, and wooded lands are essential to the balance between man and nature, particularly in a crowded, urban civilization. Dairy farms and vegetable farms that are close to major cities are also essential for maintaining a supply of fresh milk and vegetables at reasonable prices.

In a speech to the American Farm Bureau Federation, President Ford this week proposed a tax change that would ease the problem. The President suggests that the tax due on small farm or business properties should not be paid until five years after the death of the owner—and then the tax could be stretched out over a period of twenty years.

The Ford proposal if adopted by Congress would alleviate the problem but not really resolve it. What is needed is a system under which farm land would be valued for tax purposes only at its optimum agricultural value and not its "fair market value" if it were converted to industrial, commercial, or residential use. Only this kind of reform can remove the heavy hand of the tax-collector and, ultimately, the "developer," from the family farm.

Senator DOLE. Could I ask permission to put my statement in the record at the outset of these hearings?[1]

Senator MONDALE. Yes. What I thought we would do is hear from the panel en bloc and ask questions. Mr. Wilson, president of the Minnesota Farm Bureau.

STATEMENT OF CARROLL G. WILSON, PRESIDENT, MINNESOTA FARM BUREAU FEDERATION

Mr. WILSON. My name is Carroll G. Wilson. I am a cash grain farmer and apple orchard owner from near Faribault, in Rice County, Minn. I am also president of the Minnesota Farm Bureau Federation and Affiliated Companies, headquartered in St. Paul, Minn. Farm Bureau is my State's largest general farm organization, with 35,521 member families in 84 organized counties.

I appreciate the opportunity to appear before this committee today to express my own personal views, as an active farmer, and the views and policy of Farm Bureau on what is, in my honest opinion, one of the most serious problems with which the Nation's farmers and small businesses are confronted.

The United States has long pursued public policies designed to encourage family farming, with the strong argument that the preservation and enhancement of the family farm is an absolute must if a viable, balanced economy is to be assured. The Federal farm programs of the last 40 years are an example of such policies.

While many of these policies have been unsuccessful, it appears that the recent movement toward a more market-oriented economy for agriculture has slowed the exodus from the Nation's farms and ranches.

However, as more and more young people have moved into agriculture, frequently in partnership with a father or father-in-law, there has surfaced a new problem which, as I see it, poses a serious threat to the future of family farms.

Over the past 30 years or so, inflation and urban development have combined to push up land values drastically; land values in rural communities, in fact, have soared 220 percent-plus since 1942. Farms located in populous areas have been threatened with extinction by

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[1] See p. 2.

rising assessed valuations based on higher uses. States such as Minnesota have generally recognized this and have adopted, in some form or other, farmland assessment laws to resolve, or at least modify, the problem as it relates to property taxes.

But Congress has yet to come to grips with problems encountered in the application of excessive Federal taxes to the transfer of an estate to his heirs upon the death of a farmer or rancher.

Let me hasten to add at this juncture, however, that I am pleased that both U.S. Senators and Representatives are now proposing ways of reforming Federal estate tax provisions of the Internal Revenue Code. Farm Bureau, as you know, for the past several years has been much aware of the need and the strong sentiment for corrective action to update the statute.

A decade or so ago, most farmers had little reason to be concerned about Federal estate taxes; most medium-sized farms then were not so large but what they were under the $60,000 exemption.

Today, though, the situation has changed—and changed very drastically. Farms in recent years have grown rapidly in size and value, and because Federal estate taxes are figured on a graduated scale (from 3 percent to 77 percent), and because exemptions have remained virtually unchanged since 1942, they are taking an ever-increasing share of farm capital.

Several years ago, the Economic Research Service (ERS) of the U.S. Department of Agriculture undertook an in-depth study of the Federal estate tax subject. It found that Federal estate taxes do indeed have the potential for dismantling the family farm. The ERS study showed conclusively that, without careful planning, estate taxes would take nearly 20 percent of the total capital of three types of farms: irrigated cotton farms in the Texas high plains; cattle ranches in the northern plains; and cotton farms in the Mississippi Delta.

Adding to the burden of the actual amount of death taxes is the fact that most farms cannot readily convert assets to cash for payment of taxes. Most of a farmer's assets are fixed—in land, in buildings and in machinery—and a heavy estate tax bill could require selling part of the farm. The average value of farm production assets increased from $47,500 per farm in 1962 to $102,000 in 1972 because of expanding farm size and rising property values. Today, it is estimated that 70 to 90 percent of total capital on most farms is in fixed assets.

Further illustrating the impact on the estate's funds, I cite a typical corn belt hog-beef farm which in 1971 was worth approximately $87,000. Had its production assets increased at the same rate from 1968 to 1972 as did farms generally nationwide, its assets would have been $240,000, 4 years ago. Due to the graduated nature of the tax, death taxes would have climbed from less than 2 percent of farm capital in 1968 to 10 percent in 1972

Thus, it becomes readily apparent as to why farm property owners and their heirs are today becoming increasingly concerned about estate taxes. Inflation, higher commodity prices and improved technology are accelerating farm property values. In 1975, for example, U.S. farm real estate values per acre averaged 11 times higher than in 1940 and three times higher than in 1960.

The estate tax has been part of the Federal revenue system since 1916, with the present $60,000 exemption in effect since 1942 and the present rate scale since 1941. Obviously, if these levels were appropriate at that time, they are now grossly outmoded and totally unrealistic. Adjusting for inflation, the $60,000 exemption in 1975 was worth only $18,000 in terms of 1942 dollars. To be equivalent to the $60,000 exemption of 34 years ago, it would require a Federal estate tax exemption today of nearly $200,000.

Elected voting delegates of the member State Farm Bureaus to the 57th annual meeting of the American Farm Bureau Federation, held in St. Louis, Mo., January 4-8, 1976, adopted the following policy position:

> Laws covering the taxation of estates and gifts have not been changed materially since 1942.
>
> We place a high priority on major amendments to the estate and gift tax provisions of the Internal Revenue Code. At a minimum, these amendments should include (1) an increase in the standard estate tax exemption to reflect the effects of inflation since the present $60,000 was set in 1942; and (2) a substantial increase in the marital deduction to minimize the problem of the so-called "widow's tax"; and (3) provisions for basing the value of farmland and open spaces at levels reflecting their current use rather than their highest possible use.
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> Immediate passage of such legislation is necessary if we are to allow farms and small businesses to be passed from one generation to another, if we are to relieve unnecessary hardships on widows and widowers and, if, at the same time, we are to maintain open spaces in urban areas.

Based on this official statement, Farm Bureau's priority national affairs activity this year is Federal estate tax reform. Swift, remedial action for meaningful change is overdue. In Farm Bureau's view, three basic reforms in the existing Federal estate tax law as it applies not only to farm estates but to all estates are needed:

One. Raise the specific estate tax exemption from $60,000 to $200,000. This would make adjustment for the inflation which has occurred since 1942 when the $60,000 went into effect.

Two. Raise the maximum marital deduction from 50 percent of the value of the adjusted gross estate passed to a surviving spouse to $100,000 plus 50 percent of the total value of the adjusted gross estate. This would recognize the importance of partnership between husbands and wives and the special problems of wives who are widowed at an early age.

Three. Establish a procedure which would permit an estate's executor to choose to have land use for farming, woodland, or scenic open space assessed for estate tax purposes on the basis of its current use rather than on the basis of higher potential uses.

We recognize, of course, that proposals to amend the Federal estate tax laws are not without their opponents.

Some maintain that it is special interest legislation on behalf of farmers and ranchers.

But they fail to note that reform would also lift an unfair burden from small businessmen and others as well.

Other critics oppose estate tax reform on the basis of its costs to the Federal Treasury.

While there is no firm estimate as to the fiscal impact of legislation Farm Bureau proposes and supports, we find it difficult to conceive its enactment resulting in a substantial loss of Federal receipts since Federal estate and gift taxes represent about 2.5 percent of the $187.5 billion the Government receives in general revenues.

On a related note, let me point out that the basic purpose of an estate tax levy is to redistribute wealth rather than to raise revenue. Since this is the case, there must be other alternatives to recouping the dollars and cents loss. For one, we would commend decreasing Federal spending to offset that portion of estate tax moneys that would be lost by increasing the exemption.

For the most part, we are family enterprises and, as farmers, we are anxious to be able to transfer our businesses to succeeding generations in as orderly and as inexpensive a manner as possible. Considering the importance of food production, not only in the United States but in the world at large, it is essential that our family farms be allowed to operate efficiently without being threatened by the inequities of antiquated Federal estate tax laws.

The climate is right. There never was a more opportune time for the Congress to act positively, decisively, and effectively. Bills—H.R. 1793 and S. 1173, the Burleson-Curtis bills—developed and introduced in the 94th Congress to carry out Farm Bureau policy alone have more than 100 sponsors of both political parties.

In conclusion, permit me to state simply that the burden of excessive Federal estate taxes creates serious problems for farmers when estates are transferred to heirs. Farm Bureau has long had an interest in the Federal estate and gift tax issue. In both the 93d and 94th Congresses we have been, and continue to be, in the forefront in pressing for legislation to alleviate these problems.

Farm Bureau looks upon the Burleson—H.R. 1793—and Curtis—S. 1173—bills as legislation which would, if enacted, bring about sorely needed revisions in the Federal estate and gift tax statutes.

Again, I thank you for soliciting my comments and the views of the Minnesota Farm Bureau Federation.

Thank you.

Senator BENTSEN. I think in fairness to how fast the gentleman from Minnesota can speak, you ought to give him 7 minutes.

Senator MONDALE. Seven minutes.

Our next witness is Mr. James Whittenburg, president of the Texas and Southwest Cattle Raisers Association, who will have 7 minutes.

STATEMENT OF JAMES WHITTENBURG, PRESIDENT, TEXAS AND SOUTHWEST CATTLE RAISERS ASSOCIATION

Mr. WHITTENBURG. Thank you very much. I will probably need it.

My name is J. A. Whittenburg III, of Amarillo, Tex. I am president of the Texas and Southwest Cattle Raisers Association and appear here before this committee representing that organization.

Founded in 1877, the Texas and Southwest represents over 14,000 cattlemen involved in all phases of the livestock industry located in Texas and surrounding States.

As the members of this committee well know, the livestock industry has many problems. I am appearing today to discuss briefly with you one of the most serious problems facing the long-term future of the industry—the forced sale of all or part of many ranches to pay Federal estate taxes.

The problem—valuations based on selling price.

Under present law, the Federal estate tax is imposed on the fair market value of ranch assets. This value is determined by the IRS

as being the selling price of the property between a willing buyer and a willing seller, each being equally knowledgeable and neither under compulsion to buy or sell. The problem, stated simply, is that due to external factors, the selling price of ranchland is usually greatly in excess of its earning capacity.

FORCED SALE TO PAY DEATH TAXES

When a rancher dies, his estate is faced with a very serious problem of coming up with the cash to pay Federal estate and State inheritance taxes within 9 months following his death. Unless the rancher's estate has substantial liquid assets such as cash or listed stocks and bonds, or other readily salable assets, these death taxes must be raised by borrowing, which must be repaid from income from the ranch, or from a sale of part of the ranch. Since statistics show that borrowing by ranchers is higher than ever in the history of the industry, it is obvious that the only real source for the death taxes in many cases is the forced sale of all or a part of the ranch property.

BORROWING NOT THE ANSWER

These high land prices upon which the death tax valuation is based make it practically impossible to repay borrowed funds since the earnings from the ranch are very low in relation to the inflated prices. Thus, if the family of the deceased rancher is dependent upon the ranch for living expenses, about all the ranch can produce is the living for the family, and there is nothing left over for the repayment of loans on the ranch for the purpose of meeting the death tax obligations.

PAYMENT OF ESTATE TAXES IN INSTALLMENTS

Under existing law there is a provision which permits the payment of Federal estate taxes in installments over a 10-year period, if the ranch is a substantial part of the deceased's estate. Under prior law there was interest at 4 percent charged on the unpaid balance. However, when interest rates were adjusted in 1975, the 4 percent rate was rejected and a variable interest rate was imposed, which is now 7 percent. This provision has not proved to be satisfactory, even at the 4 percent rate, for several reasons. It is difficult or impossible to earn even 4 percent per year in the fluctuating agricultural economy, much less to obtain sufficient cash flow to repay the principal. The latter is particularly true when the estate tax is based on the inflated selling price of ranch land rather than on its productive value. Finally, the IRS is virtually your partner during the payout period and must be consulted at every turn. After the fourth year, all undistributed net income of the ranch must be applied in payment of the deferred estate taxes, leaving little or nothing for the rancher and his family to live on.

REMEDIAL LEGISLATION NEEDED

The most pressing need is for legislation which will permit the Federal estate valuation of ranch land to be based upon such land's earning capacity or productivity for agricultural purposes. There are several bills now pending before Congress which would accomplish this relief.

There is a growing precedent in the State property tax area for this type of valuation. Over 20 States have enacted laws which provide in one form or another for the assessment of agricultural land based upon its productivity or earning capacity rather than on its market value. These laws appear to have had the desired effect of granting immediate relief in providing more equitable tax treatment for farmers and ranchers.

The present $60,000 Federal estate tax exemption has remained unchanged since 1942 while land values have increased over 200 percent in some instances. This has resulted in the inequitable situation where 1976 figures are applied to 1942 dollars. The administration has proposed an estate tax credit which is intended to benefit smaller-sized estates. If the credit is made large enough, then relief would be provided for larger estates which are more typical in the case of farms and ranches. We feel that a higher exemption would be more equitable to all taxpayers concerned and suggest a minimum exemption of at least $200,000.

The administration has also proposed relief in the form of a 25-year period to pay estate taxes. We do not think that this proposal is feasible. The most important flaw is the fact that the valuation of the assets of the decedent's estate will continue to be made at fair market value.

The simple, yet equitable answer to this most serious problem facing the ranch industry today is to permit the executor to value the ranch on its earning capacity, rather than on what it might sell for, with appropriate safeguards to prevent tax shelter exploitation. This approach is simple, workable, and equitable.

The proposal to tax the unrealized appreciation in the estate's assets at capital gains rate would add an additional tax at death which would prevent the continuation of ranch enterprises in the same family. To add the further burden of a capital gains tax on unrealized appreciation would really deal a death blow to the ranching industry as we know it today.

Let us find a way to allow our Nation to continue to be the most agriculturally productive the world has ever known. In the past, the farmers and ranchers have had the ability and the incentive to accomplish this. We must see that they do in the future.

Senator MONDALE. Thank you very much, Mr. Whittenburg. Now our final witness, William Kelly, chairman of the House Tax Committee, State of Minnesota, representing the National Conference of State Legislatures.

STATEMENT OF WILLIAM N. KELLY, GOVERNMENT OPERATIONS TASK FORCE, NATIONAL CONFERENCE OF STATE LEGISLATURES

Mr. KELLY. Mr. Chairman, Senator Mondale, members of the committee, my name is William N. Kelly, and I serve as chairman of the Committee on Taxes in the Minnesota House of Representatives. I am appearing before you today on behalf of the National Conference of State Legislatures, the organization comprised of the Nation's 7,600 State legislators and their staff.

NCSL supports revision of the Federal estate tax laws and recommends the following three changes:

One: The present $60,000 exemption should be increased to $200,000 for all estates. With the current rate of inflation, an exemption of at least $190,000 would be necessary to equal the value of the $60,000 exemption when it was enacted in 1942. Examples abound of how farmland purchased in the 1940's for $50 per acre is now worth $1,000 per acre, yet its productive value has not increased proportionately.

Small businesses also suffer from this $60,000 exemption. Quite often, small businessmen do not have liquid assets available to cover estate taxes and must either sell the business or merge with a larger enterprise.

Two: The maritial deduction should be increased to 50 percent of the adjusted gross estate plus $100,000 for all estates. Changes in this provision are necessary to recognize the partnership between husband and wife and to alleviate the discrimination against women which currently exists in the estate tax laws.

Three: Farmland should be assessed at its value for agricultural use, not at its market value. This is particularly important in areas where artificially high land values cause estate taxes to be exorbitant—and force an heir to sell productive farmland to pay those taxes.

State legislatures across the country are particularly alarmed about the disappearance of the family farm and the accompanying decrease in the availability of prime agricultural land. At a time when foreign and domestic consumers are demanding more food from the American farmer and when agricultural exports are so vital to this country's balance of trade, loss of these units cannot be tolerated. The U.S. Department of Agriculture projects that the Nation will have 1 million fewer units by the turn of the century. This is particularly disturbing in view of another USDA study which indicates that the small farm, owned and operated by one to three people, is the most efficient unit for agricultural production.

Many State legislatures are attempting to assist small farms and businesses. For example, several States have changed their own estate tax laws. Most are increasing their exemption levels, while other States, such as Minnesota and South Dakota, have equalized exemptions for widows and widowers. Wisconsin is also examining the possibility of deferring tax payments on inherited property.

The Minnesota Legislature has provided for an alternative tax valuation method. If the estate passing to the surviving spouse is less than $500,000 and if the tax computed on 50-percent of the estate, without using the exemption, is less than the tax computed with normal exemptions on the entire estate, then the lesser tax can be paid.

Several other States, including Vermont and Massachusetts, have developed State food policies which recognize the link between adequate food production and easing the estate tax burden for those who inherit farms. The Massachusetts Legislature is considering a bill to value farmland at its current use for State estate tax purposes. Vermont is considering exempting the first $10,000 of net business income (including that from a farm) from taxation.

Other State actions to preserve the family farm include regulation of corporate farming, preservation of prime agricultural land through preferential tax assessments, tax penalties on farmland converted to a higher use, and easements and other land use tools.

The Minnesota Legislature is also concerned about encouraging the young farmer to enter and remain in agriculture. We have recently enacted a program which will assist young farmers in acquiring real estate for agricultural use.

In summary, a combined State and Federal effort is needed to maintain the viability of farms and small businesses. The States have realized their role in rectifying the situation, but State actions will be overwhelmed unless Federal estate tax laws are changed—and changed soon.

Thank you, Mr. Chairman, for this opportunity to recommend legislation to ease the burden of Federal estate taxes on those who inherit farms and small businesses.

Thank you.

Senator MONDALE. Thank you very much, Representative Kelly, for a most useful presentation. I think the Minnesota Legislature is to be commended for recognizing this problem and acting on it.

Mr. Wilson, I think you are familiar with where I grew up and——

Mr. WILSON. Yes, sir.

Senator MONDALE. What would good land go for an acre in 1942 when this bill was passed, approximately?

Mr. WILSON. What date?

Senator MONDALE. 1942.

Mr. WILSON. $150.

Senator MONDALE. That would be very good land, would it not?

Mr. WILSON. Yes, sir.

Senator MONDALE. $150 an acre?

Mr. WILSON. Yes, sir.

Senator MONDALE. What would that same land go for today?

Mr. WILSON. Twenty-two, $23, $2,400.

Senator MONDALE. I read those stories in my local papers and I cannot believe that. So that land has soared at an incredible rate.

Mr. WILSON. Yes, sir.

Senator MONDALE. Which means several things. First of all, there is a serious immediate crisis, that is right with us now, and it has been exacerbated greatly in the last few years because of land inflation?

Mr. WILSON. You cannot afford to die if you own a small farm.

Senator MONDALE. You have to find some new fountain of youth or something.

Second, I am wondering about these figures that show that the average farm with equipment is worth $300,000. I wonder if those figures do not take in all of these subcommercial farms that are small in acreage, that probably the farmer is working somewhere else and he farms part time. If you were to take farms in America that are of adequate size, to be competitive, with the farmer and his family living exclusively off the earnings of that farm, would you not have a substantially higher valuation?

Mr. WILSON. I would say our farming operation is one that we live off of most years. Sometimes we do not.

Senator MONDALE. How many acres do you farm?

Mr. WILSON. About 800. I think the kind of farm you are describing you have to put a price tag on it of $700,000 or $800,000.

Senator MONDALE. That is my impression. And the farm equipment now is very expensive.

Mr. WILSON. Yes, sir.

Senator MONDALE. If you are going to have a commercially sized farm you have to have it.

Mr. WILSON. Correct.

Senator MONDALE. And if we want family farmers, first, it has to be a family farm that is economically viable, so it has to be in the range you are talking about?

Mr. WILSON. You have to buy the tractors, fertilizer, pay the taxes and pay the interest and pay the principal.

Senator MONDALE. Let us take the low side of your estimate. Let us say it is $700,000. Take off $60,000 for the exemption, say, $650,000. The estate tax on that for the last heirs is $145,000?

Mr. WILSON. That is right.

Senator MONDALE. And, say your wife predeceased you, you would have paid an earlier tax on half of that, if you say half of it is hers?

Mr. WILSON. Yes.

Senator MONDALE. So that is roughly $200,000 in estate taxes that have to be paid immediately on a farm that returns an income, that is very modest by national standards; seems to me to explain this New York Times article in which it quotes Progressive Farmer as projecting that 200 to 400,000 farmers a year would disappear from family farm ownership for the next 20 years if today's trend were not stopped?

Mr. WILSON. Yes; that is correct.

Senator MONDALE. So if we want family farm ownership we have to act now to amend these laws affecting the estate taxes.

Mr. WILSON. Yes. If I do not go home from this meeting, something happens to me, there will be no Wilson farm in Rice County, they will sell one farm to one neightor and one to another to settle the bill.

Senator MONDALE. Mr. Johnson, would you want to comment on that?

Mr. JOHNSON. I have with me my associate, David Weiman, who I think would like to comment on that.

Mr. WEIMAN. Referring to Senator Kennedy's chart, I think the point that Mr. Wilson has underscored, this is why a family farm shows up in the upper 7 percent of all estates. In some instances there is no economic relationship between the value of the farm and the farm income on that farm. In your State, if you happen to own a farm on the outskirts of the Twin Cities, the development pressures, depending on where new shopping centers will be, where an energy site or a recreation site, will be—any number of factors which change the value from a farming value to a commercial value. The price of that land is skyrocketing. We found in the last couple of years, if you just took the increase in land values in the seventies, they are staggering. When we had the fly-in one of the farm wives turned to us and described to a lawyer from the Treasury Department who helped draft some of the President's estate tax proposal, about the new tractor purchased on their family farm, and the cost of that tractor was $54,000. When you have that kind of equipment, or a new milking barn, for example, or any number of these things, the cost is prohibitive, so you can have a tremendous capital investment and yet, as you point out, your income is rather modest.

Senator MONDALE. Mr. Whittenburg, would you like to comment on this issue?

Mr. WHITTENBURG. These similar facts certainly apply in Texas as well as they do in the Northeast or Midwest. We have had the same increase in applicable land values over the period of time and this has created a situation that virtually it is impossible to retain ownership through one or certainly more than one estate tax.

Senator MONDALE. What would you consider to be the minimum value of a commercially feasible cattle ranch in Texas?

Mr. WHITTENBURG. Well, to bring an economic operating unit you would start at $1 million, in that vicinity, to support a family, of adequate size and potential to make a family unit.

Senator MONDALE. So one again, those $300,000 average farm value figures do not get at the point we are trying to deal with, which is what is the value of a family farm that has a chance of survival, or a family cattle operation that has a chance of survival?

Mr. WHITTENBURG. Yes.

Senator MONDALE. Representative Kelly, would you like to comment on that?

Mr. KELLY. Just briefly, Senator. The NCSL did not discuss these things in detail, so I am speaking for myself. I think there is considerable merit to the comments that the gentlemen made. My personal preference leans somewhat more toward a credit than toward large exemptions. There is a great diversity in agriculture itself and a farming unit of base value in Mr. Wilson's area of half a million or $800,000 is a very small farm in the district that I have because of the type of agriculture that we work on.

Senator MONDALE. Wheat and potatoes?

Mr. KELLY. Yes, and sugar beets. These crops take more acreage and the cost of equipment is much greater and the type of enterprise is substantially more valuable.

Senator MONDALE. I think the Farmers Union's testimony that was not read pointed out that in a survey in Wisconsin, about a third of the farmers never resorted to estate counseling; is that correct?

Mr. WEIMAN. I believe that is correct, Senator. The Wisconsin Farmers Union polled, I think, a thousand members and asked the question, "Do you have a will today?" Many of these people who were in their fifties and sixties said no.

Senator MONDALE. Of course, that will does not necessarily mean there is wise estate planning.

Mr. WEIMAN. It shows an absence of estate. Everybody in Wisconsin has a will because there is one filed by statute. Part of the problem, in going back to Senator Kennedy's chart here, is that the deferral of the estate tax payments for farms shows a $50 million deferral and I was quite surprised at that number. When we polled our members and asked whether or not they take advantage of the 10-year deferral, we are finding they are not, and in great part it is because rural lawyers are not advising them they have that right.

Senator MONDALE. Of course, up until a couple weeks ago you had to pay 9 percent. That is not really helping them much.

Mr. WEIMAN. To some of the local rural banks, 9 percent might look pretty good.

Senator MONDALE. Yes; the point I am getting at is that I think it makes a lot of sense from a public policy standpoint to have a law that does not punish farmers and small businessmen of modest means

for failing to anticipate all of the estate tax ramifications and hiring expensive counsel and getting officer's insurance and the other things that you might do. I grew up in those areas and I know that is not the way we think. Maybe we ought to, but we do not. That estate tax planning is usually for families of wealth and by tradition they go to counsel. It seems to me this ought to be a law that works fairly for persons operating farms and small businesses and small estates and not for those who go and anticipate the tricks that might be played—generation skipping and whatever games you might play.

Mr. WEIMAN. Well, Senator, you pointed out that many farms, you take a farm that has a valuation of $300,000 or $400,000 and they have a $10,000 or $15,000 or $20,000 income, these are people of modest means. They do not perceive themselves as being very wealthy or in the uppercrust and so there is an important psychological factor at work here. They do not take the precautions. Their own lifestyles are such they are very simple lifestyles, very modest, so there is that factor which I think is working.

Senator MONDALE. Of course, if you have a reasonable size farm, or small business, and go out and have an estate planned, probably you will be told to take out a big insurance policy on your life. That premium may run $3,000 or $4,000 or $5,000 a year.

When I look at the income the farmer is living on, that is a rough bite, too.

Mr. WEIMAN. Prohibitive.

Mr. JOHNSON. May I say since you referred to the part of my statement that was not presented, that it appears in the record in its entirety?

Senator MONDALE. Yes; and I will see that all of the statements appear in the record as though read.

Senator Curtis?

Senator CURTIS. Well, I want to say to the panel, I feel that we must have some relief from the estate tax. I think it must be in the bill that we report out in the next few weeks.

As a matter of fact, for most families is it not true that a delayed period to pay the tax does not meet their problem at all? Is that not correct?

Mr. JOHNSON. I certainly agree with you.

Senator CURTIS. Many times individuals die, the widow is still living, and she may be along well in years, with an opportunity to prolong that tax does not meet any of the problems she is facing.

I think also we must all be active in correcting the erroneous notion about tax expenditures. My idea of an expenditure is something paid out of the Treasury and carries the assumption that it rightfully belongs in the Treasury. Certainly, the figures for the estate tax exemption and so on, should be brought up at least equal to the inflation factor which in my opinion, would make the $60,000 exemption at least $200,000.

I will not take time to question you further but I do appreciate your being here.

Senator MONDALE. We had figures that the University of Minnesota estimates that in 2 years land values in Minnesota rose by 72 percent, and I think the inflation rate in land values far exceed the generalized national inflation rate.

Senator CURTIS. Yes; we have some land in Nebraska that has doubled in price in the last 6 years. Doubled in 6 years.

Senator MONDALE. Senator Bentsen.

Senator BENTSEN. Thank you very much, Mr. Chairman.

Let me congratulate you on calling these hearings because I am very pleased to join you and Senator Curtis in introducing legislation to try to help in this regard.

When you talk about these farmers and these ranchers not doing estate planning, that is very much true. A lot of them do not plan on going anyplace. If they do they plan on taking it with them. Any time I drew a will I never had a farmer tell me "When I die," he always said "If I die." [Laughter.]

Mr. WEIMAN. I think that confirms the survey Farmers Union took in the State of Wisconsin.

Senator BENTSEN. They were thinking about the kids and they were thinking about their wives, because those wives just outlive us, and you never hear about any group of old men over in Europe traveling together on a bus spending that Prudential policy.

I think it is very important that we try to find a way to keep the continuity of these family farms and ranches together.

Senator Mondale is talking about a figure of, as I recall, about $12,000 a year in net income for a farm of $300,000 in valuation. If you talk about a 10-year payback, stretching payment over that period of time, at the present time, I believe Mr. Whittenburg, you said it is a 7 percent rate Treasury is charging?

Mr. WHITTENBURG. I believe that.

Senator BENTSEN. It fluctuates some based on prime.

Senator MONDALE. We passed a law last year dropping it from nine to seven.

Senator BENTSEN. Seven percent. If you talk about $250,000 farm, based on market value, you would have a tax of about $65,000. Then if you had to pay a 7 percent rate on that $65,000, you would be talking about $4,550, approximately a year. Then, if you had a straight 10-year amortization of that thing, or level payments on the principal, you are talking about another $6,500. You are talking about $11,050 a year.

Now, if you make $12,000 a year net off that farm, and you have to pay back $11,050 once a year, the way I figure it you have about $950 to live on. Again, you get to the point do you sell off an acre of your farm or 10 acres or 50 acres, and there is no way you can do that because you do not sell off a feasible farm unit or ranching unit.

What happens to you if you have got yourself a 3-year drought? In the part of Texas you live in and the part I was born and reared in, we have seen that time and time again. So I think what you run into is a situation where you really are forced into liquidation of the farm or ranch, and that is what we ought to try and avoid if we possibly can. I think it is in the economic and social objectives of this country that we continue to have the small family ranch and small family farm and small business in this country, and I am very pleased to have this kind of testimony before us. I think it is fruitful and helpful.

Senator MONDALE. Thank you. That is a very intersting set of statistics which shows you have to look at that.

Senator Hansen.

Senator HANSEN. Mr. Chairman, I want to join with you in thanking this panel for its appearance here today. You know, a few figures occur to me. I think it may be nationally or it may be only in the West on livestock operation, maybe Mr. Whittenburg would know about that, the average age of the operator is amazingly high. The young people are not staying in this business. They are not staying in it for one very good reason. Why is that? I think by the very nature of the total amount of investment, contrasted with the net return per year is one of the poorest things you can go into. The opportunities in any other field of endeavor are better than they are in farming and ranching. I know I speak with a little background because I am a livestock operator and we approach these problems differently.

Some people, though historically, when you look at the overall thing, you cannot expect to get any significant return on investment as most corporate businesses have to look at if you are setting up a corporation, and you go out to try to solicit people to join with you, and if you put out a prospectus on it you have to talk about returns on your original investment. Most people do not look at that that way but, the average ranch, my gosh, if the operator can come out at the end of the year with a fair return for his services, he has done pretty well. There are lots of years when the livestock operation does not give that sort of return. And I think that fact underscores the statements that I heard you make here this morning, that you have got a big investment for the small amount of profit or return that is shown at the end of the year and I would ask the panel if that is not true for the area each of you represent?

Mr. WHITTENBURG. Yes.

Mr. JOHNSON. That is very true.

Mr. WILSON. No question about it.

Senator HANSEN. I think that is an important thing to keep in mind as we try to put in perspective the presentation made earlier by our colleague, Senator Kennedy.

Senator MONDALE. I suspect also if you are a wealthy businessman you might put a lot of your estate in one of those generation skippers so it would not show up there in those figures.

Senator HANSEN. That is exactly right. One other point I think needs to be kept in mind is that if a person is in a high tax bracket, and being aware, as everyone must be these days, of what is happening on inflation, investing in land is a good loophole for a person who is not a farmer or a rancher. If you want to keep the people in the business, in that business, why then we had better address the problems that this hearing was called for here.

On the other hand, if a person is in the high enough tax bracket he can afford to go out an buy a ranch or buy a farm when the estate tax hits and the heirs have to sell it. That is the only way they can possibly approach that problem. If he is in a high enough tax bracket and is willing to hang on to it without really doing very much with it, if he can get somebody to operate it for a few years, the capital gains will be helpful to him because he very conceivably could find that he would pay less taxes that way. But to address the problem that you called for here, and we are talking about now, I think one has to recognize the fact that the investment in land and livestock and machinery, in that kind of operation, or if it does not include livestock,

just land and machinery, is such that you get a very marginal return on the original investment that you have in it, and I think you members of the panel, you, Mr. Chairman, and the other members of the committee, have made that point very clear this morning. I think it is a point that is not understood very well.

Senator MONDALE. Thank you very much.

Senator Dole.

Senator DOLE. I know there are other witnesses, so I will be very brief. Maybe each panelist would say whether or not you support the Kennedy proposal.

Mr. JOHNSON. Mr. Chairman, David Weiman and I were discussing earlier here between us some of the recommendations made by Senator Kennedy and to be very honest with you, we do not understand all of its ramifications.

Senator DOLE. Do you support those you understand?

Mr. JOHNSON. Some of them. I suppose that we would like to look at some of the tactical considerations regarding the tax credit. I can see how we might get squeezed in terms of getting this relationship to the exemption in a tactical sense and I want to back off and take a little look at that before I give you any firm conclusion here.

I think it might be well to have your views along the way, Senator Dole and members of this committee, about what you think. You are the men who have to figure out some way to pass this legislation.

Senator DOLE. I never knew one of the farm unions to want my views.

Mr. JOHNSON. Since the last vote record of you we published, you moved up your percentage so far and fast I am coming to see you frequently to ask your advice.

Senator DOLE. I may be in more trouble than I thought.

Mr. JOHNSON. We are pleased we are beginning to see mutual problems in a more mutual light with you.

Senator DOLE. I must say Reuben and I have been friends for 15 years. That is fine, I think I have the same problem you have on the total impact of this proposal. Some of it appears to be, on the surface, sound.

Mr. JOHNSON. There is another thing here that I am wondering about. That is the timing on this legislation. These ladies of ours—I keep referring to these fine ladies that we call flyers. They were told repeatedly by some of the Members over in the House, not to expect any action on this legislation any time before election time because there are Members of Congress, of course, except members of this committee, who want to kick this on into the election time and not to expect any action this year. We would hope the timetable would be a little sooner than that.

Senator MONDALE. It is my hope that we can shape an amendment and put it on the tax reform bill.

Senator DOLE. I do not see any problem with that on this side. I think we are all in agreement, whatever happens in the election, we ought to do something for the estate and gift tax.

Mr. WHITTENBURG. To speak to your question there, I think there are some logical conclusions drawn there. I do feel that it is somewhat complicated and in areas, inequitable, and I would like to relate that or to take the opportunity to reemphasize the logic of the evaluation

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based on the productivity of the land as a more equitable and simple direct attack on the problem that we are discussing here today.

Mr. WILSON. My comment would be very simple. I think we have two better proposals, at least maybe a third one, than this. I do not understand this, either. I certainly would not shut the door on it, but I know that I personally would go much stronger for what you now have before you.

Mr. KELLY. The National Conference of State Legislatures has really not discussed these ideas but I do have an opinion I would like to share with you. I think the question of estate tax is one that you have to address this year in a limited time frame and that is why my particular remarks were stated in terms of Minnesota. But if we were to look at the large question, I think we have got to look at it in terms of taxes in general, and that includes certainly the Federal income tax. For that reason, I think there is some merit personally to the use of a tax credit as opposed to exemption or deduction. The second thing is that this subject gets to the issue of the pattern of land ownership and the pattern of land use in the United States. While we can talk about estate taxes and the transfer of wealth in the immediate family, I think this larger question also is apparent. An illustration is that some 85 to 90 percent of the land sold in this country, for example, farmland sold for estate tax purposes, or whatever, is sold to other farmers in that immediate area and some 5 percent or so to speculators.

So we have a situation where people with land are getting larger and larger, and it seems to me there are some long-range implications that we ought to address.

Senator DOLE. As I said to Senator Kennedy, there is some great difference of opinion on how we define family farm and small business. It is easy to talk about the family farmer. Everybody wants to help the family farmer and small businessman. If you limit it to the family farmer, what about the large family farmer or large small businessman. Would they be discriminated against? And what about everyone else who may have worked and saved a little money?

Senator MONDALE. Well, I do not think we are talking about an exemption or a credit system that applies to all small estates. I do not think we are talking about that.

Senator DOLE. That was my next question. The bill I introduced does not limit it. I think the American Farm Bureau limited it to farms. I do not think it would ever pass in that form. And does anyone feel we should limit it to "family farms and small business?"

Mr. JOHNSON. Senator Dole, I do not think it is practical.

Senator DOLE. I do not see how it could be, either.

Mr. JOHNSON. I do not believe that the Congress would ever pass legislation that would be that discriminatory to other groups. I think small business has a lot of the same problems we have in agriculture. We are all small businesses if you relate the size of the businesses that we are talking about.

Senator DOLE. If you tried to provide benefit to one group you are going to create a lot more tax shelters down the road and everybody is going to rush into that area and you are going to have a bigger problem than you have now. I would hope there is no effort to nail it down in any one group.

Mr. WEIMAN. Senator Dole, you are quite accurate and one of the counterarguments to the use value determination has been that it will actually provide an attraction for investment or syndicate capital. This is something about which we are very concerned about and would urge the panel in framing an amendment that you take that into consideration. While we recognize from our perspective the needs of family farmers and small business, and my dad is a small businessman in California, they have the same type of problems, the amount of capital tied up, the lack of liquidity and so on. The parallel is striking. Yet, protecting this entity, which we have said is worthy of protection, we do not want to attract the type of syndicate investment in agriculture which we have seen in many parts of the country and are continuing to see with an increasing trend.

Senator DOLE. I think in that case the cure might be worse than the disease. We really have not helped agriculture and I do not think we have helped small business. I assume then we should not limit the reform. We should make certain we are not setting up some attraction down the road that might turn out to be a tax shelter.

Mr. WILSON. I am on the American Farm Bureau board. If they had their assistance, I am sure they are not going to have it very long. They are just talking about farmers.

Senator DOLE. I introduced two bills earlier on, one satisfied the Farm Bureau and one I thought was good legislation. [Laughter.]

Mr. KELLY. May I respond to that?

Senator DOLE. Yes.

Mr. KELLY. I appreciate your comment because you stated it in terms of discrimination of small farmers and small business versus large. One of the elements of the proposal that was discussed by Senator Nelson and Senator Kennedy and others has to do with the credit versus deduction. One of the advantages of credit is that it treats all those persons and estates the same; and if you stay with an exemption or deduction, you tend to have the reverse of what was said. Those larger estates have a larger tax benefit than do the smaller ones. So I think we want to be as conscious of that as the reverse situation that you brought out.

Senator DOLE. I think when we talk about marital deduction, if you are going to postpone all of it, you are going to delay the tax and interfere with a good marriage. I am not certain. That is in the Kennedy proposal, it is a matter of interest.

Mr. WEIMAN. It is also conceivable that you would also increase the ultimate tax.

Senator DOLE. Right.

Mr. WEIMAN. That is basically the part of the administration's present package. On the one hand, it looks very inviting because you say, well, the spouse does not have to pay the tax at the time, yet the entire estate will be taxed, and it is a little bit of a gamble depending on the age of the person when this happens, the life expectancy of the spouse, one tax method versus the other. If she dies 2 years later it could be very expensive.

Senator DOLE. That is right.

Mr. WILSON. The only thing that delaying does, in fact, it hurts you. Immediately upon the day of death it decreases the assets of the estate, the net, and you are better off to pay it than you are to linger on. We do not go for the Ford bill at all.

Mr. JOHNSON. I would really say you would be a lot better off to pay it and settle it as far as running a viable business is concerned.

Mr. WHITTENBURG. The problem with keeping an estate open over a prolonged period of time is it gets unwieldy and I think impossible.

Senator DOLE. If you can increase the marital deduction, I think it sounds attractive.

Senator HANSEN. I wanted to make one point of possible interest to the panel, and that is, I agree completely that the chances of getting some relief in this legislation, I mean in this area, by legislation, will be incomparably increased, I think to make it across the board. I do not believe we have any chance, I do not think when you consider it for a matter of fairness, it ought to single out by definition small farmers or small ranchers or anyone else. What I am trying to say is that I favor increasing the exemption from the present $60,000 limit to at least $200,000. I think underscoring my basic conviction is the fact that we are trying to grope with inflation. If you talk about trying to buy an acre of land or a bale of cotton or a car or whatever it is, inflation has been the factor that has given the taxpayer the trouble these days, and it so seems to me the best chance of getting that done is to make it across the board. I cosponsored several bills that single out land use goal and open space concept and family farmer and my main reason for doing it, while there is some justification in each one of these proposals, I think I was trying to stimulate as much interest as I could in the problem, and if enough can do that, I would hope we could be successful in raising the exemption.

Senator MONDALE. Thank you very much and I wish to thank the panel.

[The prepared statements of the preceding panel follow. Oral testimony continues on p. 71.]

PREPARED STATEMENT OF REUBEN L. JOHNSON, DIRECTOR OF LEGISLATIVE SERVICES, NATIONAL FARMERS UNION

The National Farmers Union appreciates the opportunity to present its views before this Committee on a matter that is very important to each and every member of the Farmers Union—reform of estate and gift taxes.

Mr. Chairman, we believe that the law is inadequate and in desperate need of overhaul. And, we have recognized the pressing need for changing the tax codes for several years. In 1972, delegates to our national convention adopted a resolution calling for a change in the tax exemption—raising it significantly. In the ensuing years, we have studied this problem, met with other members and have concluded that it is the Congress that must act.

Delegates to our recent national convention held last March, adopted the following as a special order of business with regard to reforming the estate tax provisions of the law: "The Federal Estate and Gift Tax Laws should be amended to include the following: (1) Raising the exemption from $60,000 to $270,000; (2) Raising the gift tax exemption from $30,000 to $60,000 per person; (3) Utilizing use value taxation basis in determining the value of a farming estate; (4) Increasing the annual gift tax exemption from $3,000 to $6,000 per person; and (5) Allowing transfer of the first $240,000 of farm business and related property to a surviving spouse, tax free, at the time of death.

"Since 1972 delegates to each succeeding Farmers Union Convention have adopted a policy calling for a change in the federal estate codes. We, therefore, urge that the Congress act promptly."

Present law establishing a $60,000 deduction was adopted in 1942, raising it from the $50,000 level which had prevailed since 1916. The present tax table was established in 1941 and the marital deduction was enacted in 1948. In short, we are dealing with a taxing structure dating back three decades or more.

Agriculture, like many facets of the economy, has experienced substantial inflation in the intervening years. According to the Balance Sheet of the Farming

Sector 1975, real estate values for farms in 1940 were $33.6 billion. In 1960, that figure almost quadrupled to $130.6 billion. Ten years later, in 1970 the value jumped to slightly more than $200 billion. Four years later, in 1974, this report states that the value increased to a whopping $325.3 billion. And the just reported figures for 1975 shows still another substantial increase to $371.4 billion.

In other words, from 1942 when the estate tax was enacted to today, the total real estate values jumped from $33 billion to more than $370 billion. Livestock and poultry assets have jumped substantially as has the value of farm machinery. A post World War II value of farm machinery of $12.2 billion is now more than $55 billion. Total farm assets since 1940 have jumped a staggering ten times—$52.9 billion to more than $520 billion.

Thus, the family farm that passed from one generation to the next just a few years ago will today face a sizeable estate tax. The land is the same. The farmhouse is the same—albeit slightly older. The buildings are the same. The barn is the same. In short, the farming unit remains unchanged, until the federal government comes around to collect the estate tax. Only then is the same unit considerably "larger".

The problem for the family farmer is obvious. Like small businessmen, the farmer generally has all he owns invested in the family farm. Liquid assets are generally a small percentage of the enterprise. Therefore, there is great difficulty in paying the taxes due on the estate. According to a 1973 USDA-Economic Research Service Report, "70 to 90 percent of total farm assets are in the form of fixed assets (land and buildings)." Thus, to pay the tax, either part or all of the farm must be sold. When that happens, then family farming is disrupted. The continuity of passing the land from one generation to another is destroyed.

A provision in the law would allow the estate taxes due to be paid over a ten-year period, but the little-known provision in the law is rarely used because of the legal liabilities that attorneys must bear while the estate remains open.

Unfortunately, most farmers don't fully appreciate the impact inflation has had on their farming operation and therefore are generally unaware of their estate tax liability—the tax that would be owed if they died today. We surveyed several hundred members of the Farmers Union in Wisconsin last January and found that only a third had any idea of the tax liability. Less than half had a will.

Another inequity in this policy is the treatment of the farm wife after the death of the husband. Her contribution, often equal to the husband, is unrecognized. The tax penalty is severe—and grossly unfair. Many farm wives sit on tractors, work in the barn, and tend to the same chores as their "farmer-husbands". Frequently, they actively assist in the management of the farm by keeping the books, ordering supplies, and assisting with marketing responsibilities. A quick trip through almost any farming community would confirm this. However, that "partnership" is recognized for estate tax purposes. That must be changed.

It is this provision—the marital deduction—that is particularly offending to many of our members. To a farm wife, her unrecognized contribution is intolerable. To combat this problem, one farm wife recently told us how her son and daughter-in-law were handling the situation. To establish that the wife owned and contributed to the farm, each had his own bank account and everything for the farm is purchased with two checks—one in each name. The last major purchase, a large tractor, was paid for with two separate checks.

This is obviously ridiculous. That family farmers must go to these extremes is absurd too. And for what? It is merely to establish for the Internal Revenue Service that they live, work and participate *together* on a family farm.

Farmers have long believed that if they own a farm, they should be taxed as a farm. This is commonly known as "use value" taxation. Unfortunately, property and estate taxes discriminate against the family farmer by taxing that land—a dairy farm, a grain and livestock farm, or a Dakota wheat farm—on the basis of its highest and best value. That means, the wheat farm may not be taxed as a wheat farm, but rather as the future supermarket in the new shopping center. Or, the farm might be taxed as the next housing development. As such the taxes are significantly steeper. We believe unfairly so. If we're a farm, then tax us as a farm. The recent hearings in the House of Representatives and the substantial attention that this issue has attracted have determined that it is difficult enough for the next generation of family farmers to pay the tax and remain in farming. Why then, should the farmer be saddled with a taxing basis that doesn't even recognize his profession? The failure to recognize a family farm as one is a serious deficiency in the law and should be changed.

Family farming is more than the present generation of family farmers on the land. It's a succession of generations. The keystone of our highly successful

agricultural system, the family farm, must be preserved. Provide us with reasonable protection. Provide us a future.

Let's keep the family on the farm and the farm in the family.

PREPARED STATEMENT OF THE MINNESOTA FARM BUREAU FEDERATION, PRESENTED BY CARROLL G. WILSON, PRESIDENT

Mr. Chairman and members of the Senate Finance Committee:

My name is Carroll G. Wilson. I am a cash grain farmer and apple orchard owner from near Faribault, in Rice County, Minnesota. I am also President of the Minnesota Farm Bureau Federation and Affiliated Companies, headquartered in St. Paul, Minnesota. Farm Bureau is my state's largest general farm organization, with 35,521 member families in 84 organized counties.

I appreciate the opportunity to appear before this Committee today to express my own personal views, as an active farmer, and the views and policy of Farm Bureau on what is, in my honest opinion, one of the most serious problems with which the nation's farmers and small businesses are confronted.

The United States has long pursued public policies designed to encourage family farming, with the strong argument that the preservation and enhancement of the family farm is an absolute must if a viable, balanced economy is to be assured. The federal farm programs of the last 40 years are an example of such policies.

While many of these policies have been unsuccessful, it appears that the recent movement toward a more market-oriented economy for agriculture has slowed the exodus from the nation's farms and ranches.

However, as more and more young people have moved into agriculture, frequently in partnership with a father or father-in-law, there has surfaced a new problem which, as I see it, poses a serious threat to the future of family farms.

Over the past 30 years or so, inflation and urban development have combined to push up land values drastically; land values in rural communities, in fact, have soared 220 percent-plus since 1942.

Farms located in populous areas have been threatened with extinction by rising assessed valuations based on higher uses. States such as Minnesota have generally recognized this and have adopted, in some form or other, farmland assessment laws to resolve, or at least modify, the problem as it relates to property taxes.

But Congress has yet to come to grips with problems encountered in the application of excessive federal taxes to the transfer of an estate to his heirs upon the death of a farmer or rancher.

Let me hasten to add at this juncture, however, that I am pleased that both U.S. Senators and Representatives are now proposing ways of reforming federal estate tax provision of the Internal Revenue Code. Farm Bureau, as you know, for the past several years has been much aware of the need and the strong sentiment for corrective action to update the statute.

A decade or so ago, most farmers had little reason to be concerned about federal estate taxes; most medium sized farms then were not so large but what they were under the $60,000 exemption.

Today, though, the situation has changed—and changed very drastically. Farms in recent years have grown rapidly in size and value, and because federal estate taxes are figured on a graduated scale (from 3 percent to 77 percent), and because exemptions have remained virtually unchanged since 1942, they are taking an ever-increasing share of farm capital.

Several years ago, the Economic Research Service (ERS) of the U.S. Department of Agriculture undertook an in-depth study of the federal estate tax subject. It found that federal estate taxes do indeed have the potential for dismantling the family farm. The ERS study showed conclusively that, without careful planning, estate taxes would take nearly 20 percent of the total capital of three types of farms: irrigated cotton farms in the Texas High Plains; cattle ranches in the Northern Plains; and cotton farms in the Mississippi Delta.

Adding to the burden of the actual amount of death taxes is the fact that most farms cannot readily convert assets to cash for payment of taxes. Most of a farmer's assets are fixed—in land, in buildings, and in machinery—and a heavy estate tax bill could require selling part of the farm. The average value of farm production assets increased from $47,500 per farm in 1962 to $102,000 in 1972 because of expanding farm size and rising property values. Today, it is estimated that 70 to 90 percent of total capital on most farms is in fixed assets.

Further illustrating the impact on the estate's funds, I cite a typical Corn Belt hog-beef farm which in 1971 was worth approximately $87,000. Had its production

assets increased at the same rate from 1968 to 1972 as did farms generally nationwide, its assets would have been $240,000 four years ago. Due to the graduated nature of the tax, death taxes would have climbed from less than two percent of farm capital in 1968 to 10 percent in 1972.

Thus it becomes readily apparent as to why farm property owners and their heirs are today becoming increasingly concerned about estate taxes. Inflation, higher commodity prices and improved technology are accelerating farm property values. In 1975, for example, U.S. farm real estate values per acre averaged eleven times higher than in 1940 and three times higher than in 1960.

The estate tax has been part of the federal revenue system since 1916, with the present $60,000 exemption in effect since 1942 and the present rate scale since 1941. Obviously, if these levels were appropriate at that time, they are now grossly outmoded and totally unrealistic. Adjusting for inflation, the $60,000 exemption in 1975 was worth only $18,000 in terms of 1942 dollars. To be equivalent to the $60,000 exemption of 34 years ago, it would require a federal estate tax exemption today of nearly $200,000.

Elected Voting Delegates of the member State Farm Bureaus to the 57th Annual Meeting of the American Farm Bureau Federation, held in St. Louis, Missouri, January 4–8, 1976, adopted the following policy position:

"Laws covering the taxation of estates and gifts have not been changed materially since 1942.

"We place a high priority on major amendments to the estate and gift tax provisions of the Internal Revenue Code. At a minimum, these amendments should include (1) an increase in the standard estate exemption to reflect the effects of inflation since the present $60,000 was set in 1942; and (2) a substantial increase in the marital deduction to minimize the problem of the so-called 'widow's tax'; and (3) provisions for basing the value of farmland and open spaces at levels reflecting their current use rather than their highest possible use.

"Immediate passage of such legislation is necessary if we are to allow farms and small businesses to be passed from one generation to another, if we are to relieve unnecessary hardships on widows and widowers and, if, at the same time, we are to maintain open spaces in urban areas."

Based on this official statement, Farm Bureau's priority national affairs activity this year is federal estate tax reform. Swift, remedial action for meaningful change is overdue. In Farm Bureau's view, three basic reforms in the existing federal estate tax law as it applies not only to farm estates but to all estates are needed:

1. Raise the specific estate tax exemption from $60,000 to $200,000. This would make adjustment for the inflation which has occurred since 1942 when the $60,000 went into effect.

2. Raise the maximum marital deduction from 50 percent of the value of the adjusted gross estate passed to a surviving spouse to $100,000 plus 50 percent of the total value of the adjusted gross estate. This would recognize the importance of partnership between husbands and wives and the special problems of wives who are widowed at an early age.

3. Establish a procedure which would permit an estate's executor to choose to have land use for farming, woodland or scenic open space assessed for estate tax purposes on the basis of its current use rather than on the basis of higher potential uses.

We recognize, of course, that proposals to amend the federal estate tax laws are not without their opponents.

Some maintain that it is special interest legislation on behalf of farmers and ranchers.

But they fail to note that reform would also lift an unfair burden from small businessmen and others as well.

Other critics oppose estate tax reform on the basis of its cost to the federal treasury.

While there is no firm estimate as to the fiscal impact of legislation Farm Bureau proposes and supports, we find it difficult to conceive its enactment resulting in a substantial loss of federal receipts since federal estate and gift taxes represent about 2.5 percent of the $187.5 billion the government receives in general revenues.

On a related note, let me point out that the basic purpose of an estate tax levy is to redistribute wealth rather than to raise revenue. Since this is the case, there must be other alternatives to recouping the dollars and cents loss. For one, we would commend decreasing federal spending to offset that portion of estate tax monies that would be lost by increasing the exemption.

For the most part, we are family enterprises and, as farmers, we are anxious to be able to transfer our businesses to succeeding generations in as orderly and as inexpensive a manner as possible. Considering the importance of food production, not only in the United States but in the world at large, it is essential that our family farms be allowed to operate efficiently without being threatened by the inequities of antiquated federal estate tax laws.

The climate is right. There never was a more opportune time for the Congress to act positively, decisively and effectively. Bills (H.R. 1793 and S. 1173, the Burleson-Curtis Bills) developed and introduced in the 94th Congress to carry out Farm Bureau policy alone have more than 100 sponsors of both political parties.

In conclusion, permit me to state simply that the burden of excessive federal estate taxes creates serious problems for farmers when estates are transferred to heirs. Farm Bureau has long had an interest in the federal estate and gift tax issue. In both the 93rd and 94th Congresses we have been, and continue to be, in the forefront in pressing for legislation to alleviate these problems.

Farm Bureau looks upon the Burleson (H.R. 1793) and Curtis (S. 1173) bills as legislation which would, if enacted, bring about sorely needed revisions in the federal estate and gift tax statute.

Again, I thank you for soliciting my comments and the views of the Minnesota Farm Bureau Federation.

Prepared Statement of J. A. Whittenburg III, President, Texas and Southwestern Cattle Raisers Association

My name is J. A. Whittenburg, III of Amarillo, Texas. I am President of the Texas and Southwestern Cattle Raisers Association and appear here before this Committee representing that organization.

Founded in 1877, the Texas and Southwestern represents over 14,000 cattlemen involved in all phases of the livestock industry located in Texas and surrounding states.

As the members of this Committee well know, the livestock industry has many problems. I am appearing today to discuss briefly with you one of the most serious problems facing the long-term future of the industry—the forced sale of all or part of many ranches to pay federal estate taxes.

THE PROBLEM—VALUATIONS BASED ON SELLING PRICE

Under present law, the federal estate tax is imposed on the fair market value of ranch assets. This value is determined by the IRS as being the selling price of the property between a willing buyer and a willing seller, each being equally knowledgeable and neither under compulsion to buy or sell. The problem, stated simply, is that due to external factors, the selling price of ranch land is usually greatly in excess of its earning capacity.

FORCED SALE TO PAY DEATH TAXES

When a rancher dies, his estate is faced with a very serious problem of coming up with the cash to pay federal estate and state inheritance taxes within nine months following his death. Unless the rancher's estate has substantial liquid assets such as cash or listed stocks and bonds, or other readily salable assets, these death taxes must be raised by borrowing, which must be repaid from income from the ranch, or from a sale of part of the ranch. Since statistics show that borrowing by ranchers is higher than ever in the history of the industry, it is obvious that the only real source for the death taxes in many cases is the forced sale of all or a part of the ranch property.

BORROWING NOT THE ANSWER

These high land prices upon which the death tax valuation is based make it practically impossible to repay borrowed funds since the earnings from the ranch are very low in relation to the inflated prices. Thus, if the family of the deceased rancher is dependent upon the ranch for living expenses, about all the ranch can produce is the living for the family, and there is nothing left over for the repayment of loans on the ranch for the purpose of meeting the death tax obligations.

PAYMENT OF ESTATE TAXES IN INSTALLMENTS

Under existing law there is a provision which permits the payment of federal estate taxes in installments over a ten-year period, if the ranch is a substantial part of the deceased's estate. Under prior law there was interest at 4% charged on the unpaid balance. However, when interest rates were adjusted in 1975, the 4% rate was rejected and a variable interest rate was imposed, which is now 7%. This provision has not proved to be satisfactory, even at the 4% rate, for several reasons. It is difficult or impossible to earn even 4% per year in the fluctuating agricultural economy, much less to obtain sufficient cash flow to repay the principal. The latter is particularly true when the estate tax is based on the inflated selling price of ranch land rather than on its productive value. Finally, the IRS is virtually your partner during the payout period and must be consulted at every turn. After the fourth year, all undistributed net income of the ranch must be applied in payment of the deferred estate taxes, leaving little or nothing for the rancher and his family to live on.

REMEDIAL LEGISLATION NEEDED

The most pressing need is for legislation which will permit the federal estate valuation of ranch land to be based upon such land's earning capacity or productivity for agricultural purposes. There are several bills now pending before Congress which would accomplish this relief.

There is a growing precedent in the state property tax area for this type of valuation. Over twenty states have enacted laws which provide in one form or another for the assessment of agricultural land based upon its productivity or earning capacity rather than on its market value. These laws appear to have had the desired effect of granting immediate relief in providing more equitable tax treatment for farmers and ranchers.

The present $60,000 federal estate tax exemption has remained unchanged since 1942 while land values have increased over 200% in some instances. This has resulted in the inequitable situation where 1976 figures are applied to 1942 dollars. The Administration has proposed an estate tax credit which is intended to benefit smaller sized estates. If the credit is made large enough, then relief would be provided for larger estates which are more typical in the case of farms and ranches. We feel that higher exemption would be more equitable to *all* taxpayers concerned and suggest a minimum exemption of at least $200,000.

The Administration has also proposed relief in the form of a twenty-five year period to pay estate taxes. We don't think that this proposal is feasible. The most important flaw is the fact that the valuation of the assets of the decedent's estate will continue to be made at fair market value.

The simple yet equitable answer to this most serious problem facing the ranch industry today is to permit the executor to value the ranch on its earning capacity, rather than on what it might sell for, with appropriate safeguards to prevent tax shelter exploitation. This approach is simple, workable, and equitable.

The proposal to tax the unrealized appreciation in the estate's assets at capital gains rate would add an additional tax at death which would prevent the continuation of ranch enterprises in the same family. To add the further burden of a capital gains tax on unrealized appreciation would really deal a death blow to the ranching industry as we know it today.

Let us find a way to allow our nation to continue to be the most agriculturally productive the world has ever known. In the past, the farmers and ranchers have had the ability and the incentive to accomplish this. We must see that they do in the future.

PREPARED STATEMENT OF WILLIAM N. KELLY, CHAIRMAN, COMMITTEE ON TAXES, HOUSE OF REPRESENTATIVES, STATE OF MINNESOTA, TASK FORCE ON GOVERNMENT OPERATIONS, NATIONAL CONFERENCE OF STATE LEGISLATURES

Mr. CHAIRMAN, my name is William N. Kelly, and I serve as Chairman of the Committee on Taxes in the Minnesota House of Representatives. I am appearing before you today on behalf of the National Conference of State Legislatures, the official organization comprised of the nation's 7600 state legislators and their staff.

NCSL has long supported revision of the federal estate tax laws and had recommended that the present exemption of $60,000 be substantially increased. However, after further consideration, we expanded our policy position to include that: (1) The present $60,000 exemption be increased to $200,000 for all estates; (2) the marital deduction be increased to 50% of the adjusted gross estate plus

$100,000; and (3) farm property be assessed at its value for current agricultural use, not at its market value.

While raising the exemption level should have the highest priority when Congress revises the law, the other two provisions are essential for reinforcing the positive effect on small businesses and farms. Changes in the law will have major ramifications, both for the financial stability of those who inherit small estates, and, more important, for the fabric of American agriculture itself.

Statistics show that the small farm is disappearing at an alarming rate. The United States Department of Agriculture projects that America will have a million fewer units by the turn of the century. Another study by the Department of Agriculture indicates that the small farm, managed and operated by 1 to 3 people, is the most efficient unit for agricultural production. This 1968 study points out that efficiency reaches a plateau with the small unit and remains constant throughout the large-size range. Agriculture is just not subject to the same opportunities for economies of scale that industry is.

The pressures of urban development are also taking their toll on the availability of prime agricultural land. Such urban growth consumes about 2.2 million acres per year—and 20% of all farms in this country are already within metropolitan areas.

It is on the rural-urban fringe, though, where the small farm suffers its greatest demise. The pressures of development force up land values to an artificially high level in this margin. An heir to farm property in this fringe area, then, discovers that the high property value causes his estate taxes to be exorbitant. Unfortunately, a farm's productive capacity does not increase when its market value increases. Therefore, to afford the tax payments, an heir must sell the property, even if he/she desires to keep it in agricultural use. The unfortunate result is that more acreas of productive farm land are surrendered.

This problem is also arising in rural areas as the pressures for development, particularly from second home and recreational communities, are increasing. Farm property is especially attractive to a developer because it is nearly flat, is cleared of trees and shrubs, and generally has good drainage.

Losing these units, then, will have serious repercussions for the productive capacity of American agriculture. At a time when both domestic and international consumers are demanding more food from the American farmer and when agricultural exports are maintaining a healthy balance of trade for this country, loss of these units cannot be tolerated.

This problem is not regional in scope; state legislatures across the country are alarmed about the disappearance of the family farm and the accompanying decrease in the availability of prime agricultural land. Many legislatures are now attempting to rectify these problems.

For example, several States are currently proposing changes in their own state estate tax laws. Most are increasing their exemption levels, such as Wyoming, which raised its exemption to $60,000 from $10,000. Other States, such as Minnesota and South Dakota, are attempting to equalize the exemptions for widows and widowers. Wisconsin is also examining the possibility of deferring tax payments on inherited property.

The Minnesota legislature has also considered an alternative tax valuation method. If the estate passing to a surviving spouse is less than $500,000 and if the tax computed on 50% of the estate, without using exemptions, is less than the tax computed with normal exemptions on the entire estate, then the lesser tax may be paid.

Several other States, including Vermont and Massachusetts, have developed state food policies which recommend, among other changes, estate tax benefits for farms which are willed to succeeding generations and remain in active farm production for a certain time period. Vermont is also considering the feasibility of exempting the first $10,000 of net business income (including that from a farm) from taxation. The Massachusetts legislature is considering a bill to value farm land at its current use for state estate tax purposes.

Other state legislative actions to preserve the family farm include regulation of corporate farming. Nine States (Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota, Oklahoma, South Dakota, and Wisconsin) have enacted laws in this area. Kansas was the first to do so in 1931, and North Dakota followed shortly thereafter. Minnesota was the first State in this decade to regulate corporate farming. It allows only two classes of corporations to farm and own agricultural land. "Family farm corporations" must be founded for the purpose of farming, have none of the stockholders as corporations, and have at least one of the stockholders qualify as a Minnesota resident. A corporation which owned land before the effective date of the law is also permitted to farm in the State.

In addition, the majority of States have laws attempting to preserve prime agricultural land. Most accomplish this by alleviating the property tax burden in one of the three ways: (1) Preferential assessment, which allows farm land to be assessed at its current use, not at its market value; (2) deferred taxation, which allows land to be assessed at its current use value, but which provides that if farm land is used for development, unpaid taxes on the value are recaptured; and (3) restrictive agreements, which allow state and local governments to negotiate with a landowner to restrict development in exchange for a tax preference.

At least eleven States have preferential assessment laws, although requirements vary with each State. At least twenty-three States have deferred taxation laws, while another eleven States have restrictive agreements. Still other States are considering the use of development rights and easements, while the California legislature is also considering a bill to establish an Agricultural Resources Board to have final authority over the State's prime agricultural land.

The Minnesota legislature enacted the "Green Acres" law, which allows farmers to maintain their land for agricultural use even though surrounding land may be developed. If the land is sold or converted to a higher use, then the tax differential must be paid.

The Minnesota legislature is also concerned about encouraging young farmers to enter and remain in agriculture. A recently-enacted piece of legislation will assist young farmers to obtain credit for acquiring farm real estate. Under this bill, eligible persons could receive low-interest loans for ten years, with an option to renew for an additional ten years. To be eligible, applicants must reside in Minnesota or intend to reside there, have a net worth of less than $50,000, purchase and use land for agriculture only, and be trained or experienced in the type of agriculture for which the loan is requested.

State actions to preserve the family farm and its accompanying agricultural land will not be successful, however, while the federal estate tax imposes such an exorbitant burden on the small farmer and heirs to farm property.

Therefore, NCSL recommends that, first of all, the exemption level be increased to $200,000 for all estates. With the current rate of inflation, an exemption of at least $190,000 would be necessary to equal the purchasing power of the $60,000 exemption enacted in 1942. Examples abound of how farm land purchased in the 1940's at $50 per acre is now worth $1,000 or more per acre. The antiquated exemption of $60,000 is not substantial enough to ease the tax burden on an heir.

Second, the marital deduction for all estates should be increased from the present 50% of the adjusted gross estate to $100,000 plus that 50% rate. Changes in this provision are necessary to recognize the partnership which exists between husband and wife and to alleviate the discrimination against women which currently exists in the estate tax laws.

And third, NCSL recommends that farm land should be assessed at its value for current agricultural use, and not at its market value. By including this provision, an heir to farm property located in areas pressured by development will not be forced to sell land that he/she wishes to keep in agricultural production. NCSL also supports a provision stipulating that land assessed at its current use value be kept in that use for at least five years prior to and five years following the owner's death. Then, if the land is converted to development or sold, the market value assessment would be invoked.

In summary, a combined state and federal effort is needed to maintain the viability of the family farm and to insure that prime agricultural land is preserved for the food production so essential to the American consumer and our foreign customers. The States have realized their role in rectifying the problem, but state actions will be greatly overwhelmed unless federal estate tax laws are changed—and changed soon.

Thank you, Mr. Chairman, for this opportunity to recommend legislation to ease the burden of federal estate taxes on those who inherit small farms and businesses.

Senator MONDALE. Next we have a panel consisting of Mr. Harry Austin, president, Smaller Manufacturers Council, accompanied by Mr. James D. "Mike" McKevitt, Washington Counsel, National Federation of Independent Business.

Mr. James P. Wicker, Small Business Council, Minneapolis and St. Paul Chambers of Commerce.

I ask this panel what I have asked previously; namely, that you try to keep your statements to 5 minutes so that the committee can ask questions. We will start with Mr. Austin.

STATEMENT OF JAMES D. "MIKE" McKEVITT, WASHINGTON COUNSEL, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Mr. McKEVITT. Mr. Chairman, my name is Mike McKevitt. I would like to introduce and give some brief history.

I formerly served as a member of the House Small Business Committee. Since I have departed from Government I began to serve as Washington Counsel for the National Federation of Independent Business.

I will not read my statement. I would like to point out the fact that in the last year the various independent small business associations have come together, have worked their tails off to develop a small business tax reform package that would insure the continued independence of the small business community, provide incentives for its future growth and simplify the heavy administrative and paperwork burden it faces in the area of taxes. That package has now been introduced in the Senate by Senator Gaylord Nelson as S. 3397 and in the House by Congressman Evins and Congressman Conte as H.R. 13687. We are anxious that this proposal be studied carefully so that the small business community can begin receiving the meaningful tax relief it deserves.

The list of members and employees are set forth in the statement.

The thing I want to point out, as Senator Humphrey pointed out to us this last week, the small stores, and farmers, are starting to come together as well.

Mr. Harris Austin is president of the Smaller Manufacturers Council. He is also a member of the national Federation of Independent Business. He also runs a business in Mars, Pa. I think this story is of the greatest interest in the problem he faces unless he sees relief, and people like him, in this particular problem and, therefore, I would like to introduce Mr. Harry Austin for his statement to you.

Senator MONDALE. Thank you, Mr. McKevitt.

May I say many of us view this growing alliance with great interest.

STATEMENT OF HARRY AUSTIN, PRESIDENT, SMALLER MANUFACTURERS COUNCIL

Mr. AUSTIN. Thank you, Mr. Chairman.

I have a prepared statement here that I would like to submit for the record.

Senator MONDALE. Very well.

Mr. AUSTIN. I would like to tell you the story as far as I personally am concerned. The James Austin Co. was founded by my grandfather. I am a third generation. We were founded in 1889. We now have 154 employees and our plant is located in Mars, Pa., which is a small rural community of 1,400 population in western Pennsylvania.

We manufacture household cleaning needs, products, and our competitors are Clorox Chemicals, Proctor & Gamble, and a few of the other big ones. We have had a hard time staying alive in this competitive world.

Ten years ago our sales were a million dollars, after 68 years of hard labor on the part of my grandfather, my father, and myself. At that time I made the decision to get into manufacturing our own containers. This involved me going in hock for $500,000 for two molding machines, and subsequently we have added two additional machines and a building to house them in, and right now I owe about $1 million and I guess if that is any consequence, hopefully in 8 years, why, I will be out of hock.

In the last 10 years, therefore, we have increased our employment from 35 persons to 154. We are now the lifeblood of that small rural community of Mars, Pa. And in addition to trying to meet the obligations of financing this equipment and staying ahead of sales, and juggling all the other balls in respect to employees and so forth, I have had the horrible situation of finding my estate increasing in value as I progressively increase the sales of this business from $1 million 10 years ago to $7 million today.

Interestingly enough, as I sit down with these estate planners once a year and I do have good tax advice, and this year they have suggested another $200,000 worth of life insurance, and I hear it mentioned today rather than $100,000 worth of life insurance might be $3,500 to $5,000. For the benefit of the Senate here, I just brought $200,000 worth of life insurance and I am in darn good health and I am 60 years of age, and it costs me $5,700 per $100,000.

I do not take a big salary out of my business because I have obligations. Another interesting thing has happened in the years I progressed in this business. That is, many of the national firms now are showing interest in James Austin and want to buy us out, and they all talk about a tax free exchange of stocks. You give me your stock, Harry, and I give you our stock and you are home free and you are independently wealthy.

This just cuts me right to the core. Here I am with 154 people I am in love with and built my business that are the backbone of Harry Austin's very existence, and these national firms want us to sell out to them and we know what they want, they want to take our brands, put them in their plants, sell off the assets in Mars, Pa., and down the tube goes that little village in which we are such a viable force. So, gentlemen, that is my statement. I think it is a good one. I think you are looking at the very thing that we have been talking about all morning here. The farmer or the small businessman has the same problem.

Thank you very much.

Senator MONDALE. Thank you very much.

Mr. Wicker.

STATEMENT OF JAMES P. WICKER, SMALL BUSINESS COUNCIL, MINNEAPOLIS AND ST. PAUL CHAMBERS OF COMMERCE

Mr. WICKER. Thank you, Mr. Chairman and members of the Committee.

I would like to also ask that my written statement be entered on the record.

Senator MONDALE. It will be made a part of the record.

Mr. WICKER. I am presenting this statement on Federal estate and gift taxes on behalf of the Greater Minneapolis Chamber of Commerce

Small Business Committee and the St. Paul Area Chamber of Commerce Small Business Council.

These organizations represent approximately 5,000 small businesses in the State of Minnesota. As you know, small businesses are a vital part of America's economic future. They presently employ about 60 percent of our work force and aggregate in number 95 percent of the businesses in this country.

One of the small business communities most pressing problems is in providing for the continuity of those businesses from generation to generation.

It should be recognized that estates of small business owners often differ from other estates. Assets are not readily marketable and sale may be forced during depressed economic conditions with resultant losses. Also, the value of a small business may deteriorate dramatically upon the death of an owner whose leadership was a prime ingredient in the success of the company.

Moreover, the traditional methods of valuing business do not always apply to small business. All too often it is necessary to sell the business to pay estate taxes. These forces lead to the decreased competition and less motivation to the entrepreneur to start and nurture a new business. We in Minnesota cannot imagine what the Minnesota economy would be like without such businesses as Data Control, Minnesota Mining and Manufacturing Co., and many other businesses which just a few years ago were themselves small businesses.

For these reasons the small business committee of the Minneapolis and St. Paul Chambers of Commerce recommend that the Senate Finance Committee consider the following changes:

First: Increase the estate tax exemption. We have heard a great deal today about what the estate tax exemption was worth in 1942 and various proposals to increase the estate exemption. We wish that the committee would favorably consider Senator Mondale's proposal to increase the estate tax exemption from $60,000 up to $100.000.

For the reasons cited above with respect to the estate of small businessmen, we also urge the committee to favorably consider Senator Nelson's proposal to increase the gift tax exemption from $30,000 to $60,000.

At the present time estate taxes must be paid within 9 months after the date of death. In certain circumstances if an estate is composed of various assets that period can be extended for 12 months.

If the decedent's estate can prove undue hardship or the estate includes a farm or small business, which amounts to a significant part of the estate, an addtional 10-year period can be gained in which to pay the estate tax.

We belive this provision should be liberalized so simple hardship would allow the estate tax to be paid over a 10-year period.

I think in this connection it goes without saying that the interest rates on such deferred payments have to be more realistic. Up until the end of February 1976, the interest rate on such deferred payments was 9 percent. At the present time it is 7 percent. I think interest rates like this in connection with the 10-year payout of estate tax is like telling one's child they can use the car for the junior prom but they have to be home at 9 o'clock.

We think a rate of 4 percent is more realistic.

Furthermore, we believe that the definition of small businesses which would automatically qualify for the 10-year payout should be liberalized. At the present time one has to have less than 10 shareholders to qualify as a small business, together with another definition. Many businesses have more than 10 shareholders.

Minnesota has recently enacted legislation which reduces the impact of inheritance taxes by modifications including an increase of the inheritance tax exemption. We feel that our State's willingness to respond to the inequities created for the small business owner by inflation should lead the way to improved Federal legislation.

Thank you very much for the opportunity to present this testimony.

Senator MONDALE. Thank you, very much, Mr. Wicker.

Mr. Austin, I missed part of your testimony. You have a business with 125 employees?

Mr. AUSTIN. 154, Senator.

Senator MONDALE. What do you produce?

Mr. AUSTIN. We produce house-cleaning needs products, household bleach, ammonia.

Senator MONDALE. Did you start that business?

Mr. AUSTIN. Third generation.

Senator MONDALE. That has been in this community all those years?

Mr. AUSTIN. No; that has been in the last 25 years. Prior to that in the city of Pittsburgh.

Senator MONDALE. I don't know if you want to say, but what is the estimated worth of that business, the economic value? You may not want to give that figure.

What I am getting at is this: What is small? I like the idea of the credit——

Mr. AUSTIN. This is tough.

Senator MONDALE. I like the idea of the credit because it may be that we can use the same money and get a lot more relief for small businesses. But there are a lot of businesses, which, like economically viable farms are more expensive than a lot of people realize. Just to make a good living off of a farm in Minnesota, according to Mr. Wilson, is a $700,000 or $800,000 farm.

Similarly, a small business, to be effective, to really compete, may have to be a lot larger than a lot of people realize.

That is a tough question, what is small. And I think maybe your business is a good example of that.

Mr. AUSTIN. I think it is a darn good example. We are operating, of course, as I explained to your committee, our competition is Procter & Gamble and we have a little plant but our plant is 78,000 square feet.

The appraised valuation for insurance purposes is $15 per square foot, which puts the plant well over a million dollars. I have got $1½ million worth of equipment out there. And this just gives you $2½ million now for an operation such as ours in order to employ 154 persons.

Senator MONDALE. If you weren't at about that size you couldn't compete, could you?

Mr. AUSTIN. No, sir, I could not. As I explained earlier, our size after 60 some years in business only grew 1,100,000 in size. Now we

are at 7 million and that has only happened in the last 10 years, since I put the equipment in and since I expanded the physical plant.

Senator MONDALE. Now you could sell if you wanted to, couldn't you, to Procter & Gamble?

Mr. AUSTIN. I could sell tomorrow with an exchange, a free exchange of stock, tax free.

Senator MONDALE. And then you wouldn't have to worry about liquidity.

Mr. AUSTIN. I would be a millionaire.

Senator MONDALE. Right now. You wouldn't have to worry about liquidity.

Mr. AUSTIN. No, sir.

Senator MONDALE. Let somebody else worry about that.

Mr. AUSTIN. True, true.

Senator MONDALE. Then this business would no longer be owned by you or someone in the community. It would be owned by an absentee corporation.

Mr. AUSTIN. I don't think the business would exist. I don't think the buyer would operate that plant in Mars, Pa.

Senator MONDALE. What he would do is just take your good will and your name.

Mr. AUSTIN. He would take our name, good will, and our brands. We have certain franchises with supermarkets within a 500-mile radius of Pittsburgh. Procter & Gamble would move it down to Cincinnati and put the brands in down there and close the facility up. I know he would, that is the reason I am hanging on, sir.

Senator MONDALE. I think your case can be repeated by the thousands.

Mr. AUSTIN. Yes; it could.

Senator MONDALE. So that this underscores the importance of this reform if we want competitive business in this country.

Mr. AUSTIN. Yes; I think we represent the crossroads of the United States. You find this in any small business.

Senator MONDALE. We had a similar witness before us representing a profitable but small newspaper in Mankato. It is independently and locally owned. He is going through the same thing you are. There are all kinds of chains that would like to buy him up.

He can get stock for his newspaper and do very well by himself and his family, and avoid the liquidity problems at estate tax time. Of course, one of the factors he has to look at is the cost of that estate tax.

Mr. AUSTIN. That is right, true.

Senator MONDALE. There you have a competitive business, you also have independent editorials and news operations which ought to be an important objective in American life.

Mr. AUSTIN. Yes.

Mr. MCKEVITT. You also have jobs involved. Small business is labor intensive. When you are starting to wipe out the small groups you are wiping out a lot of jobs. These are the ones that make the callback as far as the jobs are concerned.

Senator MONDALE. Mr. Wicker, you are an accountant, are you not?

Mr. WICKER. Yes; I am.

Senator MONDALE. Would you say that Mr. Austin's testimony is typical of the situation that many businesses face?

Mr. WICKER. Very definitely. I can give you many examples in Minnesota both through the Minneapolis Chamber of Commerce, also through my professional life where this is true. I think it is particularly true in the case of small business because success often comes, rapid success often comes in the later years. What I am saying, a man can start out a small business and just make it by for 10, 15, 20 years, and all at once through inflation, through a change of technology or whatever, the idea will catch on and all at once it is a good-sized business, a very profitable business, and a very valuable business, and it is not the sort of thing that you can plan over a long period of time to buy insurance to cover the estate tax.

All at once, at age 55 or 60, the man is faced with the possibility of a horrendous estate tax. There is no practical alternative but to dispose of the business.

Senator MONDALE. How do you counsel your clients who are in Mr. Austin's position? Do you tell them to take out life insurance or what?

Mr. WICKER. Well, it is a long process, a very complex process. It first depends on whether the individual has in mind keeping the business in his family, passing it on to a daughter or son-in-law or son, or some very close business associates. In cases such as this it would involve insurance, it would involve lifetime gifts, it would involve very careful construction of the capital structure of the company between voting stock and nonvoting stock.

In many cases the businessman does not want to pass it on to heirs, either, because he doesn't have heirs that are interested in the business or he has learned through a lifetime it is not probably worth it. In those cases the practical solution is to sell the business or exchange the stock for stock of another company.

Senator MONDALE. It is your testimony that the present estate tax in many cases might tilt toward selling out?

Mr. WICKER. Very definitely.

Senator MONDALE. So that reform is needed to help encourage the continuation of local ownership?

Mr. WICKER. Very definitely.

Senator MONDALE. Senator Hansen.

Senator HANSEN. I don't have any questions. I think the panel made some very good points, and you have underscored them very well.

Senator MONDALE. Thank you very much for an excellent statement. We are most grateful.

[The prepared statements of the preceding panel follow. Oral testimony continues on p. 84]

PREPARED STATEMENT OF JAMES D. "MIKE" MCKEVITT, WASHINGTON COUNSEL, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Mr. Chairman, Members of the Committee, I am Mike McKevitt, Washington Counsel to the National Federation of Independent Business (NFIB). It is a distinct honor for me to appear here today to brief you on some recent, important developments within the small business community.

When I served in the House and in particular, as a member of the House Small Business Committee, I became very concerned about the fragmented effort made by this important sector and asked many times why the nation's small business associations could not agree upon a common position and then take it forcefully before the Congress. As it turned out there were many reasons for this, but I am delighted to be able to tell you that this important sector of the American economy seems to be on its way towards developing a united voice on the serious issues that confront it.

75-046—76——6

During 1975 eight small and independent business associations representing over half a million American firms and millions of American workers came together to discuss effective small business tax reform. These organizations are truly representative of the U.S. small business community and include:

	Members
Independent Business Association of Wisconsin	200
National Association of Small Business Investment Companies	350
Smaller Manufacturers Council of Pittsburgh	600
Council of Smaller Enterprises of Cleveland (18–25,000 employees)	860
Smaller Business Association of New England (40,000 employees)	1, 200
National Small Business Association (500,000 employees)	40, 000
National Federation of Independent Business (3,345,601 employees)	440, 000
National Business League	5, 000

Over the last eight months all of these groups have worked closely together to develop a small business tax reform package that would insure the continued independence of the small business community, provide incentives for its future growth and simplify the heavy administative and paperwork burden it faces in the area of taxes. That package has now been introduced in the Senate by Senator Gaylord Nelson as S. 3397 and in the House by Congressman Evins and Congressman Conte as HR 13687. We are anxious that this proposal be studied carefully so that the small business community can begin receiving the meaningful tax relief it deserves

The first section of our tax package deals with estate and gift taxes—changes in the Internal Revenue Code that we believe are essential for continued small business independence. Harry G. Austin, Jr., President of the Smaller Manufacturers Council (SMC) and President of the James Austin Company is here with me to testify about is importance to small business.

PREPARED STATEMENT OF HARRY G. AUSTIN, JR., PRESIDENT OF THE SMALLER MANUFACTURERS COUNCIL AND PRESIDENT OF THE JAMES AUSTIN CO.

Mr. Chairman, thank you for this opportunity to testify before the Committee on Finance of the United States Senate for these hearings on estate and gift taxes.

I am Harry G. Austin, Jr., President of the Smaller Manufacturers Council and third generation President of the James Austin Company. The Austin Company was formed in 1889 and since that time has been a family owned and operated business.

My purpose here is not to ask for preferential treatment, but to have you recognize our unique problems and the desirability of nurturing the small business community as both a mainstay of our economy and the major hope for future economic growth and development. Some of the problems of the small and independent business community are intensified by the operation of the estate and gift tax laws.

The estate and gift tax sections of the Internal Revenue Code have not been overhauled in over 20 years. Inflation and other circumstances have eroded many of the mitigating sections of the Code since then. We are concerned with a number of issues.

1. Amount of exemption from tax (Sections 2052 and 2521).
2. Rates of tax (Sections 2001 and 2502).
3. Stock redemptions to pay death taxes (Section 303).
4. Transfer of Business Interests at death (Proposed new Section 2057).

Before we discuss the specifics, I would like to cite an example. The following is an actual case with circumstances changed sufficiently to protect the anonymity of the taxpayers. It will give you some example of the real problems confronting a small business. It will be obvious how the present estate and gift tax laws have intensified a very difficult set of circumstances.

CASE STUDY

Mr. A established X Company some years ago. Business prospered and Mr. A took in a partner, Mr. B. When X Company was incorporated, Mr. A received 62% of the shares of X Corp., Mr. B received 25% and members of Mr. A's family received the remaining 13% of the shares. Mr. A's investment was $25,000. The Company happens to be in a service business but the same circumstances apply to companies in wholesale, manufacturing and retail. Because of his skill and a good product, the company's growth has been rapid. Since X Corp. cannot raise equity capital and is limited as to the amount X Corp. can borrow, growth must be financed through retention of earnings.

In 1973, X Corp's assets were deployed toward a plan for growth. No excess resources are available. As Mr. A said, "You either grow or go". Mr. A's two children S and D have become active in the business and are the owners of the remaining 13% of stock referred to above. Mr. B is sickly, but still actively contributing to the business. Unexpectedly, Mr. A dies, partly as a result of overwork to implement the expansion plan.

Lawyers and accountants arrive on the scene. The outline of his estate is attached as Exhibit A. Mr. A's shares in X Corp. are valued at $27,000. The estate taxes and administration of the estate plus liabilities total $125,919. As is evident there is a severe liquidity problem. Mr. A's estate can only raise $58,600. Where will the rest come from? Some can be raised through the operation of Section 303 by effecting a partial redemption of the stock. Some can be deferred through an extension of time using Section 6166, but this carries with it a substantial interest rate. The beneficiaries of the estate can try to raise cash.

Finally the money is raised. Everything in sight is pledged. All parties are nervous because the estate is subject to an audit. In 1974, the 25% shareholder dies. His estate's problems are as horrendous as Mr. A's, but will not be detailed here. The business is virtually at a standstill. Fortunately, the son S proves to be an able administrator, but the problems of the estate have been a major distraction. As part of the growth program X Corp. is offered chances to acquire two small businesses at a good price. Because of the valuation question pending before the Internal Revenue Service and that of Mr. B, the corporation is advised to wait for the audit of the estate to determine the value of the corporation for estate tax purposes.

Finally, in 1975, the Internal Revenue Service arrives and proposes to value Mr. A's shares at $2,000,000. This would increase the federal estate tax by $221,000! In a panic, the shareholders attempt to sell out. They find that they are lucky if they could receive half of the Internal Revenue Service's valuation. Further, all offers involve consolidating X Corp.s business into a larger business with a resulting loss of 75 jobs. The remaining jobs would require relocation. After much negotiation, the valuation of Mr. A's shares is set at $1,000,000. Even at that, the additional federal estate tax is over $47,000!

Estate tax considerations have paralyzed the business for almost two years. The $60,000 exemption and the high rates of tax have almost caused a business and 75 jobs to disappear. X Corp. and A's beneficiaries have been forced to borrow in excess of the limits dictated by prudence. The Company is not able to redeem the shares of the 25% shareholder. No one knows how Mr. B's estate can meet its death tax requirement. The 25% minority interest is of little value on the market, but will be given some reasonably substantial value for death taxes.

Senator Nelson of Wisconsin, the Chairman of the Select Senate Committee on Small Business says, "The (federal estate) tax literally is forcing the small operator to sell out or to merge with the giant corporation. It has become in effect, a cancer in American Society, eating away at the vitals of local economies and sapping the energies of economic growth." In this case, the cancer was very nearly terminal.

The specifics of our proposals to alleviate some of this burden follows. The actual language of our proposed legislation is included as Exhibits B through E.

Amount of exemption

At present, the first $60,000 of assets are exempt from taxation in an estate. The last time any change was made in this exemption was in 1942. According to the Wall Street Journal, the inflation corrected equivalent is $210,000. According to the Joint Economic Committee, the percentage inflation from 1942 to 1975 was 289.3%. Today's equivalent of 1942's $60,000 under this formula is $173,600.

Thus the estate of the man who purchased a home in 1940 for $20,000 that is now worth $60,000, could be at the threshhold of estate taxation. This is absurd. He will surely have some other assets which will be subject to tax.

Numerous Senators and Congressmen have made various proposals to increase the estate tax exemption. These range from $120,000 to over $250,000. It is evident that some increase in some form is essential.

In light of all of the above, we suggest that $180,000 is a reasonable figure to exempt from federal estate taxation. As an integral part of that, we recommend the estate tax's relation to the gift tax be continued. This would increase the specific exemption to $90,000 and the annual exclusion to $9,000 per donee.

Rates of tax

In the same manner that inflation has eroded the exemptions, the graduated structure of the tax is also too burdensome. Our proposal is as follows:

Taxable estate	Tax rate (percent)	
	Present	Proposed
0 to $5,000	3	5
$5,000 to $10,000	7	5
$10,000 to $20,000	11	5
$20,000 to $30,000	14	5
$30,000 to $40,000	18	5
$40,000 to $50,000	22	5
$50,000 to $60,000	25	10
$60,000 to $100,000	28	10
$100,000 to $150,000	30	15
$150,000 to $200,000	30	20
$200,000 to $250,000	30	25
$250,000 to $400,000	32	25
$400,000 to $500,000	32	30
$500,000 to $600,000	35	30
$600,000 to $750,000	35	35
$750,000 to $1,000,000	37	35
Over $1,000,000 no change from present rates		

Gift tax rates are presently 75% of estate taxes. We propose this ratio be maintained.

Stock redemptions to pay death taxes

Under present law continued in Section 303 of the Internal Revenue Code, some stock may be redeemed to pay death taxes if the shares of that stock are a major asset of the estate. The distribution is not treated as a dividend and the stepped-up basis results in no capital gains tax. This is an excellent opportunity to save a closely held business from extinction through merger of liquidatiln to pay estate taxes. The problem is that the limitations are too onerous. The stock must represent more than 35% of the gross estate or more than 50% of the taxable estate of the decedent. We suggest these percentages be liberalized to more than 20% of the value of the gross estate or more than 40% of the taxable estate of the decedent.

Transfer of business interest at death

The average small business uses all its liquid resources to buy equipment, pay payroll and taxes. When a major shareholder-employee dies, there is frequently not enough cash available to effectuate a 303 redemption. Creditors are less anxious to extend credit and customers are wary of new management. What do you do in a case like this? Probably sell or liquidate. To relieve this impossible situation, we propose that the estate be allowed an optional basis for eligible stock equal to the decedent's basis. Thus, the beneficiaries would receive the stock at the old basis and the death taxes would be paid on that basis. When the business was sold or liquidated, the beneficiaries would pay a capital gains tax calculated on the decedent's basis.

We propose eligibility requirement be the same as Section 303 requirements. The business could survive, death taxes would not strangle and ultimately the federal government would get its taxes at the time money is available to pay the taxes.

CONCLUSION

Every year small businesses are strangled by the onerous burdens of death taxes. In some cases, the beneficiaries have to pledge or sell their own assets to retain the family business. In other cases, the businesses have to be sold at distressed prices. This should not be the result of years of hard work, nor should our tax laws be structured to crush the small business. Our economy suffers. The famed American technology superiority is eroded, and we end up encouraging people to take the "safe" route and work for some impersonal monolithic giant. In the forest, new trees must spring up from acorns or the forest will soon be destroyed. So, too, in our economy, we must encourage the development of new business.

Case study of the liquidity needs of the estate of Mr. A

Item	Amount
Total estate assets:	
Liquid:	
Life insurance	$50,000
Cash and securities	5,600
Total	55,600
To be liquidated: car	3,000
Total	58,600
Not liquidated:	
Business	527,000
Home	55,000
Total	582,000
Total estate assets	640,600
Gross estate: Total estate assets	640,600
Liabilities:	
Notes payable	3,000
Mortgages	2,000
Last expenses	3,000
Other	5,000
Total	13,000
Gross estate	627,600
Administration costs:	
Gross estate	627,600
Administration cost at 5 percent	31,380
Adjusted gross estate:	
Gross estate	627,600
Deductions: Administration cost	31,380
Adjusted gross estate	596,220
Federal estate tax (F.E.T.) adjusted gross estate with marital deduction	58,578
State inheritance tax	22,961
Liquidity needs: gross estate liabilities	13,000
Estate clearance costs:	
Administration	31,380
F.E.T	58,578
S.I.T	22,961
Total	112,919
Liquidity needs	125,919
Liquidity availability	58,600
Liquidity deficit	70,319

Exhibit B

Sec. 103. Adjustment of Estate Tax Rates.

(a) Section 2052 (relating to the exemption from the estate tax) is amended by striking "$60,000" and by substituting in lieu thereof "$180,000".

(b) Section 2001 (relating to the rate of estate tax) is amended by striking the rate schedule contained therein and by inserting in lieu thereof the following new rate schedule:

If the Taxable Estate is:	*The tax shall be:*
Not over $50,000	5 pct of the taxable estate.
Over $50,000 but not over $100,000	$2,500 plus 10 pct of the excess over $50,000.
Over $100,000 but not over $150,000	$7,500 plus 15 pct of the excess over $100,000.
Over $150,000 but not over $200,000	$15,000 plus 20 pct of the excess over $150,000.
Over $200,000 but not over $400,000	$25,000 plus 25 pct of the excess over $200,000.
Over $400,000 but not over $600,000	$75,000 plus 30 pct of the excess over $400,000.
Over $600,000 but not over $750,000	$135,000 plus 35 pct of the excess over $600,000.
Over $750,000 but not over $1,000,000.	$187,500 plus 37 pct of excess over $750,000.
Over $1,000,000 but not over $1,250,000.	$280,000 plus 39 pct of excess over $1,000,000.
Over $1,250,000 but not over $1,500,000.	$377,500 plus 42 pct of excess over $1,250,000.
Over $1,500,000 but not over $2,000,000.	$482,500 plus 45 pct of excess over $1,500,000.
Over $2,000,000 but not over $2,500,000.	$707,500 plus 49 pct of excess over $2,000,000.
Over $2,500,000 but not over $3,000,000.	$952,500 plus 53 pct of excess over $2,500,000.
Over $3,000,000 but not over $3,500,000.	$1,217,500 plus 56 pct of excess over $3,000,000.
Over $3,500,000 but not over $4,000,000.	$1,497,500 plus 59 pct of excess over $3,500,000.
Over $4,000,000 but not over $5,000,000.	$1,792,500 plus 63 pct of excess over $4,000,000.
Over $5,000,000 but not over $6,000,000.	$2,422,500 plus 67 pct of excess over $5,000,000.
Over $6,000,000 but not over $7,000,000.	$3,092,500 plus 70 pct of excess over $6,000,000.
Over $7,000,000 but not over $8,000,000.	$3,792,500 plus 73 pct of excess over $7,000,000.
Over $8,000,000 but not over $10,000,000.	$4,522,500 plus 76 pct of excess over $8,000,000.
Over $10,000,000	$6,042,500 plus 77 pct of excess over $10,000,000.

Exhibit C

Sec. 104. Adjustment of Gift Tax Rates.

(a) Subsection 2503(b) (relating to exclusions from gifts) is amended by striking "$3,000" and by substituting in lieu thereof "$9,000".

(b) Section 2521 (relating to the specific exemption from gift tax) is amended by striking "$30,000" and by substituting in lieu thereof "$90,000".

(c) Subsection 2502(a) (relating to the rate of gift tax) is amended by striking the rate schedule contained therein and by substituting in lieu thereof the following:

"RATE SCHEDULE"

"The rate of tax imposed by section 2501 shall be 75% of the rate imposed by section 2001."

EXHIBIT D

SEC. 105. Redemptions of Business Interests to Pay Death Taxes.

(a) Subparagraphs (A) (i) and (ii) of Subsection 303 (b)(2) (relating to the relationship of stock to a decedent's estate) is amended by changing "35 percent" and "50 percent" to read "20 percent" and "40 percent", respectively.

(b) Subsection 6166(a) (relating to payment of estate tax) is amended by changing "35 percent" and "50 percent" to read "20 percent" and "40 percent", respectively.

EXHIBIT E

SEC. 107. Transfers of Business Interests at Death.

(a) Chapter 11 of Subchapter A of Subtitle B (relating to estate tax) is amended by inserting the following new section:

"SEC. 2045. Transfers of Business Interests at Death.

In the case of a business interest qualifying under Section 303 or subsection 6166(a) (without regard to this section), if the executor so elects, the gross estate shall include the decedent's basis in such business interest rather than the fair market value thereof."

(b) Section 1014 of Subchapter shall be amended by adding at the end thereof the following new subsection (e):

"(e) The basis of property acquired from a decedent as to which an election was made pursuant to Section 2045 shall be the decedent's basis in such property."

(c) Paragraph (13) of Section 1223 (which was paragraph (12) prior to redesignation by Section 10 of this Act) shall be redesignated paragraph (14) and the following new paragraph (13) shall be inserted:

"(13) in determining the holding period of property the taxpayer acquired from a decedent as to which an election was made pursuant to Section 2045 to include only the decedent's basis in his gross estate, there shall be included the period for which such property was held by the decedent."

PREPARED STATEMENT OF JAMES P. WICKER, REPRESENTING SMALL BUSINESS COMMITTEE, GREATER MINNEAPOLIS CHAMBER OF COMMERCE AND SMALL BUSINESS COUNCIL, ST. PAUL AREA CHAMBER OF COMMERCE

I am presenting this statement on Federal estate and gift taxes on behalf of the greater Minneapolis Chamber of Commerce Small Business Committee and the St. Paul area Chamber of Commerce Small Business Council. These organizations represent approximately 5,000 small businesses in the State of Minnesota. As you know, small businesses are a vital part of America's economic future. They presently employ about 60% of our work force and aggregate in number 95% of the businesses in this country.

One of the small business communities most pressing problems is in providing for the continuity of those businesses from generation to generation. The relatively small estate and gift tax exemptions provided by present law frequently afford heirs little opportunity to continue operating a company as an independently owned small business. It should be recognized that estates of small business owners often differ from other estates. Assets are not readily marketable and sale may be forced during depressed economic conditions with resultant losses. Also, the value of a small business may deteriorate dramatically upon the death of an owner whose leadership was a prime ingredient in the success of the company.

All too often it is necessary to sell businesses to pay estate taxes. These forced sales may lead to decreased competition, greater inflationary pricing practices and, in fact, less motivation for the entreprenuer to maintain a viable entity with close ties to the community—an entity with a strong sense of civic pride and an interest in employing its community members. We recommend the Senate Finance Committee consider the following changes:

INCREASE ESTATE AND GIFT TAX EXEMPTIONS

The original legislation providing exemptions in the determination of estate and gift taxes was obviously intended to permit taxpayers to accumulate a basic level of assets which could be conveyed to heirs. That basic level of assets enabled many small businesses to be passed from generation to generation.

Inflation has eroded purchasing power and substantially increased, in terms of dollars, the value of businesses.

We urge the committee to favorably consider Senator Mondale's proposal to increase the estate tax exemption from $60,000 to $150,000 (S. 2394) and Senator Nelson's proposal to increase the gift tax exemption from $30,000 to $60,000 (S. 22683).

LIBERALIZE INSTALLMENT PAYMENTS OF ESTATE TAXES AND EXTENSIONS

Regulations requiring that a "closely-held corporation" have ten (10) or fewer shareholders before being permitted to pay estate taxes in installments should be amended to permit more shareholders. Many very small businesses have more than ten (10) family shareholders. In some cases owners have been willing to permit employees to own part of the businesses and have therefore lost the benefit of the installment payment of estate taxes.

Consideration should be given to modifying regulations permitting an extension of time for payment of estate taxes. Currently a 12-month extension is available only in the case of "undue hardship" or "reasonable cause". Rapid disposition of illiquid assets with resultant losses to heirs sometimes results. "Undue hardship" provisions should be liberalized and extensions of up to 24 months should be considered.

Minnesota has recently enacted legislation which reduces the impact of inheritance taxes by modifications including an increase of the inheritance tax exemption. We feel that our State's willingness to respond to the inequities created for the small business owner by inflation should lead the way to improved Federal legislation.

Thank you very much for the opportunity to present this testimony.

Our next panel consists of Mr. Paul Butler of the American Bankers Association; Frank Berall, chairman of the Committee on Estate Gift Tax Reform, and Richard Covery, attorney, with the law firm of Carter, Ledyard & Milburn. We will take them in that order.

Mr. Butler.

STATEMENT OF PAUL F. BUTLER, CHAIRMAN, TRUST DIVISION TAXATION COMMITTEE, THE AMERICAN BANKERS ASSOCIATION, ACCOMPANIED BY RICHARD B. COVEY, CARTER, LEDYARD & MILBURN

Mr. BUTLER. Thank you, Mr. Chairman.

My name is Paul F. Butler. I am a member of the Taxation Committee of the American Bankers Association, representing about 96 percent of the bankers in the United States, and approximately 4,000 of these banks have trust departments, so we have a keen interest in this matter.

I would like to file a broader statement of our commentary on the broad subject of the estate and gift tax.

Senator MONDALE. This will be made a part of the record.

Mr. BUTLER. Thank you.

I would like to confine my remarks to just a few of those topics. This commentary does talk about taxation at death, of gains, generation-skipping, unification, marital deduction, but today I would like to talk about only rates, exemptions, and aid to the farms and small businesses.

We realize that you have budgetary problems that you are going to have to be considering as you move here, and you may not be able to take the steps you would like to because of the restraint on the revenue posture. However, if something isn't done you are going to have an increasing situation of trouble with the smaller estates.

In 1942 when these rates and exemption were set only 2 percent of the persons who died filed estate tax returns and paid any tax. At the

rate this is going within 10 years about 15 percent will be paying. Many bills have been filed about this and you have had a lot of discussion on it. The American Bankers has been thinking about this for some time and sometime ago we did advocate that a credit be adopted versus an exemption, the reason for this being, of course, that the credit does save taxes in the larger estates, particularly, because it does not operate as a deduction on the highest rate of tax.

We advanced this several years ago. There has been increasing support for it. We don't particularly advocate a specific level. We have been thinking in terms of the credit on the first $100,000 of taxable estate, but I think this is a question of the revenue that you wish to devote to this.

A revenue credit on the first $100,000, for instance, would probably remove 45 percent of the people who are now filing and paying estate tax.

We have also turned our attention to the farms and small businesses and the suggestion that we have made is that there be a partial forgiveness of the tax resulting from these.

Our proposal in general would be that you follow the format of section 6166 with some liberalization, and as installments are due that there be reductions of tax and interest that would be otherwise due.

This percentage we would suggest would increase as time went on, therefore, there is an incentive to retain the farm.

We also feel strongly about the 4-percent interest rate. We think it ought to be restored. When the bill was put in to increase this rate and made no differentiation, we testified against it. We tried to point out that this would increase the problems and nothing happened. But we would like to emphasize that is a key part of our proposal.

And one thing I would like to mention, I hope in the question period we come to, I would like to question some of the figures that have been put up here on the charts, particularly the generation skipping figures. So far as I know, there is no authoritative basis for the $700 million annual revenue loss.

Perhaps I can say something about that later.

STATEMENT OF FRANK S. BERALL, CHAIRMAN, COMMITTEE ON ESTATE AND GIFT TAX REFORM, AMERICAN COLLEGE OF PROBATE COUNSEL

Mr. Berall. Mr. Chairman, members of the committee, my name is Frank S. Berall. I am a partner in a Hartford, Conn., law firm, and I am the chairman of the Estate and Gift Tax Reform Tax Committee of the American College of Probate Counsel. The American College, who I am representing here today, is a group of more than 1,700 lawyers, from all over the United States, with special expertise in estate planning and administration. We would like to offer our assistance to you in solving the technical problems of estate and gift tax reform and in determining how proposals you are considering will affect probate and estate planning. We have a written statement, including a cover letter.

Senator Mondale. It will be received.

Mr. Berall. Thank you.

The statement suggests improvements based on our knowledge and experience that we think will make the Federal estate and gift taxes work better from the viewpoint of the Government, the taxpayer, and the economy.

I am going to highlight proposals we believe to be of greatest interest to this committee.

Basically, of course, these are the proposals that deal with the problems of family farms and small businesses. We agree with the American Bankers Association and certain other groups that have testified, that the exemption level is too low at the present $60,000. The estate tax now affects a great many middle-class people whom it was never intended to affect, but we are concerned about the revenue loss from an increased exemption; therefore, we do suggest a credit against the estate tax due on the first $100,000 of taxable estate.

We think it is very important that the credit be designed so that gross estates of $100,000 or less need not file returns. Otherwise there are going to be new administrative difficulties and extra costs in estate administration.

I would like to deal briefly with the liquidity problems of small farms and businesses. We think that these should be handled not by special treatment for these assets, such as special valuation techniques, but instead, the provisions we have suggested would avoid the special treatment which could violate criteria that we believe essential in the estate tax system; namely, neutrality, uniformity, and equity. We believe that special provisions would lead to creation of new estate tax shelters while failing to cope with the liquidity problems of most illiquid estates.

Instead of special provisions we recommend more liberal and objective standards in granting extensions for the payment of Federal estate taxes under sections 6161 and 6166. Specifically, we think that the definition of a closely held business that gives to it a 10-year extended payment of estate tax should be broadened.

We also would change the present discretionary guidelines used by the Internal Revenue Service to determine whether to grant extensions to pay the estate tax for 1 year to objective standards, as opposed to these discretionary standards, so that an extension would be automatic if the executor files an affidavit that the estate meets the standards.

We would lengthen the 1-year period to 5 years and the 10-year period for both closely held businesses and hardship extensions to 20 years.

We agree that the interest rate on deferred estate tax payments under sections 6166, 6163 (that is the section that deals with future interests) and section 6161, should be two-thirds of the rate currently charged on deficiencies rather than going back to the 4 percent.

Since you are using a flexible rate tied to the prime we think we should tie into the two-thirds level as it was before last July when it went up.

In the marital deduction area, we think a qualitative expansion of the marital deduction would be a great help for a number of families where there are second marriages and children by a first marriage. We also think that many problems are caused and marital deductions lost because of the technicalities of the terminable interest rule.

We would eliminate the terminable interest rule, giving the marital deduction for any life income interest passing to the surviving spouse,

although at the death of that spouse it passes to others. But the other side of that coin is the inclusion of the full value of the corpus in the surviving spouse's estate. The details are in our statement.

With respect to gift tax filing, we urge this committee to eliminate the extra cost of quarterly filing by returning to the annual filing of gift tax returns, unless a gift is in excess of $100,000 in a calendar quarter.

Finally, with respect to the effective dates of any changes that the Congress should enact in the estate and gift tax laws, particularly far reaching changes such as dealing with gains at death, generation skipping transfers, or unification; we think these should all be prospective, they should not affect previous transfers. If the Congress decides to do something about gains at death, it should have a new basis date for all property and a reasonable period should be permitted to amend existing estate plans.

The written statement we have submitted for the record covers our proposals in detail, along with our transmission letter, which indicate some background about our organization.

We would like to offer our services to you in drafting estate and gift tax reform proposals. We are perfectly willing, on a pro bono basis to be available by long distance phone for consultation or to come down here to Congress at any time that you would need services that we can provide.

Thank you very much for the opportunity to testify.

Senator MONDALE. Thank you, Mr. Berall.

Senator Hansen, did you notice how lucid and talented those lawyers are? [Laughter.]

I was interested that both organizations, the ABA and the American College of Probate Counsel recommends the credit rather than the exemption. And as you know, there are several that are considering that side that originally talked in terms of the exemption.

I gather what you are getting at is progressivity that the exemption has with these steep rates and they are very steep, going up to 70-percent on estate taxes affect the richer estate the more you save because in effect that exemption comes off the highest bracket or brackets. But the credit, you take the same amount of loss in revenue and target it in, give more relief for the same amount for the smaller businesses and farmers and smaller estates.

Is that essentially——

Mr. BERALL. That is correct, Senator.

Mr. COVEY. What you would get is apparently you are going to try to tack on the 10612, which means you have revenue problems. You can't clearly give as much relief as you want to, though.

Senator Hansen has talked about $200,000 as an exemption and that would cost you $2 billion. I don't think that is realistic. I think you are going to have to come in considerably lower than that. And the credit does that more effectively than the exemption does.

Senator MONDALE. Mr. Wicker, would you come back to the witness table? I want to ask you about that.

What is your view on credits versus exemption?

Mr. WICKER. At the committee level at the Minneapolis Chamber and the St. Paul Committee we did not discuss that. After listening to the testimony today, expressing my own views as a CPA, I certainly would go along with the credit in lieu of the increased exemption.

I think that it probably does the job and does it better for much less cost.

Senator MONDALE. Apparently the Small Business Committee has found we can get more relief, substantially more, for farmers and small businessmen and smaller estates through the credit route with the same or less overall budgetary impact.

Mr. WICKER. I think it might be similar to what we discussed in Minneapolis in December when you visited our committee, about phasing in the surtax exemption, larger surtax exemption for all companies and then phasing it back out again for companies with larger levels of income.

Senator MONDALE. The corporate income tax.

Mr. WICKER. Yes.

Senator MONDALE. That is what we did. I don't think we phased it out but in the last go-around on taxes we did reduce by about $7,000 the average corporate tax, which was helpful.

Mr. Berall, I think in your prepared statement you commented if we changed the marital deduction that would cause massive estate replanning in this country.

Mr. BERALL. Yes.

Senator MONDALE. With all estate plans, one of the first things you do is calculate the marital deduction. If you would change it substantially, or change it at all, it would require every plan in the country to be refigured. Is that correct?

Mr. BERALL. That is correct, Senator Mondale. In fact, any of the major changes, such as those dealing with generation skipping transfers, unification of the taxes or expansion of the marital deduction above the present 50 percent of adjusted gross estate are going to require a considerable amount of extra work and thus legal expense to a number of people in this country.

Senator MONDALE. I think Senator Kennedy said he was for 100-percent marital deduction. Wouldn't that be subject to the same progressivity argument as the exemption itself?

Mr. BUTLER. Yes; we have studied that and we feel that unlimited is not needed. We don't think a $10 million estate should be able to escape tax completely if it wanted to. By the same token, I think that most of the very large estates won't do that because you see if you combine and pospone and put everything into the second estate then the total tax is going to be larger than if you do make a division between the two estates, even if you have an unlimited deduction.

Senator MONDALE. Suppose you had, say, a $2 million estate and you could establish that each spouse owned half, approximately, at the time of the death of the first spouse, there would be a tax on that spouse's estate of whatever the rate is against that estate minus 50 percent, and minus the $60,000 exemption.

Then that is granted to the surviving spouse. Then when the surviving spouse dies, you don't get to carry a credit from the first estate.

Mr. COVEY. You have pyramided. You than have $500,000 taxable in the first estate and $1,500,000 in the second. What you have done is get yourself out of tilt. The cheapest tax would have been $1 million in each and with the marital gone $500 the first time.

Senator MONDALE. We don't do it that way. So that by however much the inheritance increases the estate of the surviving spouse,

he pays estate tax on the whole thing. He can't agrue well, my deceased wife's estate paid the tax. He can't argue that under the present law.

Mr. BERALL. One of the problems that you have should you go to an unlimited marital deduction is that in our opinion would tend to distort the present method of disposing of property where people want to take care of their wives and children.

If you enact an unlimited marital without a qualitative expansion of the marital deduction, it would be possible, for persons who are interested in saving immediate tax to leave everything to his wife—say in a power of appointment type of trust, or outright, and have no taxes at his death. Then his wife remarrying after his death could leave everything to her children by her second husband and the children of the first marriage would receive nothing.

Senator MONDALE. I think one suggestion is to leave the 50 percent, but then add maybe $100,000. Does that make sense?

Mr. BUTLER. That is one way. Our solution would be unlimited up to $250. If the estate were larger, it would be half the estate.

Senator MONDALE. I believe——

Mr. BUTLER. Either one of those. It would cover the estates up to $300,000, $300,000 to $400,000, depending on what you take as a credit, and this is the size of the estate, whether they own farms or small business which need the protection.

Senator MONDALE. Once again, it targets the relief to the smaller estates.

Mr. BUTLER. Yes, sir.

Senator MONDALE. In your argument, if you add 100 percent you think there would be a tendency to slight the children of the first family?

Mr. BERALL. That is right, Senator. It has been my experience that unfortunately, too many people who come in for estate planning work are more concerned with saving taxes than making a sensible disposition for their family. I try to encourage my clients to decide what is sensible for their family and then save the taxes, but with an unlimited marital deduction there would be a great deal of pressure in the wrong direction and we are quite concerned about second marriages. This is why we advocate the qualitiative expansion of the marital deduction so that a person can get a marital deduction for a life income interest to his wife with the remainder over to the children of his first marriage. You cannot do that under present law.

Mr. COVEY. One problem is if you talk about expanding the marital deduction and you underrevenue constraints you are going to lose money there, and given the choice between losing money in an unlimited marital deduction or losing money by means of increased trade or exemption, I think the choice in my opinion is undeniably I would much rather lose it in terms of increased credit or increased exemption than I would increased marital deduction.

Senator MONDALE. That would tend to be the last progressive.

Mr. COVEY. Yes.

Senator MONDALE. You take it off the top bracket.

Mr. COVEY. On limited marital it will cost you about $700 million per year. That is an awful lot of revenue to lose for that kind of change.

Senator MONDALE. Now, one final point. This came up in some of the earlier testimony. About all of us, I think, in our different versions have proposed that farmland be valued for farm purposes. We have seen this phenomenon in which for estate evaluation purposes this land in close to urban growth has its value assessed for the highest market value, which would be clear out of proportion to what its value is for farm purposes.

You argue that it introduces a complexity into the tax laws which is tough and difficult to deal with.

Second, I think you argue that it may create an unintended tax shelter that would entice nonfarm capital into an absentee owenrship of farming, is that correct?

Mr. BERALL. That is right.

Senator MONDALE. Can you give us your argument?

Mr. BERALL. Senator, we believe that if you come up with a special valuation method for a given asset, and we thought about this very carefully before we formulated our position in committee, that special valuation for farmland or open space or historical sites at its use value, will encourage wealthy investors to come in and buy these assets for tax shelters.

The recapture provisions that you might have in such a statute. are not going to be particularly effective and could be very complex.

We have seen these things work rather poorly in connection with property tax systems such as Connecticut's and California's, where there are use values and recaptures and in neither State has it worked out staisfactory. But we believe that instead of giving special treatment to these assets if you adopt some of the proposals that we have talked about in connection with liberalization of the deferred payment provisions of the code, we think that the problem of valuation will be eased because we are talking about paying out the tax over a 20-year period. There are several other proposals which we did not discuss but which are in our written testimony which I think will also deal with this problem more adequately than something that will give a new tax shelter.

Senator MONDALE. Does that mean that where they have these use valuations, people see this as a way of sheltering money at estate tax time so they will come in and buy land.

Mr. BERALL. I think that would happen, Senator. Prior to 1962 the Federal estate tax did not tax foreign situs real estate. In other words, if you owned a ranch in Alberta, for example, or a hotel in the Bahamas, you could completely shelter it from estate tax. This shelter was closed off in the Revenue Act of 1962. I think you would be opening a somewhat comparable shelter if you went to use valuation.

Senator HANSEN. I would like to ask you, I have been reading about increasing divorce rates in this country, and one thing and another. Do you think $700 million is too much to pay to insure the instituion of marriage?

Mr. COVEY. Yes, I think it is in terms of the estate tax, and if I have got to use $700 million I will use it in increased credit down below. If the wife gets half and the husband half, I think this is not a bad arrangement. That is the way the community property States go.

Senator HANSEN. Seriously, assuming Congress wished to increase the estate tax exemption to $120,000 and used the tax credit device,

allowing a credit of $9,500, wouldn't we achieve the same result if we were to increase the exemption to $120,000 and begin the tax rate at 28 percent.

Mr. COVEY. There are two ways you can handle the problem.

Senator HANSEN. And this would achieve the same end result, would it?

Mr. COVEY. I would point out your figure would be wrong. Your figure on $120,000 would not be $9,500. When you eliminate the exemption it would then be the tax on $120,000, which would be $20,700, plus 30 percent of the additional $20,000. That is the way it works. So it would be $6,000. It would then be $26,700 would have to be the credit.

In short, if you are going to the credit approach you have to take the exemption out to get to that. So if you set your credit level at $120,000——

Senator HANSEN. You mean you have to take credit out, you have to take exemption out if you want to save the money on the upper end to put in the credit end.

Mr. COVEY. That is correct. So if you were trying to have a credit against tax on the first $120,000 and you kept your rates the same, that would be today the tax on $120,000 is $20,700. The tax on the additional $20,000 is $6,000. So you would need a credit of $26,700. All estates of $120,000 get off that tax roll. You can do it the other way and keep it and then lower your rates or increase your rates.

Senator HANSEN. Well, you are presuming, I gather in your response, that the present $60,000 exemption would be kept in place.

Mr. COVEY. No, it would go out. It would go out. You would take the $60,000 out entirely and would just have a credit against tax on the first $100,000, first $120,000. The administration proposal in effect is a partial exemption, partial credit, because what the administration does, it wipes out all rates underneath 30 percent. So by doing it that way the extra 90 that the administration proposes acts as a tax credit.

Senator HANSEN. Won't the 100 percent marital deduction remove the present tax incentive to the husband in the common law States to give his wife some ultimate control over one-half of the estate?

Mr. BERALL. Senator Hansen, I think the way the 100 martial deduction would probably work under the proposals that I have studied would be that it would be the same as the 50 percent in that the wife, assuming no qualitative expansion of the marital deduction, would still have to have outright ownership of the property or the equivalent, which is the general power of appointment type of trust that we use today.

So I don't believe that this would remove it from the wife's control. In fact, it would put 100 percent of the property into the wife's control, which is what we are concerned about happening, because we are concerned about the children and other beneficiaries.

Senator HANSEN. I don't think I disagree with you. I am wondering if you may have misunderstood my question. At least I reached the same conclusion you have.

Mr. BERALL. I am sorry, perhaps I did misunderstand your question.

Senator HANSEN. Thank you.

Senator MONDALE. I have been asked by the Small Business Committee staff to ask Mr. Berall this question.

Would the argument against use valuation apply with the same force against a covenant limiting the use of the property legally for defined purposes in periods of time?

Mr. BERALL. I am afraid they would, Senator.

Again, I hark back to some of the experiences in States such as Connecticut and California where there have been property tax reductions based on use valuation, which is the equivalent of a covenant, and we have elaborate recapture provisions that occur at different times, say if a sale is made within 10 years. These statutes just did not work out the way they were supposed to work out and we are quite concerned that this covenant will not succeed in accomplishing what the small business owners would like to accomplish.

Senator MONDALE. Very well. Thank you very much for the most useful contribution.

[The prepared statement of the preceding panel follows:]

PREPARED STATEMENT OF PAUL F. BUTLER ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

SUMMARY

The ABA recommends that the following three changes in the estate tax law be added by the Senate to H.R. 10612:

1. Substituting an estate tax credit for the current $60,000 exemption so as to remove smaller estates from the estate tax rolls.
2. Granting a partial forgiveness of estate tax plus interest for farms and other small businesses which qualify for the deferred payment of estate tax under section 6166.
3. Reinstating the 4% interest rate on amounts of estate tax deferred under section 6166.

In order to qualify for items 2 and 3, the farm or other small business should constitute at least 65% of the decedent's gross estate reduced by the deductions allowable under sections 2053 and 2054.

STATEMENT

Mr. Chairman and members of this Committee: My name is Paul F. Butler. I am a member of the Taxation Committee of the Trust Division of the American Bankers Association and am a Vice President and Associate Counsel of State Street Bank and Trust Company of Boston. I am accompanied by Richard B. Covey, who is a member of the law firm of Carter, Ledyard & Milburn, New York City, and acts as special tax counsel to the American Bankers Association on matters affecting trusts and estates. The ABA is an organization composed of about 14,000 banks, or some 96% of the banks in the country. Approximately 4,000 of the banks exercise fiduciary powers, thus serving their customers as executors and trustees.

The ABA appreciates the opportunity to testify on the important subject of estate and gift tax revision, which has received considerable attention in recent months. Our organization presented testimony on this subject before the Committee on Ways and Means of the House of Representatives in March of this year. With your permission, we would like to file with this Committee a Commentary which we have prepared discussing the subject and suggesting certain alternatives, if changes are to be made.

The ABA understands the budgetary problems which confront this Congress. In the light of these problems, members of this Committee and other members of the Senate may believe that it is impossible to reduce estate tax revenues as much as they might otherwise desire bearing in mind what has occurred since the rates and exemption were last changed in 1942. Since then the estate tax has affected a steadily increasing percentage of estates. If something is not done to change the situation, in another 10 years approximately 15% of all decedents will be paying some federal estate tax. This contrasts with the figure of under 2% which existed in 1942, when the estate tax was viewed as a rich man's tax. It is certainly not that today.

One of the most important issues is whether the current estate tax exemption of $60,000 should be changed. Many bills have been introduced in the Senate to increase this amount substantially. One of the ABA alternatives discussed in the Commentary is the substitution of an estate tax credit for the current exemption. We were the first organization to suggest this approach and did so before the House Committee on Ways and Means in its 1973 hearings on estate and gift tax revision. Since that time many groups and individuals have endorsed an estate tax credit, which in effect operates as a deduction against a decedent's tax at his lowest rates rather than at his highest rates, as does the current exemption. The merit of the credit approach when compared to an increased exemption is that for the same revenue loss more relief can be given to smaller estates. We believe that this is desirable as a matter of policy.

The ABA suggests that a step be taken now to eliminate all smaller estates from the estate tax rolls by changing the current $60,000 exemption to a credit against the estate tax. The amount of the credit should depend upon what revenue reduction is deemed acceptable. A majority of the proposals to date have fallen in the range of the tax on a taxable estate of $100,000 to $200,000.

During the last year the impact of the estate tax on farms and other small businesses has received much attention. This is due in part to the hearings of the Senate Select Committee on Small Business under the Chairmanship of Senator Nelson dealing with the effect of the estate tax on small businesses. Specifically, the problem is that the tax payable on the farm or small business under current law is so high that the heirs who would like to continue to operate the farm or business are forced to sell it to pay the tax. The problem is a real one and something should be done about it.

In its commentary, the ABA suggests that partial estate tax forgiveness be granted to estates consisting of farms or other small businesses which meet the requirements of section 6166 for a deferred payment of the estate tax. The percentage of the forgiveness could be set at any level which is deemed desirable and under our proposal would be granted annually against the estate tax and interest as it is paid in installments. Partial tax forgiveness is similar in effect to granting a special estate tax credit for farms and other small businesses as has been suggested by Senators Packwood and Nelson of this Committee. The ABA favors a return to the 4% interest rate on amounts deferred under section 6166. In order to qualify for the partial tax forgiveness and the 4% interest rate, the farm or other small business should constitute at least 65% of the decedent's gross estate reduced by the allowable deductions under sections 2053 and 2054.

Another way of granting relief to estates consisting of farms which has been suggested is to value a farm for estate tax purposes as its "farm value" rather than its fair market value. The ABA considered this approach and rejected it for two main reasons. First, it would provide relief for farms which would not be available for other small businesses, and such a distinction was deemed unwise as a matter of policy. Second, in order to assure that relief is given in only appropriate cases, restrictions must be imposed upon the use of the farm valuation. These restrictions, including recapture of the estate tax based on the fair market value in the event of sale before the passage of some period of time, present a number of difficult problems, particularly in cases where, as often occurs, all of a decedent's children are not given the same interest in all estate assets, including the farm.

Obviously, any estate tax relief given to estates consisting of farms or other small businesses will reduce estate tax revenue. The amount of the loss depends upon what type of relief is given. The loss would, however, not be a large percentage of the current estate tax revenues because farms and other small businesses constitute only a small part of the total gross estate figure for all decedents. Although no figures have been published indicating what percentage of the assets of decedents' estates are those qualifying under section 6166, we doubt that the percentage would be over 10%. The total estate tax collections for fiscal 1975 were $4.2 billion. Using this figure and a 10% estimate for section 6166 assets, total tax forgiveness to all such estates would cost only $420 million and 50% forgiveness would cost $210 million.

There has been talk that any estate tax revision must be balanced in terms of revenue. We disagree. The inflation which has occurred over the last few decades has eroded the true value of all estates.

American Bankers Association Commentary on Proposed Tax Reform Affecting Estates and Trusts

FOREWORD

During recent years the laws governing the income tax cost basis of a decedent's assets and various provisions of the estate and gift tax laws, all of which have been essentially unchanged for many years, have been criticized. Two comprehensive proposals have been the 1968 Treasury Studies during the Johnson Administration and the American Law Institute Project published in 1968. The most recent criticism has been directed at what is regarded as the modest $60,000 estate tax exemption and high estate tax rates which may force the sale by the decedent's family of a farm or closely held business. The so-called liquidity problem was accentuated by the increase in 1975 of the 4% interest rate applicable to estate tax on farms and closely held business.

Since early 1970 the American Bankers Association (the ABA) has been studying changes. In 1972 ABA published a Commentary reviewing current law, some major proposals for change, evaluation of these proposals, and alternatives. This Commentary modifies in some respects and expands the 1972 publication.

SUMMARY OF EXEMPTIONS; LEVEL OF TAXATION; FARMS AND CLOSELY HELD BUSINESSES COMMENTARY

Current law

Since 1942 the estate and gift tax exemptions of $60,000 and $30,000, respectively, and estate and gift tax rates have remained the same. The estate tax rates progress rapidly in the lower brackets, reaching 30% at a taxable estate of $100,000 The result has been that over this 34 year period, with continuing inflation, the estate tax has ceased to be a rich man's tax and now has a significant impact on estates of the middle class. The tax causes particular hardship for estates with farms and closely held businesses and in a significant percentage of cases requires their sale even though family members would like to continue their operation. This result has been criticized with increasing frequency in recent years.

Major proposals for change

Estate tax relief has been proposed in either of two ways, or a combination of both:

1. Increase the estate tax exemption to a figure in the range of $100,000 to $200,000;
2. Limit relief to estates with farms and closely held businesses which under current law are eligible to pay estate tax in ten annual installments. The Administration has recently proposed a five year moratorium on the payment of estate taxes on certain farms and closely held businesses. No interest would be paid during the five year period. The payment period would be extended from the current 10 year period to 20 years after the end of the moratorium. The special 4% interest rate on deferred estate tax which was increased last year would be reinstated. Eligibility would be limited to $300,000 of assets, with a dollar for dollar reduction from $300,000 to $600,000.

ABA evaluation

An increase in the estate tax exemption to a figure in the range of $100,000 to $200,000 would substantially decrease estate tax revenues. The revenue loss from giving relief only to estates with farms and closely held businesses would be much smaller. The Administration's proposal is questionable in a number of respects. A moratorium, which amounts to a five year interest free loan on the amount of the deferred estate tax, seems unnecessary and will encourage the continued operation of farms and closely held businesses which cannot survive economically. An additional 20 year payment period is not needed and would raise additional complications when one or more of the heirs receiving the property dies during this period. A dollar for dollar decrease in eligiblity between $300,000 and $600,000 seems too rapid and will operate inequitably when compared with some cases where the asset has a value under $300,000.

ABA alternative

An increase in the $60,000 exemption should not be considered in a vacuum, but rather as a part of the issue whether estate and gift tax revenues should be increased, decreased or held at approximately the same level. The ABA assumes that the current level of estate and gift tax will not be significantly decreased.

Based upon this assumption, it believes that the $30,000 gift tax exemption should be retained, but that the estate tax exemption should be increased to $70,000 *plus* that part of the gift tax exemption which is not used during life. The ABA favors changing the exemption from a deduction, which may be claimed against a decedent's highest estate tax rates, to a credit against the tax at the lowest estate tax rates. This change will minimize the revenue loss from the estate tax exemption increase.

The ABA favors relief for farms and closely held businesses. In order to assure that relief is given only in deserving cases, three additional requirements to the ones that now exist to qualify for the ten year installment payment provisions should be imposed, namely, that the farm or closely held business be at least 65% of the decedent's adjusted gross estate, that it be owned by the decedent for at least two years prior to his death and that the heirs continue in the business as "operators" rather than as "investors". If these requirements are met, the interest rate on the estate tax installment payments would be reduced to 4% and a part of the installment payments of tax and interest would be forgiven. The forgiveness would be 10% of the first installment and would increase by 5% for each succeeding installment until it is 55% for the tenth installment. If the value of the farm or closely held business exceeds $400,000, the forgiveness percentages would be appropriately reduced.

The ABA recommends other changes which will increase the usefulness of the installment payment provisions.

SUMMARY OF BASIS COMMENTARY

Current law

Current law providing a step-up of income tax cost bases of a decedent's assets to their market values at death has been criticized for allowing a permanent escape from income tax on appreciation which encouraged investment retention or "lock-in."

Major proposals for change

1. Retain step-up in basis but levy a capital gains tax on appreciation at death; assess as part of the decedent's final income tax return; and allow the tax paid as a deduction in computing the estate tax. Usually only appreciation beyond a current valuation start-up date would be taxed under this type of proposal.

2. End step-up and carryover the decedent's bases for estate assets, but increase these bases by the estate tax attributable to the asset's appreciation element.

ABA evaluation

The capital gains tax proposal is undesirable because its estate tax deductibility would result in a proportionately lower combined tax on appreciation in larger estates than in smaller estates. The carryover basis proposal is objectionable because of its administrative complexity in allocating basis increases; its unfairness in giving basis increases to assets which occasioned no estate tax because they qualified for the marital or charitable deduction; and the lesser hope it offers for reduced estate tax rates. Both proposals would further complicate the administration of estates and increase the "cost of dying" which is high enough now.

ABA alternative

As an alternative, the ABA recommends an additional (or appreciation) estate tax (AET), which would be a flat rate tax reported in the estate tax return but have a separate and equivalent exemption (currently $60,000). Since the AET would not be a deduction against the estate tax, its tax effect would not be regressive. It also would be the simplest approach administratively. The AET rate would be set so that the tax paid would be the same as the largest estates would pay under the capital gains tax proposal while smaller estates would pay less. Because the ABA considers the current "cost of dying," including state taxes, high enough, the ABA suggestion of the AET is conditioned upon both (1) a new cost basis valuation date for all assets in computing the AET, and (2) a reduction in estate taxes comparable to the projected AET collections.

Thus, the AET would permit lower estate taxes on all estates, and reduce the "cost of dying" for those estates, usually smaller in size, which contain few appreciated assets.

SUMMARY OF GENERATION-SKIPPING COMMENTARY

Current law

Current law imposes a tax on the transfer of complete control over property, but a shift of interests in property without such a change in control is not a taxable event. A trust embodying a succession of interests lacking the control element may be insulated from estate or gift tax for 100 years or more. To thwart this tax delay, the theory is espoused that all property should be subject to estate tax every generation, and that thrusts which do not create taxable interests in the next generation should bear an added tax burden.

Major proposals for change

The 1968 Treasury Studies would assess a tax at 60% of the transferor's top rate on any transfer made outright or from a trust to a grandchild or more remote descendant. The ALI Project would not levy an extra tax on outright transfers but, using the same general approach as the Studies, would do so on thrusts which may distribute to grandchildren or more remote descendants at a time later than the deaths of the transferor's children.

ABA evaluation

Both of the above proposals are objectionable. A person should be able to provide for his family without a tax penalty. Family includes ancestors, spouse, children, and grandchildren. Outright bequests to grandchildren should not be penalized, and the tax rate on transfers in trust should not be determined by reference to the transferor's estate.

ABA alternative

Any change in the taxation of trust transfers should be accomplished in such a manner that a person may create a trust having his family—his ancestors, spouse, children, and grandchildren—as its beneficiaries without the imposition of an additional transfer tax when compared with current law. The additional tax should be limited to the long-term trust where the property "vests" in a person more remote from the transferor than a grandchild or at a time later than the death of the last living child of the transferor. The tax would be paid from the trust property and should be determined by inclusion of the trust property in the transfers of the skipped beneficiary—usually a child of the transferor.

The result of the ABA alternative would be to eliminate the excessive insulation of trusts from taxation but still permit them to be used in a normal way for the benefit of a person's Family without a tax penalty.

SUMMARY OF UNIFICATION COMMENTARY

Current law

Current law provides separate tax rate structures for lifetime transfers (gifts) and transfers at death. Because each tax rate is progressive, a person can incur gift taxes at relatively low rates and remove property from exposure to higher estate tax rates. Further, the fact that the gift tax is both a deduction in computing, and a credit against, the estate tax can be deliberately exploited to achieve substantial tax savings by taxable transfers just before death despite their inclusion in the estate.

Major proposals for change

The 1968 Treasury Studies recommend: (1) all transfers should be cumulative and be subject to one set of tax rates; (2) all lifetime transfers should be increased for computation purposes by the tax the transfer caused (a "tax on a tax" procedure called "grossing-up"); and (3) a change in the law to allow transfers to escape taxation at death even though control is retained so long as a tax was paid at time of transfer and the property could not be regained by the transferor ("the easy-to-complete" transfer rule). Another proposal, which is a "simplified" unification approach, would retain the dual rate structure but would treat all transfers after its effective date as cumulative for purposes of determining the level of the estate tax rate to apply. The ALI Project took no position on a single rate structure applicable to all transfers but did say that a condition to such a change should be a reduction in current estate tax rates.

ABA evaluation

The "grossing-up" concept is unnecessarily complicated and actively discourages lifetime transfers. The "easy-to-complete" theory is no improvement, but rather a step backward, when compared with current law in terms of certainty of operation and sound tax policy. The simplified unification proposal has the

virtue of reducing the tax advantage currently enjoyed by persons able to make gifts during lifetime, but offers no lowering of estate taxes to those smaller estates unable to make gifts, which the ALI Project considered the primary justification for shifting to a single rate schedule.

ABA alternative

If there is a reduction of estate tax rates, the ABA would not oppose the "simplified" unification approach combined with the elimination of the "double deduction" for a gift tax paid on a gift in contemplation of death, viz., a gift tax credit and a deduction in computing the estate tax by in effect allowing a refund of the gift tax paid on the gift. These changes would both benefit the smaller estates unable to make gifts and end the tax reduction currently permitted in the case of deliberate transfers in contemplation of death.

SUMMARY OF MARITAL DEDUCTION COMMENTARY

Current law

Current law allows property transferred either outright or subject to the control of a spouse to qualify as a deduction against either estate or gift tax. There are quantitative limits on this deduction which for estate tax is one-half of the decedent's gross estate after debts and expenses, and for gift tax is one-half of any qualifying transfer. Both requirements have been criticized; qualitatively—that the deduction should be available even though the owner spouse retains control over the ultimate disposition of the property; quantitatively—that all qualifying property should be able to avoid the estate tax until the death of the surviving spouse.

Major proposals for change

Proposals for changes in the law in both the Treasury Studies and ALI Project recommend: (1) no quantitative limit; and (2) a qualitative dilution in that a transferee spouse would not need to control the property transferred for it to qualify for the marital deduction but merely have a "current beneficial interest" (an income interest) in the property. Vesting of a succeeding interest in the property in someone else would occasion a transfer attributed to the transferee spouse.

ABA evaluation

The ABA opposes an unlimited marital deduction since this could cause unwise dispositions to achieve a temporary tax advantage at the expense of other family provisions, and because the ABA thinks it poor tax policy to allow very large estates to postpone all taxes until the surviving spouse dies.

The ABA believes the problems presented by the "current beneficial interest" theory outweigh its benefits.

ABA alternative

The ABA suggests that there be a quantitative change to allow the greater of $250,000 or one-half of a decedent's gross estate to be eligible for the marital deduction but that no major qualitative change be made.

COMMENTARY

EXEMPTIONS; LEVEL OF TAXATION; FARMS AND CLOSELY HELD BUSINESSES

Current law

While the estate and gift tax exemptions ($60,000 and $30,000, respectively) and estate and gift tax rates have remained constant since 1942, inflation has severely eroded the purchasing power of the dollar. The estate tas has ceased to be only a rich man's tax and now significantly impacts the middle class. In many cases the family residence alone, although purchased at a modest cost by today's standards, will require the filing of a estate tax return. The only relief from its impact during this 34 year period occurred indirectly in 1948 as a result of the enactment of the marital deduction, which permits postponement of the tax on 50% of an estate until the death of the surviving spouse.

The estate tax reaches a 30% rate at a taxable estate of $100,000 and creates particular hardship for estates with farms and other closely held businesses. In some cases a sale is required to pay the tax, even though the decedent's family would like to continue the operation of the business. This result has been criticized with increased frequency in recent years.

Major proposals for change

In recent years, and particularly in this Congress, bills have been introduced to provide estate tax relief. Two major types of changes with significantly different revenue impacts or a combination of both have been proposed:

1. Increase the estate tax exemption. Figures in the range of $100,000 to $200,000 have frequently been suggested.

2. Restrict the relief to estates with farms and other closely held businesses. Some bills would exempt from all tax farms not exceeding a stated value. Other bills would create a special valuation method for such assets. In order to qualify, the farm or other business would have to be operated by the heirs for a stated period, usually five years, both before and after a decedent's death.

ABA comments

Our member banks in farm areas have confirmed the fact that a substantial number of farm sales are made by estates and that the number has been increasing in recent years. The primary reason is that the value of farm land has been increasing rapidly. For example, we have been advised by one of our member banks that in central Illinois the value of farm land has increased by 150% during the past 18 to 24 months. The most serious cash problem may not be payment of the estate or death taxes, but rather "buying out" the child or children who will not continue in the business. When there is a surviving spouse, the cash problem is less serious because of the availability of the martial deduction which can reduce the estate tax impact by more than 50%. This problem is often more difficult for a non-farm closely held business than a farm because sale of the business is more difficult than sale of a farm.

One important question in considering the farm and closely held buiness problem is in what percentage of cases does a family member desire to continue the operation of the farm or other business. Inquiries directed to some of our member banks indicate that in a significant number of cases no family member wants to continue actively in a farm's operation.

The ABA believes that a sound solution to the farm and closely held business problem should be based upon the following four objectives which are not consistent with each other and must be weighed in terms of their individual importance:

1. Increasing the ability of family members to retain these assets when they desire to do so and continue an active participation in the business;

2. Avoiding a tax incentive of such magnitude (a) that "outsiders" will acquire these assets, (b) that family members will retain assets which should be sold because they cannot be operated with a reasonable profit, or (c) that provide unreasonable distinctions in the treatment of different assets, particularly in the minds of owners of other assets;

3. Minimizing the revenue loss from the tax law changes; and

4. Not further complicating the law.

The first objective does not include cases where the heirs desire to retain the asset as an investment but not to participate in the active management of the business. An example of such a case would be where the family desires to retain a farm, but leases the farm to a tenant and does not participate in its management.

A substantial increase in the estate tax exemption would satisfy all of the objectives except minimizing the revenue loss. An increase in the $60,000 estate tax exemption to a figure in the $100,000 to $200,000 range would result in a substantial revenue loss when viewed in terms of estate and gift tax collections of $4.5 billion during fiscal 1975. Estimates of this loss, based upon estate tax returns filed during 1973, are as follows:

Exemption:	*Billions*
$100,000	$1.0
$120,000	1.3
$150,000	1.7
$180,000	2.0
$200,000	2.1

Losses of this magnitude cannot be offset by any other changes in the estate and gift tax area except (1) a change in the income tax basis rule (discussed below) or (2) a significant increase in estate tax rates in the lower and middle ranges. Each of these two changes would, however, adversely affect the *same* estates intended to benefit from the increased exemption. This would be particularly true in the case of farms since their per acre value in early 1975 averaged eleven times higher than in 1940 and three times higher than in 1960 and since the average size of farms has more than doubled in the last 25 years.

We have assumed that, despite the large number of bills introduced in this Congress for an exemption increase, this is not a viable approach because of the substantial impact it would have on estate tax collections. Thus we have searched for another solution with a smaller revenue loss. Also, we believe a substantial increase in the exemption would probably be offset in part by the states increasing their death taxes.

An alternative to an increased exemption exists for providing estate tax relief to smaller estates at a more modest revenue loss. The operation of the exemption may be changed from a deduction available at an estate's *highest* tax rate to a credit against tax at an estate's *lowest* tax rates. Estimates of the revenue loss from substituting a credit for the current $60,000 exemption based upon estate tax returns filed during 1973 are as follows:

Credit:	Loss (in millions)
$25,000 ($115,000)	$400
$40,000 ($165,000)	940
$50,000 ($200,000)	1,320

The figures in parenthesis indicate what taxable estate figure would be required using current rates and no exemption to match the credit and, with the preceding exemption table, afford a means of comparing the credit and exemption approaches in terms of revenue loss.

The ABA recognizes that a compelling case for providing estate tax relief is presented by estates with farms and closely held businesses, or more specifically those with assets which qualify under Section 6166 for paying the estate tax thereon in up to ten annual installments, when the decedent's family desires to participate in the active operation of the business. The estate tax, which reaches a 30% rate at a taxable estate of $100,000, forces the sale of farms and closely held businesses, in such cases. The problem was magnified last year by the increase of the 4% interest rate on estate tax deferred under Section 6166.

Unfortunately, it is impossible to make reliable estimates regarding the revenue loss that would be involved if tax relief is limited to farms and closely held business because the Internal Revenue Service does not publish statistics giving totals for estate assets that qualify under Section 6166. The best judgment which we can make is that 10–15% of the gross estate total is attributable to these assets.

Various proposals have been made in recent years to alleviate the "forced sale" problem. One is to establish a special evaluation method for estates that continue to operate the business for a fixed period of time after death, usually set at five years. This is particularly appealing as to farms because of the belief that the market value test produces "inflated" values. Nevertheless, while the value is high based upon the actual rate of return it is realistic in terms of what the farm would bring if sold. The ABA believes the special valuation method presents problems. One is that the federal estate tax audit would still have to resolve the fair market value issue, at least in the case of a sale before the holding period requirement is satisfied. Another problem is that the special valuation method itself would be imprecise and therefore the benefit derived therefrom uncertain.

A second proposal is to exempt from estate tax a farm having a value that does not exceed a stated amount. The figure of $200,000 has been suggested. We oppose a complete exemption from tax on the ground that it would ceate too great a disparity in treatment between farms and closely held businesses and other assets. Also, even if this approach is subject to restrictions regarding the period of time the farm must be operated before and after death, investments by "outsiders" would be encouraged.

The Administration recently proposed another solution. It would create a five year moratorium on the payment of estate taxes on certain farms and closely held businesses that qualify under Section 6166, with no interest payable during this period, and would extend the payment period from 10 to 20 years after the end of the moratorium. The 4% rate of interest would be reinstated. Eligibility would be limited to $300,000 of assets, with a dollar for dollar reduction from $300,000 to $600,000.

The ABA believes that a moratorium period is unwise. It would lull heirs into a false sense of security that an estate tax debt is not due and will encourage the retention of farms and closely held businesses which have no long term future. Another way of phrasing our concern is to say that the moratorium provides too much "front end" relief. As proposed, it is a five year non-interest bearing loan to the estate. Using the 6% rate of return in the Treasury tables, the value of this loan is slightly more than 25% of the amount borrowed, viz., the estate

tax on the asset. If tax relief is to be granted, it should be done directly by forgiveness rather than indirectly through a moratorium.

An extension of the estate tax payment period from 10 to 20 years is in our opinion undersirable for several reasons. Two of these are (1) our experience indicates that the current 10 year period provides sufficient time for payment in the case of an economically viable business and (2) a doubling of the payment period will increase the likelihood of an heir dying before payment of the tax is complete in the first estate, thus producing complications in integrating payments from two estates.

The ABA believes the dollar for dollar decrease in eligibility from $300,000 to $600,000 is unsound. The Internal Revenue Service will be given two other reasons—tax deferral and the lower interest rate—in addition to an increase in tax for asserting high values. The problems with auditing agents in this regard are bad enough now. Also, when the eligible amount is say $50,000 or below as a result of the business having a value of $550,000 or more, the amount of the tax is not large enough to warrant a moratorium and an extended payment period.

The Administration's proposal gives relief in some cases when it should not be granted and gives no relief in more compelling cases. This results from eligibility being based upon the percentage requirement of Section 6166—35% of the gross estate or 50% of the taxable estate. A $1,000,000 estate, with $700,000 of liquid assets and a $300,000 farm, which takes full advantage of the marital deduction qualifies because the value of the farm exceeds 50% of the taxable estate. Relief in such a case seems questionable. On the other hand, a more justifiable case would be an estate of $650,000, which included a farm valued at $600,000, where there was no surviving spouse.

Our experience with Section 6166 demonstrates that the provision is not used in may eligible estates. This is caused in part by the continuing personal liability of the executor for the payment of the postponed taxes. Other technical changes in the Section would improve its utility.

The increase in 1975 of the 4% interest rare on estate tax deferred under Section 6166 was ill-advised. Interest as well as the tax itself is a part ot the liquidity problem for farms and closely held businesses. The reason for enacting the lower rate in 1958 was to make it easier to pay the postponed tax and interest from the earnings of the business. The cash flow problem in this regard would seem as serious today as in 1958. An alternative to a return to the 4% rate would be to set the rate at 2% below the normal rate of interest in effect when the annual installment is due. The 2% difference would be the same as the difference which existed when the normal interest rate was changed last year. A drawback to this alternative is that the estate cannot plan on fixed payments. In general, fixed payments are preferable to fluctuating payments.

ABA alternative

An increase in the $60,000 exemption should not be considered in a vacuum, but rather as a part of the issue whether estate and gift tax revenues should be increased, decreased or held at approximately the same level. The ABA assumes that the current level of estate and gift tax collections will not be significantly decreased. Based upon this assumption, it believes that (1) the $30,000 gift tax exemption should be retained, (2) the estate tax exemption should be increased to $70,000 *plus* that part of the gift tax exemption which is not used during life and (3) the exemption should be changed from a deduction, which may be claimed against a decedent's highest estate tax rates, to a credit against the tax at the lowest estate tax rates. Based upon estate tax returns filed during 1973, the substitution of a credit against tax on the first $100,000 ($70,000 plus a maximum of $30,000) for the $60,000 exemption would result in 47% of the estates presently filing returns and paying some tax being granted relief from all estate tax. If the estate tax revenues are to be significantly decreased, the ABA would favor rate reduction, particularly in the $100,000 to $500,000 range, over an increase in the exemption.

The ABA supports relief for farms and closely held businesses. It believes that the objectives referred to above in our evaluation of other proposals are best accomplished by using the existing Section 6166 framework and creating a tax incentive through a partial forgiveness of tax plus interest which increases as the period of time from the decedent's death increases. In order to assure that relief is given only in deserving cases three additional requirements to the ones that now exist for qualify to the ten year installment payment provisions would be imposed, namely, that the farm or closely held business be at least 65% of the decedent's adjusted gross estate, that it be owned by the decedent for at least two

years prior to his death and that the heirs continue in the business as "operators" rather than as "investors". A clear dividing line between an operator and an investor is not easily drawn, but we believe it may be accomplished with reasonable precision and be based to a considerable degree upon continued active participation in the business and in the case of a farm with the heir having farming as a principal occupation. If these requirements are met, the interest rate on the estate tax installment payments would also be reduced to 4%.

The forgiveness the ABA recommends would be 10% of the first installment and would increase by 5% for each succeeding installment until it is 55% for the tenth installment. The total percentage forgiveness for the full ten year period would be 32½% of the deferred tax plus interest. Most of this forgiveness would come in the fifth through tenth years. If the value of the farm or closely held business exceeds $400,000, the forgiveness percentages would be reduced by applying a fraction the numerator of which is $400,000 and the denominator of which is the total value of the farm or closely held business. An acceleration of payment of the deferred estate tax under Section 6166(h) would cause a loss of any forgiveness as to the accelerated amount but would not affect forgiveness for installments already paid.

We would also point out that our proposal for increasing the marital deduction to the greater of $250,000 or one-half of a decedent's adjusted gross estate will create indirect tax relief for farms and closely held businesses when there is a surviving spouse.

The ABA recommends other changes which will increase the usefulness of the installment payment provisions. These changes would include eliminating (1) the personal liability of a fiduciary for estate tax deferred under Section 6166 and (2) a technical problem that exists under current law to the use of this section when the qualifying asset is held in a trust on the decedent's death.

The ABA believes that changes should be made in Section 303. This section provides that a distribution of property to a shareholder in redemption of stock is entitled to capital gains treatment (as contrasted to dividend treatment) to the extent that the amount of the distribution does not exceed all death taxes imposed as a result of the decedent's death and all funeral and administration expenses of his estate. The percentage requirements of this section are the same as Section 6166 but the time provision is only three years. The time period should be extended to the Section 6166 time period. On the other hand, Section 303 should be restrictrd so that it may be used only to the extent the redeeming shareholder is liable for the payment of death taxes or funeral or administration expenses.

BASIS

Current law

Under current law property included in a decedent's gross estate is given an income tax basis equal to its estate tax value. This rule is criticized on the grounds that all net unrealized appreciation occurring prior to the date of death permanently escapes income tax, thus favoring the individual who builds an estate through unrealized appreciation rather than through realized appreciation, currently taxable as income and that this escape distorts investment choices by "locking" older people into their investments that have substantial unrealized appreciation.

Proposals for change

Two proposals for change suggested are:

First, to treat death (and perhaps transfers by gift) as a taxable event and to allow a deduction in computing the estate tax for the income tax on the gains realized by death (the capital gains tax proposal) and,

Second, to carry over the decedent's basis for each asset included in his gross estate to the recipient of the asset and then to increase this basis by that part of the estate tax atrributable to the unrealized appreciation in the asset at death (the carryover basis proposal).

The carryover basis proposal is patterned after the current basis rule of Section 1015(d) for transfers by gift, except that under this section the basis is increased by the entire gift tax paid including that on the donor's cost. It seems reasonable to assume that enactment of the carryover basis proposal would be accompanied by a change in Section 1015(d) to limit the increase in basis to the gift tax attributable to the unrealized appreciation in the asset as contrasted to the gift tax on the entire value of the gift property.

ABA comments

The ABA believes that a change in the basis rule should not be considered in isolation, but rather in conjunction with the issue of transfer tax rates. Estate tax rates are now high and reach a rate of 30% on a taxable estate of $100,000 and a top rate of 77%. State death taxes must also be considered. In many states, they exceed the credit that is allowed under the federal estate tax law, with the result that state death taxes are a part of the "cost of dying." For example, in New York the highest estate tax rate is 5% above the maximum rate of the state death tax credit. Thus, when federal and New York estate taxes are combined, the top rate of tax is 82%. The "cost of dying" is high enough and should not be increased indirectly by a change in the basis rule.

If any change in the basis rule is to be made, estate tax rates should be significantly reduced. Any such change should also be accompanied by (i) liberalized rules regarding proof of basis and (ii) a new basis for each asset owned on the effective date of the change equal to its value on that date for the purpose of computing the tax under the "new" law. This position is consistent with that taken in the Treasury Studies, which recommended the capital gains tax proposal. We recognize that use of a new start-up date means that the estate tax reduction would have to be phased in over a period of time.

An important consideration in determining what form a change in the basis rule should take is simplicity of operation. To the extent possible, a new rule should not complicate the administration of estates. On this point, we find both the carryover basis proposal and the capital gains tax proposal of the Treasury Studies seriously defective. It is indisputable that the simplest system would be one that continues current law to the extent of giving assets included in a decedent's gross estate a basis equal to their estate tax value because no new rules would have to be developed regarding the administration of decedent's estates. Carryover does not do so. Neither does the Treasury Studies capital gains tax proposal because of its exemption from the new tax of property qualifying for the marital or charitable deduction and its complex reallocation of basis procedure. The Studies' hybrid approach, when one of these deductions is present, of part capital gains tax and part carryover combines the worst elements of both proposals.

Another important consideration is fairness. Here again we find the capital gains tax proposal, and to a lesser extent carryover, defective. The impact of the capital gains tax proposal when taken in conjunction with the estate tax is uneven and favors the large estate. Put another way, the tax is regressive. This is caused by the removal, through an estate tax deduction for the capital gains tax, from the estate tax base of a portion of the estate assets which would otherwise be taxed at the highest estate tax rate or rates. Thus, the true rate of tax on the gain is a function of the complement of the highest estate tax rates at which the deducted capital gains tax would otherwise be taxed in the estate (i.e., the complement of x is 100-x). To illustrate using current rates, an estate taxed at the highest rate of 77% would be subject to an effective net additional tax commencing at only 23% of the actual capital gains tax paid but an estate whose highest estate tax rate was 30% would be subject to an effective net additional tax of at least 70% of the actual capital gains tax paid.

Lower estate tax rates alone cannot remedy the inequitable and unfair impact of the capital gains tax proposal on the medium estate. In place of a single variable—size—presently employed to determine the estate tax, fairness requires that two variables—size and percentage (or amount) of gain—be considered. A reduction in estate tax rates deals with only one of these variables—size.

The regressive nature of the capital gains tax proposal may be demonstrated by an illustration using the lower transfer tax rate schedule of the Treasury Studies and the 25% capital gains tax rate in effect when the Studies were published and comparing two estates one with a $4,500,000 gross estate and an aggregate basis of $1,500,000 and the other with a $450,000 gross estate and an aggregate basis of $150,000. When compared with the estate tax payable under current law, the increase in tax would be 28% for the smaller estate and less than 1% for the larger estate. The percentage difference becomes almost 37% if current capital gains rates are used and income averaging is ignored.

Moving to the carryover basis proposal, when a martial deduction or community property is present the basis of all estate property including that qualifying for the marital deduction or the surviving spouse's share of the community would be increased by the estate tax attributable to net appreciation. This result is unfair because property qualifying for the marital deduction or the surviving spouse's share of the community does not generate any estate tax. The entire basis increase should be allocated to the non-marital property and none to the surviving

spouse's share of community property. The effect of not making such an allocation will often be to increase the capital gains taxes incurred to raise funds with which to pay estate taxes because the basis increases in the non-marital property will be lower than it would be if the entire increase were allocated to such property.

In a separate property estate involving the martial deduction, a solution is difficult because it will not be known at a decedent's death what property passes to the marital and non-marital funds and, therefore, the property entitled to the basis increase is uncertain at the very time sales will be made for taxes. As a result, the Internal Revenue Service would become an active participant in the distribution of estates.

In a community property estate, the basis adjustment can easily be allocated entirely to the decedent's half of community assets but in so doing the surviving spouse may be penalized. Sales to raise funds for taxes and expenses may include both halves of community assets and the surviving spouse is involuntarily burdened with reporting gain realized as to her community half of each community asset sold for such purposes.

Beyond the issues of simplicity and fairness, we have a more fundamental reservation concerning the carryover basis proposal. A part of the tax (i.e., the tax on gain when the property is sold) is deferred until the sale. This, in combination with the addition to basis of the estate tax, makes it very difficult if not impossible to devise a revised estate tax rate structure which will properly reflect the additional tax attributable to carryover.

ABA alternative

The ABA believes that if a change is to be made in the basis rule it should take the form of an additional estate tax (AET) on net unrealized appreciation included in a decedent's gross estate. The current basis rule for property included in a decedent's gross estate that gives such property an income tax basis equal to its estate tax value would be continued. The rule of section 1015(d) for property transferred during life would also be retained except that the part permitting an increase in basis for the gift tax paid which is attributable to the transferor's basis would be eliminated. The AET would be applied at a single flat rate. In contrast to the capital gains tax proposal, the tax would not be deductible in computing the basic estate tax. This fact justifies an AET substantially below the applicable capital gains tax rate or rates.

The AET rate should reflect the complement of the highest estate tax rate and the highest capital gains tax rate. In this way a decedent whose estate is subjected to the highest estate tax rate would pay approximately the same AET as he would pay in capital gains tax under the capital gains tax proposal after the estate tax reduction resulting from the deduction for this tax is considered. All other decedents would pay a smaller AET than they would pay in capital gains tax under this proposal if exemptions were ignored. We visualize a reduction of the highest estate tax rate to 60%. Using this rate and the current capital gains tax rate of 35% but ignoring the minimum tax, the AET would be set at 14%-35% times 40% (100-60). A minimum basis equal to the estate tax exemption, currently $60,000, would be allowed. Thus, no AET would be owed by any decedent's estate not required to file an estate tax return.

Certain assets, life insurance and annuity contracts, income in respect of a decedent and any item (a collection would be a single item) of tangible personal property held for personal use having a value of $5,000 or less would be deemed to have a basis for AET purposes equal to its estate tax value and thus would not generate any tax. A surviving spouse would be given an election to subject her share of community property containing net appreciation to the AET at the time of her spouse's death, in which case her basis would be increased to the property's current value.

Property qualifying for the marital deduction would not be exempted from the AET. This does not necessarily mean that the sum of the basic estate tax and the AET would be greater than the current estate tax on an estate using the marital deduction. The lower basic estate tax rates plus acceptance of another recommendation of the ABA, to increase the amount of the marital deduction (discussed below), would act as an offset to the AET. A deduction could be granted in computing the AET based upon the percentage of the gross estate passing to charity.

The ABA believes the AET would be the fairest and easiest method of changing the basis rule for property included in a decedent's gross estate. Nevertheless, it does not support enactment, but rather would prefer retention of the current basis rule.

GENERATION-SKIPPING

Current law

Under current estate and gift tax law, the tax imposed on a transfer of property does not take into account the status of the recipient of such property, except in the case of the marital and charitable deductions, and the termination of an interest in a trust, such as an income interest, is not a taxable event. Thus, a single transfer tax is imposed on outright transfers that skip one or more generations, such as a transfer to a grandchild, and on transfers in trust even though two or more generations of beneficiaries will have enjoyed benefits from the trust. This result is criticized as eroding the transfer tax, based upon the premise that an ideal transfer tax system is one that imposes a tax every generation. Most of the criticism has been directed at transfers in trust, in part because it is possible to give successive generations a combination of interests that come close to full ownership rights.

In any estate plan a choice must be made between an outright transfer and a transfer in trust. The normal expectation of an heir is to receive property outright. Why then should an estate owner make a transfer in trust? It is not to create successive interests in proprety, because they can be created through legal life estates in combination with remainders or through life insurance and annuities or other contractual relationships.

A trust is used because it provides flexibility and enables the disposition of property to be altered to accommodate changes in circumstance. An estate plan may be created which will accomplish the estate owner's objectives for his family through the creation of various powers in the trustee and/or beneficiaries, such as investment powers, powers of appointment and powers to pay income and/or principal to a beneficiary or among the members of a class of beneficiaries. A trust is no more than a single fund in which beneficiaries have interests which relate to their requirements.

Proposals for change

The Treasury Studies proposed that an additional transfer tax be imposed upon an outright transfer, or a transfer in trust, of property to a person who is more than one generation below the transferor. Thus an outright transfer to a grandchild of the decedent would be subject to the additional tax. The rate of tax would be 60% of the highest transfer tax rate of the transferor applicable to the transfers during the taxable period if made during life or to the transfers at death if made upon death. The Treasury Studies described the application of the proposal to a transfer in trust as follows: "When the generation-skipping gift or bequest is by trust, there would be generally the same options as to when the tax must be paid as would be available to the skipped generation has he elected to pay the tax. Thus, the transferor or his representative (i.e., executor or trustee) may elect to treat the taxable event as occurring at the time of the original transfer or as of the first day of any calendar quarter thereafter. In no event, however, may the tax be postponed beyond the date of the death of the last survivor among the group consisting of the transferor, his children, and any beneficiaries under the trust who are not within the category of individuals to whom a gift would be considered a generation-skipping gift. At this time, it becomes certain that there is a generation-skipping transfer involved and no reason to further defer the tax."

Distributions of current income as well as those of principal or accumulated income would be subject to the additional tax.

The American Law Institute proposed another solution. No additional tax would be payable on outright transfers. An additional tax would, however, be imposed on transfers in trust under which distributions are made to a persom more than one generation below the transferor at a time later than the death of a person or persons one generation below the transferor or in the same generation or in a higher generation than the transferor. Thus, an additional tax would not be payable on a transfer in trust with the income to be paid to a child for life, and the principal to be distributed to the child's issue living upon his death.

A tax, if imposed under the ALI proposal, would be computed at the average rate applicable to all transfers by the transferor during the taxable period if made during life or to the transfers at death if made upon death.

A third solution, a varient of the ALI proposal, has been proposed. It would not apply to outright transfers but would apply to all transfers in trust for descendants of the transferor, except those where the sole income beneficiary is a child and the child's only interest in the trust is an income interest. Thus, powers of withdrawal and invasion of powers of appointment would not be permitted.

ABA comments

The concept of "family" is important. Logically, in the case of outright transfers, an individual ought to be able to leave property to any member of his Family at the price of a single transfer tax. His "family" means persons living at his death. The definition is more difficult in the case of transfers in trust. If the transferor lives out his actuarial life expectancy, "family" consists of spouse, children and grandchildren. With trusts if the transferor dies prior to the expiration of his actuarial life expectancy he ought not to be penalized by a narrower definition of Family; similarly, if he outlives his actuarial life expectancy, he ought not to benefit from a broader definition of "family."

The ABA believes each of the proposals discussed above has one or more serious defects. The most unsatisfactory solution is that of the Treasury Studies. It is premised upon the concept that a transfer tax should be imposed every generation even though the skipped generation receives no beneficial interest in the transferred property. Leaving aside for the moment the soundness of a once a generation theory of taxation, the Studies proposal does not even apply this theory on a uniform basis to all transfers; transfers to persons in a generation above the transferor (parents), or in the same generation as the transferor (brothers and sisters), are not exempted from the transfer tax as they should be if the theory is to be applied impartially. Returning to the soundness of this theory, we do not understand why an additional tax on outright transfers to grandchildren is appropriate. One of the stated objectives for transfer taxation is dispersal of wealth. If this is so, why should transfers that disperse wealth be penalized? If there is an abuse in the generation-skipping area, it exists only where a splitting of benefits between generations is present. This does not occur on outright transfer. Further, the transfer tax wheel of fortune commences immediately upon an outright transfer and an "early" death of the donee will trigger off inclusion in his estate. Finally, we know of no county or state that has imposed an additional transfer tax on outright generation-skipping transfers. While the fact that an idea has not been tried before does not automatically justify its rejection, it does suggest that an additional or substitute tax on outright generation-skipping transfers is alien to the concept of fairness regarding transfer taxation.

For three reasons, the ABA disagrees with the proposals of the Treasury Studies and the ALI concerning the determination of the amount and time of payment of the additional tax for transfers in trust, which in our judgment impose the tax at the "wrong" time on the "wrong" person:

First, the additional tax is computed by reference to the transferor's tax rates and is therefore inconsistent with the Studies every generation tax. The tax should be computed with reference to the estate of the skipped generation.

Second, the tax is dependent upon the transferor's rate applicable at the time of transfer. It is inappropriate to create an incentive for making generation-skipping transfers early when the transferor's tax rate is low.

Third, the election device permitting the tax to be determined based upon value at the time of transfer or at a later time is ill advised and injects aspects of a lottery into the computation of the tax.

We have other difficulties with the proposals. The application of the Treasury proposal to the distribution of current income will create complexity. If the additional tax is to be paid from the distributed income, the income tax plus the additional tax may exceed 100%. Also, the ALI proposal may be criticized in that, by imposing a single additional tax that is not related to the term of the trust or the number of generations skipped, the creation of long-term trusts is encouraged.

The third proposal described above—to exempt from an additional tax transfers in trust for a child where the child's sole interest in the trust is an income interest—is unsatisfactory in that it is inconsistent with the clear and socially desirable trend toward flexibility in trust dispositions.

ABA alternative

The ABA believes that any change in the taxation of trust transfers should be accomplished in such a manner that a person may create a trust having his "family"—his ancestors, spouse, children and grandchildren—as its beneficiaries without the imposition of an additional transfer tax when compared with current law. The additional tax should be limited to the long-term trust where the property "vests" in a person more remote from the transferor than a grandchild or at a later time than the death of the last living child or the transferor. The tax would be paid from the trust property and be determined by inclusion of the trust property in the transfers of the "skipped" beneficiary—usually a child or the transferor.

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The effect of the ABA proposal, in the context of a trust for descendents of the transferor, would be to shorten the period during which trust property may be kept outside of the transfer tax base from as much as 100 years to a period not to exceed the life or lives of children of the transferor. The ABA proposal would not inhibit in any way the use of a flexible trust through the creation of various powers in the trustee and/or beneficiary, such as powers of appointment and discretionary powers to pay income or principal among a class of beneficiaries. A more detailed explanation of the proposal is contained in Appendix A.

UNIFICATION

Current law

Generally speaking, an estate tax is imposed on transfers at death and a gift tax on transfers during life. Each tax has a separate rate schedule and a separate set of exemptions. The effect of a gift is to remove property from the top estate tax rate at the cost of a gift tax computed in almost all cases at a substantially lower gift tax rate. As a consequence a tax advantage is derived from gifts under current law. The existing dual system has been criticized as preferring the wealthy individual who can afford to make gifts over the less well-to-do individual who cannot afford to do so.

Proposals for change

Two proposals for changing the present dual estate and gift tax system have been made:

First, to "unify" the estate and gift tax laws. As suggested in the Treasury Studies, this proposal would have three facets. One, transfers during life and at death would be subject to one set of rates that would be applied cumulatively. To give a simple illustration and ignoring exemptions, if a man transferred $50,000 during his lifetime this amount would be subject to tax at the lowest rate and upon his death the initial rate applicable to his transfers at death would begin with the rate applicable to $50,000. Two, a "grossing-up" concept would be created under which an individual making a gift of property during his lifetime would be subjected to transfer tax not only on the value of the property transferred but also on the transfer tax itself. Under current law, an individual making a gift pays a gift tax only on the amount of the gift. Three, a shift would be made from what is now a "hard-to-complete" rule on the time of imposing the tax to an "easy-to-complete" rule. Under the current "hard-to-complete" rule, a transferor may remove trust property from his gross estate only if he gives up both beneficial enjoyment of the property and the right to control who will receive the income or principal of the trust or the time of its enjoyment. Under an "easy-to-complete" rule a transferor could retain control over, but not beneficial enjoyment of, the trust property and still not have the property included in his transfers at death.

Second, to retain the existing dual structure but to compute the estate tax by, in effect, including the amount of the decedent's taxable gifts in his gross estate for the purpose of determining the applicable estate tax rates. The estate tax payable would then be the difference between (1) the estate tax that would be payable on his taxable estate plus an amount equal to his taxable gifts and the gift tax paid, and (2) the estate tax that would be payable if his taxable estate consisted only of his taxable gifts and the gift tax paid.

ABA comments

The ABA opposes the "grossing-up" concept as being an inappropriate way of taxing a lifetime transfer, which is different from a transfer at death. Also, we see no reason to impose this complication, which would introduce an algebraic formula into the tax computation, and the confusion that would result for the sake of logical symmetry in the method of determining the tax on lifetime transfers and death time transfers.

With respect to shifting from a "hard-to-complete" to an "easy-to-complete" transfer tax rule, we believe that as a matter of tax policy such a shift is wrong. An individual should not be permitted to insulate future appreciation or income accumulations from transfer tax when he retains control over the transferred property. Another reason why we oppose an "easy-to-complete" rule is that it would involve changing present estate tax law which is now reasonably clear in its effect after many years of interpretation. Unless there is a provable advantage to the "easy-to-complete" rule, the time spent in shifting from existing law to the new approach is an unproductive use of time and money.

A shift to an "easy-to-complete" rule is usually justified on one or both of two premises. We believe that each of the premises is incorrect. The first premise is that although we have struggled for many years to draw a line between complete and incomplete transfers, using a "hard-to-complete" approach, we have the skill to draw an "easy-to-complete" line which is free from doubt. Our experience with tax law makes us doubt that this is true. A line between a taxable transaction and a non-taxable transaction is always hard to draw. We should not abandon the knowledge which we have painfully acquired over the years regarding the "hard-to-complete" rule.

The second premise is that since all transfers will be subject to a single rate schedule even an imprecise dividing line will not generate controversy. This is erroneous. If an individual makes a lifetime transfer and the property appreciates in value, it is to the Government's advantage to take the position that the transfer is a deathtime rather than a lifetime transfer. Under existing law, increases in value between the time of transfer and the time of death, more than rate differentials, cause the Government to challenge the time of completion of the transfer. An "easy-to-complete" rule will not change this situation unless the law is drafted so that, if an individual makes a transfer during life and pays a tax, the Government is estopped from raising the question of the time of completion of the transfer for transfer tax purposes. Absent such an objective test, existing law is superior because of the knowledge acquired as to the time of transfer. Further, we do not think that the Government should make such a concession.

The second and simplified "unification" proposal discussed above is unsatisfactory in that it would not be accompanied by a reduction in estate tax rates and the person of modest means who does not feel able to make lifetime gifts would not be benefited by the change.

ABA alternative

The ABA believes that the simplified "unification" proposal discussed above is worthy of consideration, but only if the current estate tax rate schedule is reduced. Otherwise, there would be no benefit to be derived from the change for the person of relatively modest means who cannot "afford" to give property away during his lifetime. The present rules which permit a "double deduction" for the gift tax paid on a gift in contemplation of death, viz., a gift tax credit and a deduction in computing estate tax, should be eliminated by in effect allowing a refund of the gift tax paid on the gift. For the reasons given above the ABA favors retention of the the "hard-to-complete" transfer tax rule.

MARITAL DEDUCTION

Current law

A marital deduction of 50% of a decedent's adjusted gross estate is available for property passing to a surviving spouse. This deduction is also available for lifetime transfers to a spouse subject to the same 50% limitation. In order to secure the deduction, the spouse must be given the unrestricted right to control the disposition of the qualifying property either during life or at death. Current law has been criticized both quantitatively and qualitatively, and also as being unnecessarily complex. As to quantity, it is contended that spouses view property owned by each of them as "their" property and that a tax should not be imposed until both spouses have died. As to quality, the contention is made that the transferor spouse is put to an unfair and unnecessary choice in that in order to obtain the deduction the other spouse must be given control over the marital deduction property and this may not be desired, particularly in cases where there is a second marriage and children by a first marriage.

Proposals for change

The Treasury Studies and the ALI recommended liberalization of the marital deduction provisions in terms of both quantity and quality: no limit would be placed on the amount of property which could be transferred free of transfer tax between spouses and a life estate (or income interest), viz., a current beneficial interest in property unaccompanied by a power of disposition (appointment) in the spouse, would be permitted to qualify for the deduction.

ABA comments

The recommendations of the Treasury Studies and the ALI are appealing. They do, however, present some significant problems. With regard to an unlimited marital deduction the problems are twofold. First, a complete exemption from tax for transfers to a spouse would encourage such transfers at the expense of transfers to other members of the transferor's family. When the spouse will need all of the income to live on—as will usually be the case with the small and medium size estate—this result should not have an adverse effect. However, in the case of a large estate, where the income is more than sufficient to satisfy the spouse's needs, the tax "pull" of avoiding all tax may lead to unwise dispositions ignoring other family members, at least until after the spouse's death. A shift to a current beneficial enjoyment theory for marital deduction qualification would be helpful, particularly in cases of second marriages and children by a first marriage, in permitting the first spouse to die to control the disposition of the property after the surviving spouse's death. Nevertheless, the problem will to some extent remain. Second, when a part of the estate is more than sufficient to satisfy the spouse's needs we question whether postponement of the collection of all tax as a result of an unlimited marital deduction should be permitted.

With regard to the current beneficial enjoyment test, one problem is "forcing" transfers upon the surviving spouse as a result of the termination of the current beneficial interest prior to death. In such a case, later transfers by that spouse will result in a higher tax because the "forced" transfer will result in the application of higher transfer tax rates. This problem could be elimniated by requiring that the spouse's interest cannot be terminated during life without his or her consent.

We have encountered among our members a substantial amount of opposition to a shift to a current beneficial enjoyment test. A change is opposed because:

(1) It will result in considerable litigation even though it resembles the income requirement of a marital deduction trust under current law.

(2) It will produce undesirable complexity because of the absence of control in the surviving spouse through a power of appointment. The fact that the same type of interest may both qualify and not qualify for the deduction may create tracing problems.

(3) It will tend to produce an inconsistency between the estate tax law and applicable elective share laws of a majority of common law states under which a surviving spouse is entitled to an *outright* share of a decedent's estate.

(4) It will create a further disparity in property dispositions between community property and common law states. Under community property laws, a surviving spouse has control of her half of the community property and under current law the surviving spouse in common law states must receive this control in order to qualify the property for the marital deduction.

(5) It will produce more conflict between the surviving spouse and the remaindermen over what is an appropriate level of income, particularly in the case of second marriages where an adversity is more likely to exist between the spouse and the remaindermen.

(6) It will raise some technical problems regarding its application to annuities which are avoided if current law is retained.

ABA alternative

The ABA suggests that the current marital deduction law be modified quantitatively to permit qualification of the greater of $250,000 or 50% of a decedent's adjusted gross estate but that no qualitative change be made.

Future developments may, of course, cause a change in our thinking concerning the matters that have been discussed.

APPENDIX A

EXPLANATION OF ABA PROPOSAL IMPOSING A TAX ON CERTAIN TRUST TRANSFERS

The ABA solution is to subject to transfer tax the "value of property passing" to a "beneficiary's" "descendents" upon a "termination" or "distribution" by imputing ownership to the beneficiary of the property so passing unless an "excluded transfer" is present. Each of the quoted terms is given a defined meaning. Three of these terms, "termination", "distribution" and "excluded transfer" are of primary importance. Their meanings may be summarized as follows:

Distribution.—a transfer causing property to cease to be a part of a trust.

Termination.—any occurrence, other than a distribution, causing a person to cease to be a beneficiary of a trust. The occurrence will usually be the beneficiary's death.

Excluded transfer.—this term is defined separately for distributions and terminations. Any distribution to a child or grandchild of the transferor or to a person no more than two generations below the transferor is an excluded transfer. Any termination is an excluded transfer if immediately after such occurrence there is a beneficiary of the trust who is no more than one generation below the transferor.

A payment of current income is not treated as a distribution or a termination.

The general scope of the excluded transfer provisions may be illustrated by two examples:

Example 1. A creates a trust with income payable to his son B for life, remainder upon B's death to his then living issue, per stirpes. Any property distributed to a grandchild of A upon B's death is an excluded transfer.

Example 2. A creates a trust to continue until the death of the survivor of his three children, with the income to be distributed currently to any one or more of the issue of A then living as the trustee determines and the principal to be paid upon the death of the last surviving child to A's issue then living, per stirpes. No payment of current income, even if made to a great-grandchild of A, is subject to transfer tax. The terminations caused by the deaths of the first two children to die or by the death of any grandchild or more remote descendant of A (each of whom is a "beneficiary") are excluded transfers. At the death of the last surviving child the "termination" excluded transfer provision would not apply, but the "distribution" excluded transfer provision would apply to the extent trust property is distributed to a grandchild of A. If at the death of the last surviving child trust property is distributed to a great-grandchild of A, a transfer tax will be paid with respect to such property.

THE AMERICAN COLLEGE OF PROBATE COUNSEL,
Los Angeles, Calif., May 10, 1976.

MICHAEL STERN,
Staff Director, Senate Finance Committee,
Dirksen Senate Office Building,
Washington, D.C.

DEAR MR. STERN: Enclosed is a statement of the American College of Probate Counsel to supplement the oral testimony I will give on its behalf at the May 17, 1976, hearings.

The American College of Probate Counsel is a group of more than 1700 lawyers from all over the United States who have special expertise in estate planning and administration. The object of the College is to use the skills and experience of its membership to improve and enhance the standards and ethics of probate practice, the collection of federal and state death taxes and the administration of justice. Its membership includes, as honorary Fellows, Chief Justice Warren E. Burger and the late Chief Justice Earl Warren, as well as Justices Harry A. Blackmun and Lewis F. Powell, Jr. of the United States Supreme Court.

Because of the nationwide membership of the College, with chapters in each state and the District of Columbia, we are able to call on the knowledge and experience of experts in probate administration and estate and gift taxation in each state to analyze the effects of the tax laws and make recommendations for their improvements.

One of the things we have learned is that the fiduciaries and beneficiaries of estates all over the country are complaining that unnecessary delays and extra costs of estate administration arise not so much as a result of antiquated systems of probate but rather from administrative problems caused by federal and state death taxes. There is a need for a closer intergovernmental relationship as well as leadership from the federal government to persuade the states to conform their death tax systems to the federal estate tax, so as to simplify the collection of death taxes at both levels of government. Our College is making a long term study of this and will ultimately publish a report which will be made available to the Congress at a later date. Meanwhile, we believe that much can be done to ease the burden of the small and the illiquid estates. The general thrust of our specific recommendations at this time is in that area.

In making this presentation, we have tried to avoid taking positions on some of the more controversial issues of estate and gift taxation. Instead, we have dealt with certain areas where we believe technical improvements can be made to the federal estate and gift tax law so that the system will work better from the viewpoint of the government, the taxpayer and the economy.

In addition, when proposed legislative changes emerge from either this Committee or the House Ways and Means Committee, we will submit to the Congress an analysis of their impact on a state-by-state basis. It is also our hope that we will be able to give further assistance to the Congress as estate and gift tax reform proposals are developed in this and subsequent years.

On behalf of the American College of Probate Counsel, I appreciate the opportunity to present testimony to your Committee.

Very truly yours,

FRANK S. BERALL,
Chairman, Estate and Gift Tax Reform Committee.

Enclosure.

PREPARED STATEMENT OF FRANK S. BERALL ON BEHALF OF THE AMERICAN COLLEGE OF PROBATE COUNSEL

This Statement has been prepared by a duly constituted Committee[1] of the American College of Probate Counsel and is being made under the direction of it, President (William P. Cantwell, Esq.) and President-Elect (J. Nicholas Shrivers, Esq.). Following introductory points on the general philosophy of this Committee with respect to estate and gift tax reform, the Statement makes some specific legislative recommendations for improving the operation of the estate and gift tax system.

A. PHILOSOPHICAL GUIDELINES

The history of the Federal estate and gift tax system show that there is little consensus as to whether the purpose of the system is to break up large accumulations of wealth or to raise revenue. As a practical matter, the foundation of the system probably rests upon a combination of these purposes. However, these purposes, and the efficiency of the system in achieving them, can not be the only criteria to be applied in judging the system. Other significant criteria include the *stability* of the system under which estates can be planned in reliance that major changes in the law will not render the plan useless (or worse) by the time the property owner dies; the *understandability* of the system, at least to the average attorney, so that it can be dealt with competently in carrying out the clients' wishes (while an equitable system is desirable, it is not always possible to develop a simple and understandable tax structure that is equitable—striving for equity often results in complexity, creating problems of understandability to property owners and their attorneys); the *neutrality* of the system, so that actions need not be distorted to achieve tax objectives; and the *certainty* of the system (a corollary of both understandability and neutrality), a principle recognized by the Congress in keeping the Federal estate and gift laws basically unchanged since the marital deduction was brought in by the Revenue Act of 1948 and the present method of taxing powers of appointment was adopted in 1951.

Achieving certainty of application of the estate and gift tax laws sometimes runs counter to obtaining complete equity since, in striving for the latter, uncertainty is all too often created. (A key illustration of this is what happened to the provisions taxing accumulation trusts during the enactment of the Tax Reform Act of1969.) This is more important from the standpoint of the property owner than from that of his lawyer, since uncertainty in the application of the tax laws creates additional costs for the property owner and increases his lawyer's fees. Another desirable principle is that the laws apply uniformly to similarly situated taxpayers. However, it is not always possible to achieve these results without losing other objectives. For example, an unlimited marital deduction (or even the present fifty percent marital deduction) penalizes people who die unmarried and argument could

[1] The Committee members are listed on the last page of this Statement.

be made that one's marital status at death should not determine the amount of the federal estate tax; on the other hand, the elimination of the marital deduction would bring back the inequities that existed between the eight community property states and the rest of the country prior to the Revenue Act of 1948, and run counter to the social policy of easing the impact on surviving spouses of the estate tax on the estate of the first to die.

The rights of the taxpayer must also be considered in any tax system. The taxpayer (in the case of the Federal estate tax, it is the decedent's estate), if insufficiently liquid, will find that the payment of the federal estate tax imposes a great hardship, sometimes forcing the sale of family farms, ranches or small businesses or the loss of the family residence. Easing the burden of the tax where an estate's assets are relatively illiquid is an extension of the ability to pay principle since, in an illiquid situation, there is inadequate ability to pay the tax without forced sales.

Last, but not least, taxpayers should have the right to expect an efficient system of tax collection. In most cases this should lead to the earlier closing of estates, while providing for extensions in those situations involving lack of liquidity or other hardships.

B. LIQUIDITY PROBLEMS

One of the most important problems in the Federal estate tax area involves the illiquid estate, whether it be illiquid because its principal asset is the family farm, a closely-held business or some other asset, the forced sale of which would cause considerable hardship. Many proposals have been made to deal with this problem of liquidity by giving special treatment to certain types of assets, such as farms, ranches, open space or historical sites.

We reject this approach because it violates the criteria of neutrality, uniformity and equity. It could readily lead to the creation of new estate tax shelters, while failing to cope with the problems of most illiquid estates, regardless of their assets. Instead of special treatment for certain types of assets, we recommend other changes. These are designed to relieve the hardship faced by all estates by establishing rules that set more liberal, objective standards for the grants of extensions for payment of Federal estate taxes.

1. Broaden definitions of closely-held businesses eligible for deferred payment of estate tax

(a) Section 6166 permits ten-year installment payments of estate taxes attributable to a closely-held business for up to ten years (if the value of the business exceeds either 35% of the gross estate or 50% of the taxable estate) and, broadly speaking, defines a closely-held business as one in which 20% of the value of the business is in the decedent's estate or in which there are 10 or fewer partners or shareholders. We propose that the definition of an interest in a closely-held business be broadened to deal with situations in which an estate may be unable to pay the tax because its assets consist substantially of an interest in an unliquid business which does not meet the present tests.

We propose broadening the Section 6166 definition of a closely-held business to include a business 20% or more of the value of which (or of the voting stock of which) was owned either actually *or constructively* by the decedent, or the stock of which was not traded on an exchange or in the over-the-counter market. This would expand the definition of closely-held business to cover nearly all cases where the shares of a corporation may not be readily sold at their approximate fair market value.

Constructive ownership rules attributing to the estate stock owned by siblings, descendants and ancestors (and spouses) should be applied. These would extend the Section 6166 treatment to those situations where the estate owns less than 20% of the business but, for practical purposes, the estate is no more liquid than if it owned more. This is because diffusion of ownership among family members is unlikely by itself to result in dimunition of the liquidity problem, particularly because of the difficulty in selling a minority interest in a closely-held business to an unrelated third party where other important shareholders are members of a single family.

The alternative definition of a closely-held *corporation*—that it have ten or less shareholders—should be replaced by a test as to whether or not the stock is traded on a securities exchange or in the over-the-counter market, since this really deals with whether the estate is in a position to liquidate its shares, regardless of the number of stockholders.

(b) Another serious problem for the illiquid estate for which a deferral has been obtained may arise because a withdrawal from or a disposition of the interest in the business can, under certain circumstances, cause acceleration of the remaining installments of the estate tax, without providing the estate with sufficient liquid assets with which to pay it.

Section 6166(h)(1)(A) provides in substance that, if withdrawals from the closely-held business equal or exceed 50% of the value of such business, or 50% or more of the closely-held business is sold or exchanged, the payment of the remaining Federal estate tax is accelerated.

There appears to be no justification for an acceleration of the Federal estate tax regardless of the percentage of the closely-held business which is either withdrawn or sold, so long as the withdrawal or sales proceeds are applied substantially to pay the remaining estate tax due, and, in fact, the statute provides for exceptions in the case of a sale or exchange, where the proceeds are used entirely for the payment of Federal estate tax. But not all of the proceeds should have to be applied against the Federal estate tax to prevent an acceleration of estate tax payments. Some of these proceeds will be needed to pay state death taxes (or other debts) which fall due during the ten-year period of the Section 6166 estate tax installments.

If Section 6166 required all of the withdrawn funds or sales proceeds to be applied to the Federal estate tax, the executor who used such funds or such proceeds to pay state death taxes would then have to borrow an equal amount of funds to apply on the Federal estate tax at the next installment due date. This hardly helps to alleviate the monetary problems of the illiquid estate. We would recommend that the exception to acceleration apply if at least half of the proceeds are applied against the Federal estate tax.

A similar problem arises under Section 6166 (h)(1)(B). This makes an exception from the general acceleration provision where there is a distribution in redemption of stock under Section 303. The last paragraph of subparagraph (B) provides that this exception will only apply if an amount of the estate tax not less than the redemption distribution is applied on the next installment of the Federal estate tax. This requirement that the entire distribution be applied against the Federal estate tax causes the same liquidity problem noted above, namely, that where a distribution is necessary to pay the state death taxes or other pressing debts, it is then necessary for the executor to thereafter borrow the same amount of funds to apply against the Federal estate tax, thereby compounding his illiquidity problems. Again we recommend that only a portion of the redemption distribution, such as half of it, be required to be paid on the Federal estate tax at the time the next installment is due.

We also recommend defining a "disposition" uuder Section 6166(h)(1)(A)(ii) and a "distribution" under subparagraph (B) so that, when notes are received in exchange for the corporate stock, the "disposition" or "distribution" would be deemed to occur only when payments are made on the notes or the notes are pledged for a loan.

2. Set objective standards for reasonable cause for deferring payment of tax, and extend the period to 5 years

In addition to providing for more liberal relief through permitting installment payment of estate tax over a period of years to be available to a broader class of closely-held businesses, we believe that the twelve-month extension under Section 6161 (a)(1) (permitted whenever a fiduciary can show reasonable cause for his inability to pay the estate tax when due) should be available on an objective basis, rather than giving the Internal Revenue Service discretion to grant this privilege only if an examination of all the facts and circumstances discloses that a request for an extension of up to a year is based upon reasonable cause. We also believe that this extension should be for up to five years.

The Senate Finance Committee Report to the Excise, Estate and Gift Tax Adjustment Act of 1970, gives six examples of cases in which there would be reasonable cause for an extension:

The first example involves situations where farms or closely-held businesses comprise a significant portion of an estate, but not enough to satisfy the percentage requirements for obtaining a Section 6166(a) extension. Although these interests could be sold to unrelated persons for their fair market value to obtain funds to pay the estate tax, the executor could raise the funds from other sources if he had more time.

The second example deals with an estate of sufficient liquid assets to pay the tax when otherwise due, where the assets were located in several jurisdictions and not immediately subject to control of the executor, so he cannot readily marshall them.

The third example is of an estate a substantial part of whose assets consist of rights to future payments (annuities, copyright royalties, contingent fees or accounts receivable), where there is insufficient cash with which to pay the estate tax when otherwise due and a loan cannot be obtained, except upon terms inflicting loss upon the estate.

In the fourth example, the estate includes a claim to substantial assets which cannot be collected without litigation, so that the size of the gross estate is unascertainable as of the time the tax is otherwise due.

The fifth example deals with assets which must be liquidated at a sacrifice price or in a depressed market, to pay the estate tax when otherwise due.

In the sixth example, the estate has insufficient funds (without borrowing at a higher rate of interest than that generally available) to pay the entire estate tax when otherwise due, provide a reasonable allowance for the family during the remaining period of administration and satisfy claims against the estate. The executor has made a reasonable effort to convert assets in his possession to cash (other than an interest in a closely-held business to which Section 6166 applies).

In all six of these cases, we recommend that an extension of time to pay the tax for up to five years be automatically granted upon representation of the existence of the problem in a sworn affidavit from the executor. This would still leave to the discretion of the Internal Revenue Service other cases where an examination of the facts and circumstances discloses that a request for an extension for up to five years (presently twelve months) is reasonable. However, in these other cases, the Code should require the Commissioner to grant such an extension unless he determines that there is reasonable cause not to grant one. Should it later become apparent that the taxpayer submitted false or insufficient information, existing civil and criminal penalties are adequate.

The liberalization in 1970 did not extend to the discretion given the Internal Revenue Service to extend for up to ten years the time for payment of any part of the estate tax in cases of undue hardship under Section 6161(a)(2). Such an extension may be granted only for a year at a time and requires more than a general statement of hardship or showing of reasonable cause to obtain it. Undue hardship means more than inconvenience. It means sale at a sacrifice price or in a severely depressed market or the disposition of an interest in a family business to unrelated persons, even though it could be sold at a price equal to its current fair market value to these people.

As pointed out above, we recommend that the time period for an extension of the estate tax payment for reasonable cause, under the criteria of Section 6161 (a) (1), be extended from twelve months to five years and that, thereafter, the undue hardship criteria of Section 6161(a)(2) be used for further extensions.

3. Lengthen the maximum extensions to 20 years

The present maximum period for obtaining extensions of time to pay estate tax under Sections 6161 and 6166 is ten years, but an extension under Section 6166 must be elected at the time the return is filed. We recommend that this election also be available if a deficiency is assessed and, furthermore, that installment payments of the tax under the conditions described in both Sections 6161 and 6166 be permitted for up to twenty years.

4. Reduce interest rate on extensions to ⅔ of that on deficiencies

Finally, we propose that in all cases where the payment of the estate tax is to be deferred under Sections 6161, 6163 (dealing with extensions for the payment of estate tax attributable to a future interest), 6166 and the new extension provisions advocated by us, the interest be reduced to two-thirds of the rate currently

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charged on deficiencies. For many years, until 1975, interest was imposed at only a 4% rate on extensions of time for undue hardship (Section 6161(a)(2)), because of a future interest (Section 6163), or where there was a closely-held business in the estate (Section 6166), although the regular six percent interest rate applied to twelve-month extensions under Section 6161(a)(1).

Effective June 30, 1975, the preferential rate of interest was abolished at the same time that interest rates were raised to 9% (now 7%, at least until February 1, 1978). The Senate Finance Committee explanation of the change that eliminated the preferential interest rate overlooked that estates holding closely-held businesses and other illiquid assets must not only earn profits to pay the interest charge, but also to pay the unpaid installments of estate tax. We merely seek to further the purposes of the extension provisions as originally enacted and the liberalizations as proposed by us, by reinstating a preferential interest rate which would rise and fall in proportion to the current rate of interest for income tax purposes.

We believe that the adoption of the above proposals would go a long way to solve most liquidity problems experienced by estates. From the standpoint of sound tax policy, the uniform application of these provisions, regardless of the nature of the illiquid assets, would further the objectives of neutrality, equity, and uniformity of application of the estate tax laws, as well as providing certainty that relief would be available in most cases.

5. Create a new alternative valuation concept for hard to value assets

Great difficulties are created for estates holding hard to value assets and for the Internal Revenue Service in dealing with these assets. Current rules require appraisals, which can be expensive, can result in expensive and time consuming controversies with the Internal Revenue Service, and may result in unfairness to one side or the other when assets are sold within a reasonable period after death. Therefore, although we favor retention of the six-month alternative valuation date, we recommend that where an estate holds assets described in Section 6161 (a)(1) or 6166 or real estate or tangible personal property (other than property which depreciates in value due to lapse of time or normal use—such as the family car) at the time of filing of the return, the executor should be permitted to elect a deferred alternate valuation date for such property (separate from the normal election as to valuation dates) that would permit the valuation of these assets to be postponed for a period of up to three years following the date of the filing of the return, with valuation to be fixed by actual sale or, if none, by appraisal at the end of the period. Needless to say, unless otherwise deferrable, the Federal estate tax attributable to these illiquid assets should be paid on an estimated basis and the statute of limitations as applied to questions affecting these assets tolled.

C. INTERSPOUSAL TRANSFERS

The problem of inter vivos and death-time interspousal transfers is one that has produced a number of proposals to make changes in the marital deduction. We are concerned that some of the more far-reaching ones which would provide for the unlimited marital deduction, making all interspousal transfers tax-free, would create both an unacceptably high revenue loss (at least in the near term) and run counter to the objective of having a stable tax system. The two most serious problems in this area are the artificiality of the legal presumptions involving joint tenancy, particularly between spouses, and the tax pressures to distort a client's natural desire in making appropriate dispositions for a spouse and children. This is particularly serious where the client wants to be sure that his or her children, and not a second set of children the surviving spouse may have on remarriage (or even the surviving spouse's exist even more strongly in second marriages where there are children from a first marriage.

1. Inter vivos transfers of joint and community property

We propose retention of the 50% marital deduction in general, but advocate a major change involving inter vivos interspousal transfers. The gift tax marital deduction, unlike the estate tax deduction, does not permit a 100% deduction for up to 50% of the estate. The gift taxpayer gets a deduction for 50% of the actual amount given to his spouse. This requires the filing of returns for relatively small gifts, a requirement that is frequently ignored, leading to disrespect for the law on the part of many people and imposing onerous filing and payment requirements on the conscientious and well-advised taxpayers.

We believe that the same policies that led to adoption of the Section 2515 exemption from the gift tax of the creation of a tenancy by the entirety or a joint tenancy with right of survivorship between husband and wife in real estate (in the absence of an election) should be expanded to many other interspousal transfers made inter vivos. Section 2515 should be extended so that all transfers into joint ownership, including community property transfers, by either spouse, regardless of the source of the funds, would be treated as exempt unless the spouses elected to have them treated as completed transfers. Thus, the umbrella of Section 2515, now limited to real estate, should be extended to stocks, bonds, savings accounts and all other types of property. Even tenancies in common should fall into this shelter, since the tendency of people in creating all of these joint interests is to give half of an aggregate amount, so that such a rule would really rather closely parallel the present policy on joint tenancy.

Under existing provisions of Section 2515, termination of a real estate joint tenancy between spouses or a real estate tenancy by the entireties may or may not result in a gift, depending on the ratio of original contributions and the property interests acquired. This is frequently the occasion for an inadvertent gift. Extension of Section 2515 to all types of property, without any attention to the inadvertent gift problem, would exacerbate the existing problems of noncompliance in this area. As an inducement to taxpayer awareness and compliance, a new type of taxpayer election in this area is suggested below.

Unawareness is the real reason that many transfers into interspousal co-ownership form are not coupled with elections to treat the transfer to the noncontributing spouse as agift. Existing Section 2515 requirements requiring the election to be made on a timely return operate as a trap, for when the couple finally becomes aware of the possibility that the transfer might have been a gift, it is almost always too late for a timely return. To constitute the noncontributing spouse as an owner then would require a gift of the entire one-half interest. Appreciation and inflation aggravate the problem since current fair market value would be involved in a transfer at termination of the joint interest. If that value is higher, and if the termination would involve a transfer of an asset acquired by gradual payments over a period of time, the gift tax consequences can be very severe.

As an example, consider a house bought with a purchase price of $50,000 and a $10,000 down payment. Mortgage payments in annual increments are made. Had elections been made on timely gift tax returns to treat the down payment and annual mortgage payment as gifts, little if any gift tax would be paid. On the other hand, if the elections are not made and if a severance is effected on a scale with each spouse receiving one-half of the proceeds and the appreciated value is $150,000, the consequence is a $75,000 gift (subject to the gift tax marital deduction) by the contributing spouse to the noncontributing spouse. This can be very disadvantageous in many situations.

A relatively simple statutory change to permit the election to be made on a return, whether timely or not, would relieve the situation. It is particularly pertinent if the suggested Section 2515 change is made, for nonrealty transfers are virtually handled in this fashion now. Acquisition of a security in joint form under existing law involves a gift. The tax now remains due, based on fair market value at acquisition, under today's law, and can and should be paid on a return, whether timely or not. The taxable event was acquisition, and not anything subsequent. What is being urged here for an expanded Section 2515 is that acquisition *remain* the taxable event, with the election available to treat the transfer as a gift at *any time* after acquisition. In essence, the question of gift or no gift would remain open until the spouses close the transaction, but, when it is closed, the closure would relate back to acquisition cost and would not require a fair market value transfer at the date of closure.

2. Joint property at death

Section 2040 should be amended so that at death only half of the property held in any form of joint ownership would be taxed in the estate of each spouse, without tracing. But any property held in joint ownership for which no gift tax has been paid at creation should be removed from the adjusted gross estate in figuring the base on which the maximum marital deduction (50% of the Adjusted Gross Estate) is computed at death. This is the present approach to community property.

3. Extension of the credit for prior transfers

If the donee-spouse dies first, half of the property will be included in her or his estate, and the entire property will subsequently be included in the donor-spouse's estate. This is a problem that generally exists where gifts are made to a spouse. It can be alleviated by an extension of the existing credit for property previously taxed in the estate of one spouse, with the elimination of the present ten-year limit and the 20% credit decrease that occurs every two years. This specially extended credit rule for property previously taxed in interspousal transfers would permit a 100% undiminished credit, regardless of the number of years between the deaths of the spouses.

The unfortunate whipsaw consequences of the same property being included in the estates of two decedents (usually spouses) could be solved by extending the mitigation of the statute of limitations provisions in Sections 1311 through 1315 into the estate tax area. These provisions deal with inconsistent income tax determinations that either give the government or the taxpayer an unfair advantage which cannot be rectified because of the running of the statute of limitations. The provisions permit the reopening of the statute of limitations under certain conditions in the interest of fairness. However, they are quite complex and the extension of them to the federal estate tax will add further complexity to them. We believe that the same objective can be accomplished through the use of the above-described 10% credit for tax on prior transfers between spouses.

4. Qualitative expansion of the marital deduction and elimination of the terminable interest rule

With respect to the qualitative aspects of the marital deduction, we favor qualifying for the marital deduction any full income interest passing to the surviving spouse, regardless of whether there is a general power of appointment accompanying it. Thus, deductibility would be given in the first estate, provided that the interest is to be included in the second one. Furthermore, the surviving spouse should be allowed either to accept or reject the marital deduction tax result in the qualifying limited interest situation, such as where he or she receives only a life estate. Thus, in effect, the surviving spouse would have an option to prepay the death taxes when there is a straight life estate, but still receive the life estate.

In essence, the Section 2056 terminable interest rule would be abolished in the interest of simplicity, to make it easier for the nonspecialist to avoid problems and to avoid the whipsaw effect of the inconsistency involved in requiring inclusion in the survivors' estate in situations where the marital deduction is not always available in the estate of the first spouse. This is illustrated by cases involving overly broad powers to allocate between principal and income or to retain unproductive assets, so that not all the income requirements for a marital deduction power of appointment trust are met and cases where the power of appointment does not qualify as a general power of appointment under Section 2056 but nonetheless falls within the Section 2041 definition of a general power of appointment. Another example of cases which would be ameliorated by this change are those where there is disallowance of the deduction in the first estate because of a requirement of survivorship running beyond the allowable six-month period which actually is satisfied so that the property does in fact pass to the surviving spouse and is taxed in the second estate.

Perhaps the worst aspect of the present requirements is the compulsion they place upon a property owner. He must do something with his property that he might not otherwise wish to do. While he may be perfectly willing to provide for his spouse, he may not want to do this in a way that allows that spouse to divert the property from his children after his death. These fears may involve a fear of the surviving spouse's remarriage or where a donor has a family by a predeceased first spouse and then remarries, fear that the second spouse will not make the adequate provision for the children of the first marriage. To mitigate this situation, we propose amendments to Section 2056 that would permit a limited interest to qualify for the marital deduction.

If the decedent's spouse leaves the surviving spouse an interest which will cause the property to be includible in the survivor's estate upon death, that fact alone ought to be sufficient for a qualifying gift. If the survivor accepts broad benefits, such as a general power of appointment or outright ownership of the property, then of course the first estate is allowed a deduction, because the survivor has that quantum of ownership which requires estate taxation when he or she later dies.

That rather parallels the present marital deduction, except that it substitutes for the technical terminable interest rules a basic rule which simply and directly states that the interest qualifies if the surviving spouse takes such an interest as would cause inclusion in the surviving spouse's estate if retained until death (which, of course, also means that, if the survivor disposes of it before death, it is subject to the gift tax).

A further recommendation is that the spouse dying first should be able to tender to the second spouse a terminable interest which qualifies, if the first spouse to die declares a desire to have that interest qualify. Thus, in the classic case of a life estate for the wife, with remainder over to whomever her husband directs, if the widow accepts this tender, it should be deductible in her husband's estate and her acceptance of it as a marital deduction gift will constitute a stipulation that it will be includible in her estate when she later dies. Unless her husband expressly conditions this bequest on her acceptance of it as a marital deduction bequest, however, she could take the property rights but decline the tax consequences through post mortem planning, and prepay the tax by declining to take it as a marital deduction gift. She could still have the right to the income (she need not forfeit her rights under the will) but she only declines to take it as a marital deduction gift.

Protection of the husband's other beneficiaries is important in such a situation. This could be accomplished by having the additional tax caused by this unanticipated enlargement of his taxable estate borne specifically by the assets which caused that enlargement, that is, the assets tendered but rejected for the marital deduction. Of course, the husband may include an apportionment clause to the contrary, but Sections similar to the tax apportionment for life insurance under 2206 and powers of appointment under 2207 should be put in the Code to deal with the unplanned situations.

These proposed changes should not cause a significant loss of revenue, but would give much more flexibility to estate planning, particularly at the post mortem stage; the election could actually result in particular cases in revenue advantages because of the prepayment of taxes that would otherwise not be due until the wife's death. This election, however, would most likely be used in cases where it would be advantageous from a rate viewpoint. In any event, where it does reduce the tax, it does so by removing an inequity rather than creating one.

D. RAISE THE EXEMPTION TO $100,000 AND CHANGE IT TO A CREDIT

Another problem that is receiving considerable attention lately is the debate over whether the federal estate tax exemption should be increased, in view of inflation. We are concerned over the estimated $2 billion revenue loss that an increase in exemption to $150,000 would appear to create. We believe that many of the problems caused by inflation pushing far more people into the federal estate tax brackets will be solved by adoption of the liquidity proposals we have previously made. We also recognize that some allowance must be made for inflation, that complete relief from the estate tax and the filing requirements is desirable in smaller estates. However, we believe the revenue impact of this relief must be held down by changing the exemption to a credit.

We also recognize that if there is a material increase in the estate tax exemption, questions of fundamental social reform, rather than narrow tax reform, are raised because, if a tremendous tax loss results from exempting so many modest-sized estates that are now subject to tax, it may be necessary to make up that difference by accelerating rates (if the estate tax is to continue to produce the same amount of revenue) and, inevitably, even without a conscious and independent policy decision, a rate structure might then be adopted which would tend to break up even moderate concentrations of wealth and deter needed capital formation. This is not the sort of result that should be reached as an incidental part of estate tax revision, but, to some extent, it would be a by-product of raising the exemption (unless the exemption can be raised in the context of other revenue increases).

It would be most desirable to exempt the many estates which involves only modest amounts of wealth being passed to a spouse or children where both planning and administration are now complicated and little revenue is produced. Accordingly, to the extent consistent with revenue considerations, we recommend that many estates be exempted from the Federal estate tax where neither the returns nor the administration and planning are worth the effort. We suggest that this be accomplished by means of a credit, rather than an exemption. This credit could be used, in effect, to increase the $60,000 exemption to $100,000 by taking the amounts

from the bottom rather than the top (eliminating tax on the small estates, but giving the relief in the large estates at the bottom, rather than at the top rate).

We propose that in lieu of the present $60,000 exemption ($120,000 for transfers qualifying for the marital deduction), a credit against the tax due on the first $100,000 of taxable estate ($200,000 in the case of transfers qualifying for the marital deduction) be permitted. This credit should be designed so that gross estates of $100,000 or less need not file returns. This latter point is of the utmost urgency, since if it is not done, the change will cause further unnecessary complications and costs in the administration of small estates.

E. VALUATION

Turning to the question of valuation of assets, wherever there are closely-held business interests or hard to value tangibles, estates are put to a considerable amount of additional expense and both the estate and the government spend quite a bit of time and money in valuation proceedings. We believe that the settlement of estates could be facilitated by improvement of the present valuation methods. For example, Section 2031 presently requires that unlisted and untraded securities have their values determined by considering, along with all other factors, the value of securities of corporations engaged in similar lines of businesses which are listed on an exchange. The limitation of this comparison to corporations whose securities are listed on an exchange is a technical defect in the law. Accordingly, Section 2031 should be amended to permit comparisons with the securities of other corporations engaged in the same or a similar line of business, regardless of whether their securities are listed on an exchange.

Under Regulations promulgated pursuant to Section 2031, tangible personal property is valued at the price at which an item or comparable item could be obtained in the retail market. Thus, replacement value is the criterion for valuation rather than the price obtainable in the market or markets available for the holder of the property being valued. This approach of the Service was rejected by the United States Supreme Court in the *Cartwright* case, decided in 1973, which involved the valuation of shares of an open-end mutual fund. The price obtainable by the executor or donor in whatever markets are available to him is a fairer measure of value.

Accordingly, we recommend amendment of Sections 2031 and 2512 (gift tax) to provide that tangible personal property be valued for estate and gift tax purposes at the price obtainable by the executor or donor in the market or markets available to him. If this proposal is coupled with the previously made one permitting an election of a delayed valuation date for hard to value assets, many of the valuation disputes that now occur would be avoided and the large expense incurred by estates possessing closely-held businesses in obtaining appraisals of them for tax purposes could also be reduced, if not entirely eliminated in a large number of cases.

F. GIFT TAX FILING

There are two other areas of the estate and gift tax laws which are widespread in their effect where the present rules create both unnecessary complexity and inequities. The first of these deals with the gift tax filing requirements. The Excise, Estate and Gift Tax Adjustment Act of 1970 required for the first time that taxable gifts be reported quarterly, rather than annually as provided by prior law. This quarterly filing requirement has proven to be a major administrative inconvenience to the Internal Revenue Service and constitutes a costly nuisance to individuals who make relatively small taxable gifts in several quarters. The extra work required by the quarterly filing requirements may in many instances be far more costly than the relatively small value derived by the Treasury from a slight acceleration of gift tax revenue.

We recommend a prospective return to annual filing, at least for most donors. Only where an individual's gifts in one calendar quarter aggregates $100,000 should an individual still be required to file a quarterly preliminary gift tax return with respect to that calendar quarter. This amount appears to be a reasonable figure which would eliminate most quarterly returns without deferring the payment of any substantial amount of gift tax. Eighty-five percent of the persons filing gift tax returns would not have to file quarterly preliminary gift tax returns, yet 75% of the total gift tax paid for the year would be reported and paid with the preliminary gift tax returns.

Where quarterly preliminary gift tax returns are in fact required, gifts between spouses should be permitted to be split on a preliminary basis, with a nonbinding election until the subsequent filing of a final return for the calendar year. At that time the spouses could elect to split their gifts or not split them, regardless of the election made in the preliminary quarterly returns. Similarly, the election to treat acquisition by spouses of a joint interest in any property as a gift would be made in the annual gift tax return rather than in the preliminary quarterly returns.

G. ESTATE TAX CREDIT FOR GIFT TAX PAID

We recommend that Section 2012 be amended so that in computing the limitation on the estate tax credit allowed for gift taxes paid in respect of property included in the decedent's gross estate, the estate tax attributable to such property should equal the reduction in estate tax if such property were removed from the gross estate. At present, the estate tax credit for gift tax paid in respect of property included in a decedent's gross estate for estate tax purposes is limited to the lesser of the gift tax paid or the estate tax allocable to the gift. Those limitations are computed under present law by a complicated method involving the average gift tax rate and the average estate tax rate. Substitution of the highest applicable bracket rates for the average rates determined under present law would greatly simplify the computation of the credit and would reduce the number of cases in which the credit is partially lost by application of the limitations. Thus, we recommend that the computation used to determine the amount of gift and estate taxes allocable to property subject to both taxes for purposes of the limitations be changed to reflect the incremental amounts of gift tax and estate tax attributable to the doubly taxed property.

H. THE STATE DEATH TAX CREDIT

In the written statement submitted on behalf of the College by President Cantwell, he indicated that we were working on a state-by-state analysis of the economic effect of the state death credit and would submit a report, which we expected would be ready within a month, to your Committee for its consideration in connection with your deliberations. It is now apparent that this report, which we had hoped to attach to or make a part of this supplementary statement, was not as far along as we had believed in March. Therefore, it will not be ready for several more months. When it does become available, we will submit its results, together with recommendations for a closer integration of the state and federal death tax systems, based upon some form of incentives given the states to conform their death taxes to the federal estate tax, to this Committee.

I. EFFECTIVE DATES OF TAX CHANGES

Our final recommendation deals with effective dates of any and all changes that may be made to the estate and gift tax laws. We believe that all such changes should apply prospectively and not be applicable to any past transfers. The effective dates should be such as to allow a reasonable period for amendment of existing estate plans. If major structural changes (such as new taxes on generation-skipping transfers, an unlimited marital deduction, some form of taxation of appreciated property at death, a radical change in the entire death tax system by bringing in an accessions or an inheritance type of death tax or the unification of the estate and gift tax or substitution of a capital transfer tax for it) are made, we believe that an extensive period of time should be permitted for the transition to occur, in the interest of stability.

The general policy of amending tax laws only prospectively should be strictly observed in estate and gift tax revisions. Obviously, many gifts have been made and many trusts established on the basis of the present tax system and its rules, which have remained substantially unchanged since 1951. Fairness requires that significant changes not be applied to the detriment of those who relied on existing law. Specifically, if Congress decides to unify the estate and gift tax system or substitute for it a capital transfer tax, similar to that used in England, it is important, as the proposals to date have generally contemplated, that there should be a "fresh" start, with a single lifetime exemption available in full without regard to prior gifts, and without including prior gifts in computing the tax on future transfers. Similarly, if a switch to an accessions tax is made, there should be no attempt to compute and charge recipients of gifts and inheritances with any of those received prior to the effective date of the new law.

If a tax is to be imposed at death on appreciation (either a capital gains tax or an additional estate tax), or if there is to be a carryover basis, we believe that a new basis date should be provided, in order to avoid inequities caused by failure in the past to keep adequate records (which taxpayers could legitimately have considered unnecessary), similar in concept (if not in purpose) to the March 1, 1913, value used for income tax purposes, after adoption of the Sixteenth Amendment to the Federal Constitution.

If generation-skipping transfers are to be specifically taxed, the new tax rules should apply only to transfers made after the effective date. Irrevocable trusts created prior thereto, whether during the settlor's lifetime or as a result of his death, should have their dispositions exempt from these new rules.

Finally, there should be a reasonable grace period for amending wills (and revocable or otherwise amendable trusts), similar to that provided in connection with other estate and gift tax amendments that have caused major changes in the past, to allow a review of estate plans by all taxpayers and their advisers. This grace period should run for at least five years, since experience has shown that even relatively minor changes in the past have required extension of originally granted two-year grace periods (witness what occurred to the changes in the charitable remainder trust rules and the transitional rules designed to deal iwth problems caused by these changes under the 1969 Tax Reform Act).

The above proposals are those of a duly authorised Committee of the American College of Probate Counsel, created by the College's Board of Regents and appointed by President William P. Cantwell, of Denver, Colorado. The Committee consists of the following lawyers:

Frank S. Berall, Chairman, of Hartford, Connecticut; Luther J. Avery, of San Francisco, California; Joseph Kartiganer, of New York, New York; Arthur Peter, Jr., of Washington, D.C.; Raymond A. Reister, of Minneapolis, Minnesota; and E. Frederick Velikanje, of Yakima, Washington.

VIEWS ON ESTATE AND GIFT TAX REFORM OF THE AMERICAN COLLEGE OF PROBATE COUNSEL

The American College of Probate Counsel, a group of more than 1,700 lawyers from all over the United States who specialise in estate planning and administration, recently authorised the creation of a Committee on Estate and Gift Tax Reform to offer its services and expertise to Congress.

William P. Cantwell, President of the College, submitted a letter dated March 12, 1976, to the Chief Counsel of the House Ways and Means Committee, expressing the views of the College on the broad objectives of estate and gift tax reform legislation. Mr. Cantwell also testified before that Committee on March 17, 1976. Thereafter, a supplemental submission was prepared by the College's Estate and Gift Tax Reform Committee to set forth its specific legislative recommendations.

Copies of the Cantwell letter of March 12th, an edited transcript of his Ways and Means Committee testimony and the supplemental submission of the College's Estate and Gift Tax Reform Committee are enclosed for the printed record of the Senate Finance Committee Hearings on Tax Revision.

FRANK S. BERALL,
Chairman, Committee on Estate and Gift Tax Reform.

THE AMERICAN COLLEGE OF PROBATE COUNSEL,
Los Angeles, Calif., March 12, 1976.

JOHN M. MARTIN, JR., Esq.
Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Longworth House Office Building, Washington, D.C.

DEAR MR. MARTIN: This letter follows up on the telegraphic request that a representative be permitted to appear before your Committee on behalf of the American College of Probate Counsel in accordance with the press release February 20, 1976. This will supplement that request to be heard and supply the information requested by the press release.

1. CAPACITY IN WHICH I WILL APPEAR

William P. Cantwell, 2900 First of Denver Plaza, 633–17th Street, Denver Colorado 80202, (303) 893–2900. I will appear as President of the American College of Probate Counsel, an organisation described in the supplementary materials attached to this letter.

2. REPRESENTATION

I will represent the American College of Probate Counsel, whose address is 10964 West Pico Boulevard, Los Angeles, California 90064 (213) 475-1200. Attached as Exhibit A is a statement of the Object of the American College of Probate Counsel, a Forward written by me, which is a part of the Roster of the College, a list of the Members Emeritus, who are Past Presidents of the organization, a list of the State Chairman for the 1975-1976 business year of ACPC, and a list of the Board of Regents for the 1975-76 business year and a list of the American College of Probate Counsel Honary Fellows. You will note that among the Honorary Fellows of the College are three Supreme Court Justices. The membership of the College exceeds 1700 estate planning and estate administration specialists, organized on a nationwide basis, which will be described below.

3. CONFLICTS OF INTEREST

I will be making a statement on behalf of the American College of Probate Counsel. I am a member of the law firm of Dawson, Nagel, Sherman & Howard of Denver, Colorado, but to my knowledge neither I nor my law firm has specific clients who have an interest in the subject, other than the interest of all citizens seeking a sound tax system, and I am not representing any client having an interest in the subject which I will be discussing.

4. PROVISIONS OF THE ESTATE AND GIFT TAX LAWS ON WHICH I WILL TESTIFY

My testimony will be aimed at *overall* estate and gift tax reform in the sense that I do not at this time propose to discuss specific tax reform proposals that have been considered by past Congresses. My objective in discussing estate and gift tax reform is to bring to the Committee a new perspective, one which will be directed toward what, in the opinion of Estate and Gift Tax Reform Committee of the American College of Probate Counsel, is much-needed reform. In this connection, however, on behalf of the American College of Probate Counsel, I request that the record may be held open so that if the hearings during the week of March 15 through March 19 disclose specific proposals which we of the American College of Probate Counsel believe require discussion, we wish an opportunity to submit for the record an analysis or reaction to some of the proposals. This presentation to you, however, is made in the light of the special nature of our organization. Attached as Exhibit B to this analysis is a July 1973 analysis "State Inheritance or Estate Taxation of Non-Resident Estates" compiled by H. Bradley Jones, Los Angeles, California, a Fellow of the American College of Probate Counsel, with the assistance of the 50 state representatives throughout the United States.

In connection with the question of estate and gift tax reform, one of the basic issues is the integration or relationship between state inheritance or estate taxation and federal estate and gift taxation. Essentially, we are learning from throughout the country that the lawyers in the several states are finding that many consumers, many beneficiaries of estates, and many fiduciaries are complaining that the probate process and the delays of probate and the costs of probate arise not out of antiquated systems of probate about which much has been heard but rather from the administrative problems caused by the federal estate and gift tax, and the administrative problems caused by state inheritance or estate tax. There is much need for a closer intergovernmental relationship and for leadership from the federal government to persuade states to alter their systems of death taxation to procedures which will, by a simple administrative means, tie into the federal estate tax so that estates do not have two separate, independent and often inconsistent tax returns, two separate tax audits, two separate tax determinations, and two separate crises with respect to the liquidity problems of estates.

Attached as Exhibit C to this letter is a 1970 analysis by Fellow Richard H. Pershan of New York, "Applicability of United States Estate Tax and Gift Tax to Non-resident Aliens," again a subject which is the summary of studies that were made by the American College of Probate Counsel with respect to the practical types of problems that the probate practitioner is discovering throughout the country. In this case there was put together information for all of the 50 states so that those states would have a better idea of what were the situs rules in estate tax conventions with respect to foreign governments.

It is my opinion that the American College of Probate Counsel through its statewide resources and its expertise can be of assistance to the Congress in its deliberations in connection with estate and gift tax reform. As President of the American College of Probate Counsel, I am offering those resources.

In connect with current consideration of estate and gift tax reform, it is not my position at this time to comment upon the social objectives of whether or not there should be a different incidence of tax and an accompanying shifting of wealth or changing tax burdens. However, we have numerous members of the College who are prepared to discuss such social objectives. Neither is it my objective in this particular presentation to discuss such things as the technical problems with a generation-skipping transfer tax or the technical problems with an additional estate tax on appreciation at death or the basis problem if in lieu of some taxation of appreciation at death there is a carryover basis. Again, I am not proposing in this paper to discuss such technical matters, although numerous members of the College have written extensively as lawyers representing committees studying estate and fight tax reform for the American Bar Association or for their state and local bar associations. In other words, our members on a nationwide basis are prepared to submit to the Congress in a very short period of time an analysis of the nationwide impact on a state-by-state basis of any significant tax reform proposal that Congress receives or is seriously considering.

My presentation today will be aimed at giving to Congress our perception of the thrust of the concerns of our clients who are the beneficiaries of estates and who are the fiduciaries who must cope with the tax administration process, both federal and state. Thus, it will be my role to pose to the Congress some relatively basic questions which might best be wrapped up in the concept that it is the belief of our Estate and Gift Tax Reform Committee and of the President of the American College of Probate Counsel, based upon conversations with members and clients, that we have reached a point where there is need for a "Taxpayers Bill of Rights" in the field of estate and gift tax reform. Putting it another way, the American College of Probate Counsel has been one of the leaders in the development of the Uniform Probate Code which has sought to simplify probate procedures and to speed up probate settlement processes and to reduce the costs of the probate settlement process. Notwithstanding those efforts which are achieving respectable success, a persistent obstacle to even more effective probate reform has been the federal estate and gift tax laws and the state inheritance and estate tax and gift tax laws. It is our hope that through the actions of Congress looking toward estate and gift tax reform that it will not only be possible to accomplish what may be the revenue objectives or other objectives of a sound federal estate and gift tax system but that the system will also accomplish a number of the other desirable attributes of a sound tax system. We include among these a contribution toward simplification of probate procedures, a contribution toward speeding up the probate process, a reduction of the cost of the probate process, and a contribution to the simplification and understanding of the estate and gift tax laws as they apply to the citizens of the United States.

A resort to the Socratic technique may be helpful and in that spirit, to point up our concerns, I pose for the committee a series of questions:

1. We presently have a committee of representatives of the 50 states of the United States working on a state-by-state basis preparing an analysis of the economic effect of the state death tax credit. That report will be ready within one month and will be submitted to the House Ways and Means Committee for its consideration in connection with its deliberations. One question that the authors of this report have posed is whether the Congress is willing to reconsider the questions relating to intergovernmental relations. For example, is the federal government, having encouraged states to get into the state death tax field, now prepared to consider abandoning the death tax field to the states (as has been done recently in Canada) and abandoning the gift tax (as has been done recently in Canada), or is the federal government willing to consider as a matter of policy some procedure which may involve the federal government collecting the estate and gift taxes and then paying a subvention back to the states. If that alternative is not available then would a change in the federal credit to the states for the state death tax credit in such a way as to reduce the number of state death tax returns which must be filed be possible? At a minimum, it would be extremely helpful to encourage the states which presently have an inhereitance tax requiring separate complicated calculations to shift to an estate tax in the nature of a "pickup" tax as a percentage of the federal estate tax which will then make for simplification of calculations of the tax and speed up the settlement of estates.

2. How can we simplify the valuation of assets in order to reduce the costs and delays inherent in valuation of assets and the disputes that traditionally arise in the asset valuation process?

3. How can we simplify the determination of the bases of assets if there is going to be an additional estate tax at death or a carryover basis?

4. How can we simplify the taxation of jointly-held property or property held as a tenancy in the entireties in such a way as to eliminate the problems of tracing? Tracing can involve going back for many generations to determine whether the decedent or the survivor has contributed to the acquisition price of property held jointly at the time of death.

5. How can we avoid the serious problem of nonfiling in gift tax returns where people have made taxable gifts or reportable gifts over their lifetime and do not discover that they have gift tax obligations until they consult an attorney who advises them that what they have been doing over the years have constituted taxable gifts?

6. How can we solve the tracing problems in community property states to determine what is separate porperty and what is community property, or is there some way to reduce the problems of proof of title to property for purposes of calculation of death taxes?

7. How can enforcement of the estate and gift tax laws avoid uneven administration of matters subjective in nature or not susceptible of accurate ascertainment, such as contemplation of death motives, valuation of assets, contribution to jointly-held property?

8. How can we conveniently deal with contemplation of death so that we don't have the administrative and litigative problems at the time of death? For example, could we at this time shift from the three-year presumption in IRC Section 2035 to a two-year conclusive presumption in which if a transfer has occurred within two years of the date of death it will be included in the estate of the decedent, and as some offset to the possible adverse effect of that, how do we work out the exemption for small gifts, Christmas or otherwise, prior to death, and what other adjustments should be made to the concept of contemplation of death gifts to achieve administrative simplicity?

9. How can we be more objective on the tracing of the acquisition of jointly-held properties so that the probate process and the settlement of the estate need not be delayed because of the existence of jointly-held properties which may not even be a part of the estate, even though the tracing and the dispute add to the cost of administration?

10. How can we avoid the whipsawing problem between state and federal death tax agencies in which each agency refuses to close its file or settle its case until the other has done so, and where each agency will take its best shot at the estate or taxpayer but hold open the statute of limitations for the purpose of determining whether there can be a higher tax imposed because the other agency imposes a higher valuation with respect to a particular asset

11. How can we reexamine and further the objectives of the 1948 Act adopting the marital deduction which was aimed at equalizing community property states with common law states?

12. How can normal, frequent, and persistent interspousal property transactions be effectively and permanently removed from the estate and gift tax area, particularly for the purpose of more perfectly accomplishing the purpose of the Revenue Act of 1948?

13. How can we reduce the number of tax returns which must be filed by estates of decedents? For example, what is the revenue effect and is it desirable to raise the minimum exemption to $150,000 for an estate since the ravages of inflation have caused a $150,000 estate to be less than the $60,000 exemption in terms of true dollars?

14. How can we solve the problems of delinquent gift tax returns and the avoidance of the implications of tax fraud or penalties where there are innocent violations of the gift tax for filing requirements?

15. Why can't the reform of the estate and gift tax laws set up a law in which compliance is perfunctory, as income tax withholding statements are perfunctory, when someone gets a job and is paid a salary?

16. Why can't we turn the question of estate and gift tax reform into a question of probate reform aimed at benefiting the beneficiaries of estates who look to the system now as one which victimizes them because of the complexity and costs of determination?

17. If a unified tax is adopted, even more emphasis on proper reporting of inter vivos transfers will be required for even enforcement—what techniques for objective and reliable reporting requirements will be present?

18. How can an "actual use by the decedent at death" concept of valuation be effectuated to avoid very heavy liquidity demands in estates with land having potential for other higher uses, but no historical basis for valuation for such higher uses?

19. Could not an "historical use" by a decedent or his ancestors over a long period of time be useful in difficult land valuation matters?

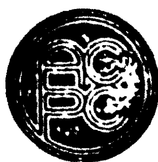
Beyond this series of questions, we believe there is one overriding consideration, central to the thought of a taxpayer's bill of rights I have suggested. We would hope that the estate and gift tax reform process would become an outstanding opportunity to give to the taxpayer as part of his bill of rights a freedom from continually increasing administrative burdens. We do not honestly believe that attempts at theoretically perfect solutions to abstract and infrequent problems or apparent abuses contribute to the objective we are discussing. In our view, the objective can best be attained if the Congress carefully defines its concepts and limits the proposed solutions to the minimum necessary to accomplish its goals. It should avoid the imposition of a "national probate system" (and corresponding national drafting standard) through the tax system.

Thus, in areas such as taxation of capital gains at death, generation-skipping, and the like, Congress could define its result and leave to the client and the practitioner maximum flexibility in planning the client's affairs (*i.e.*, the tax differentials of various approaches should not be so severe as to force clients to adopt methods of disposition which are unnatural under the circumstances). The basic philosophy of such a taxpayer's bill of rights would be to keep the estate and gift tax laws essentially neutral in order to avoid forcing one disposition or another through tax impact or drafting requirements.

I have appreciated the opportunity to present these matters and I request the opportunity to present written replies or analyses to any questions which may be presented to me when I make my appearance Wednesday, March 17.

Yours very truly,

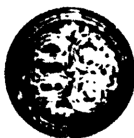
WILLIAM P. CANTWELL,
President.



THE AMERICAN COLLEGE OF PROBATE COUNSEL

Object

The object of the College is to establish and maintain as an integrated group, lawyers skilled and experienced in the preparation of wills and trusts and the probate and administration of the estates of decedents, minors and incompetents; to improve and enhance the standards of probate practice, the administration of justice and the ethics of probate practice of the profession. To accomplish these aims, the purposes of this College shall be, among others: (a) To bring together members of the profession thus qualified and who, by reason of their character, personality and ability, will contribute to the accomplishments, achievements and good fellowship of the College; and (b) To cooperate and consult with the various bar associations of the several states and subdivisions and such other groups and organizations devoted to similar attainments, including governmental agencies.



FOREWORD

The Roster of the College is a list of some seventeen hundred lawyers from every state and several foreign countries. Our charge to ourselves is to admit to fellowship outstanding probate practitioners who have demonstrated exceptional skill and ability.

It would seem, then, that being a Fellow is itself a form of recognition of accomplishment and so most of us view it. Yet, on the opposite page you may read that the association of ourselves into this grouping is only the threshold of our objective. Being associated, we have an obligation. We have adopted as our polar star the object of improving our field of law, across the board. We do so in an honorable tradition, long impressed upon me by these words of the great Elihu Root spoken in 1904:

> "He is a poor-spirited fellow who conceives that he has no duty but to his clients and sets before himself no object but personal success. To be a lawyer working for fees is not to be any the less a citizen whose unbought service is due to his community and his country with his best and constant effort. And the lawyer's profession demands of him something more than the ordinary public service of citizenship. He has a duty to the law. In the cause of peace and order and human rights against all injustice and wrong, he is the advocate of all men, present and to come."

As another year in College history opens, I hope each of our Fellows can respond to the demand for "something more." The opportunities are legion. If we are truthfully persons of exceptional skill and ability, we fit into a natural alliance to improve the law in our field by seizing such opportunities.

William P. Cantwell

William P. Cantwell
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(Revised July 1973)

THE AMERICAN COLLEGE OF PROBATE COUNSEL
10964 W. Pico Boulevard
Los Angeles, California 90064

STATE INHERITANCE OR ESTATE TAXATION OF NON-RESIDENT ESTATES

Real and Tangible Personal Property Owned Solely by a Non-resident Decedent

COMPILED BY

H. BRADLEY JONES

Los Angeles, California

FROM OPINIONS OF FELLOWS OF THE COLLEGE IN ALL FIFTY STATES

THE AMERICAN COLLEGE OF PROBATE COUNSEL
10964 West Pico Boulevard • Los Angeles, California 90064

STATE INHERITANCE OR ESTATE
TAXATION OF NON-RESIDENT ESTATES

REAL AND TANGIBLE PERSONAL PROPERTY OWNED SOLELY BY A NON-RESIDENT DECEDENT

The full value of real and tangible personal property within its borders solely owned by a non-resident decedent is taxed by all the States and the District of Columbia except that New Hampshire does not tax real property passing to a surviving spouse, lineal descendant or parent; New York does not tax estates of non-residents consisting of real property situated and tangible personal property having an actual situs in the state, the gross aggregate value of which is less than $2,000.00, and Nevada has no state inheritance tax of any kind.

REAL and TANGIBLE PERSONAL PROPERTY OWNED BY A NON-RESIDENT DECEDENT AND ANOTHER AS TENANTS BY THE ENTIRETY OR AS JOINT TENANTS

	No.		No.		No.		No.		No.
Alabama	2	Hawaii	13	Massachusetts	3	New Mexico	2	South Dakota	16
Alaska	28	Idaho	5	Michigan	10	New York	2	Tennessee	2
Arizona	5	Illinois	2	Minnesota	2 & 23	North Carolina	12	Texas	18
Arkansas	2	Indiana	4	Mississippi	1	North Dakota	15	Utah	2 & 17
California	2 & 5	Iowa	2	Missouri	10	Ohio	2 & 20	Vermont	2
Colorado	3	Kansas	7	Montana	3 & 11	Oklahoma	2	Virginia	6
Connecticut	11 & 22	Kentucky	25	Nebraska	2	Oregon	19	Washington	15
Delaware	2	Louisiana	8	Nevada	10	Pennsylvania	9	West Virginia	21
District of Columbia	3 & 4	Maine	23	New Hampshire	15	Rhode Island	2	Wisconsin	24
Florida	2	Maryland	9	New Jersey	12	South Carolina	15	Wyoming	14
Georgia	2								

1. Full value taxed.
2. Full value taxed except to the extent that the survivor can establish that he contributed to the consideration for the acquisition of the property. Nebraska makes an exception for that part, amount, or proportion of the property originally owned by the survivor and which the decedent did not pay full consideration.
3. Taxed proportionately according to the number of owners.
4. "Movables" such as automobiles and boats are not taxed; "Non-movables" such as cash, jewelry and furniture are taxed.
5. Tenancies by the entirety are not recognized. Community property passing to the surviving spouse is not taxable. Joint tenancies are taxed to their full value except such part as may be proved by the surviving joint owner or owners to have originally belonged to him or them and never to have belonged to the decedent.
6. Real property owned by the entireties is not taxed unless title was changed from the decedent to title by the entireties in contemplation of death or if one of the tenants by the entirety devised the real property by will to one other than the surviving tenant by the entirety and the surviving tenant does not elect to take by law. Joint tenancies are taxed in full against the surviving joint owners except to the extent that they can establish that the property originally belonged to him or them and had never belonged to the decedent.
7. Tenancies by the entirety are not recognized. Joint tenancies in full except to the extent proven to have been contributed by the survivor.
8. Tenancies by the entirety and joint tenancies are not recognized. Immovable property situated in Louisiana acquired in the name of either of the spouses or in the name of both none the less becomes "community property" and upon the death of either of the non-resident spouses the survivor would own one-half and the decedent's estate one-half.
9. Tenancies by the entirety are not taxed. Joint tenancies are taxed proportionately according to the number of owners.
10. Not taxed.
11. Where joint tenancy is created within three years prior to the death of a grantor without fair consideration, the entire value is taxed to the decedent.
12. Tenancies by the entirety are not taxed. Joint tenancies are not tax exempt but property held in more than one name is taxed in full except to the extent that the survivor can establish he contributed to the consideration for the acquisition of the property.
13. Tenancies by the entirety are taxed as to one-half. Joint tenancies are taxed in full except to the extent that the survivor can establish that he contributed to the consideration for the acquisition of the property. In Hawaii, surviving spouse in either type of tenancy is granted an exemption of one-half, survivor, [illegible], regardless of relationship to decedent, receives exemption to the extent he can establish that he contributed to the cost of acquisition.
14. Property held by husband and wife is not taxed. In Wyoming, the rule applies to both types of tenancies of husband and wife.
15. Tenancies by the entirety are not recognized. Joint tenancies are taxed in full except to the extent that the survivor can establish he contributed to the consideration for the acquisition of the property. In New Hampshire, if survivor is spouse or lineal descendant of father or mother of decedent, property is exempt from tax. In North Dakota, as between spouses, there is a presumption that each spouse contributed equally to acquisition cost.
16. Tenancies by the entirety are not recognized. Joint tenancies are taxed proportionately according to the number of owners except that where property is held in joint tenancy by husband and wife, the accrual to one by the death of the other shall be deemed a transfer taxable at one-half of the value of the whole property and as to joint owners other than a spouse, the accrual of rights shall be deemed a transfer taxable proportionately, except that such beneficiary is not taxed on the part thereof he may prove originally belonged to him or never having belonged to the decedent.
17. Where surviving tenant is either spouse or children of decedent, one-half of the property, but not to exceed $40,000.00 is tax exempt. This provision is in the alternative to the exclusion provided in footnote 2 above, and may not be claimed when any exclusion has been made in favor of such surviving spouse or children under footnote 2. Property received by gift or inheritance by decedent and spouse as tenants by the entirety is taxed as to one-half. Property similarly received by decedent and others as joint tenants is taxed proportionately.
18. Decedent's interest in community property is taxable (even if to surviving spouse); tenancies by the entirety are not recognized; value of decedent's interest in joint tenancy is taxable.
19. Tenancies by the entirety are taxed as to one-half. Joint tenancies, as such, in real property have been abolished; other than holding real property as tenants by the entirety, holding of property in more than one name with rights of survivorship is recognized under some circumstances, in which event the property is taxed in full except to the extent that the survivor can establish he contributed to the consideration for the acquisition of the property.
20. In Ohio, when the surviving joint owner is the surviving spouse, one-half of the total value of the property is taxed.
21. Tenancies by the entirety and joint tenancies, as such, have been abolished, but holding of property in more than one name with right of survivorship is recognized when expressly provided for in the instrument, in which event the property is taxed in full except (a) for first $2,500.00 of bank accounts and shares or savings accounts in Federal Savings and Loan Associations with surviving spouse, descendant or parent (b) for 50% in case of surviving spouse and (c) to extent survivor (including spouse) can establish contribution of consideration for acquisition of the property.
22. Tenancies by the entirety are not recognized. Joint tenancies are taxed proportionately according to the number of owners.
23. Tenancies by the entirety are not recognized in Minnesota.
24. Full value taxed except to the extent that the survivor can establish that he contributed the property or consideration for its acquisition. If acquired by gift, bequest, devise or inheritance by decedent and any other person jointly, the property is taxed proportionately according to the number of owners unless the instrument creating such ownership creates interests in a different proportion. Tenancies by the entirety are not recognized in Wisconsin.
25. Kentucky taxes the full value of real and tangible personal property owned by a non-resident but does so in the case of tangible personal property only if it has acquired a situs in Kentucky and is not taxable elsewhere.
28. Alaska's tax is the proportion of the allowable credit from Federal tax that the gross value of the Alaska property bears to the entire gross estate wherever situate, and gross estate is defined by direct reference to section 2031 (a) of the IRC, with the result that Federal construction rules apply in determining how much, if any, of jointly held assets fall into the gross estate of the decedent.

INTANGIBLE PERSONAL PROPERTY

All States of the United States and the District of Columbia either have laws prohibiting taxation or provide for reciprocal exemption therefrom with respect to intangible personal property not having a business situs within their borders belonging to a person who died a resident of another state of the United States, except:

1. Kansas taxes such intangible personal property if it is not taxed or submitted for taxation in the state of domicile of the decedent.
2. Texas taxes intangible personal property except where (1) state of domicile of decedent does not tax intangibles of residents of Texas or (2) such state has a reciprocity statute.
3. The States of California, Florida, Massachusetts, South Dakota, Utah and Washington tax such intangible personal property when owned by a non-resident of the United States.
4. The District of Columbia taxes intangible personal property when owned by an alien, whether resident or not, of the United States.
5. Mississippi has repealed its reciprocity statute and now taxes intangible personal property of a non-resident (House Bill 265-Regular Session 1956).
6. Colorado's reciprocity statute extends to intangible personal property having an actual or business situs within the State owned by a resident of the United States.
7. Arkansas does not distinguish between tangible and intangible personal property and taxes all property of a non-resident of the state located in Arkansas except if another state exempts Arkansas, in which case the exemption is reciprocal as to the tax on all property.
8. Wisconsin does not tax a non-resident decedent's personal property not having an actual situs in the state if a like exemption in favor of Wisconsin residents is allowed at the time of decedent's death by the state of his residence.
9. Kentucky taxes intangible personal property owned by a non-resident decedent if it has acquired a business situs in the state.

WAIVERS

Waivers for the transfer of stock of a domestic corporation owned by non-resident decedents are required in the following states and application therefor should be addressed as indicated:

Alabama . . . . Commissioner of Revenue
State Department of Revenue
Estate Tax Division
Montgomery, Alabama

Alaska . . . . Department of Revenue
Juneau, Alaska

Arizona . . . . Arizona Estate Tax Commissioner
State Capitol Building
Phoenix, Arizona

California . . . . Inheritance Tax Attorney
State Controller's Office
Sacramento, California

Dist. of Columbia . . . Finance Office
Revenue Division
Inheritance and Estate Tax Section
Municipal Center
Washington, D.C. 20001

Hawaii . . . . Director of Taxation
State of Hawaii
Honolulu, Hawaii

Idaho . . . . State Tax Commission
Inheritance Tax Division
Post Office Box 36
Boise, Idaho 83707

Illinois 2 . . . . Attorney General
160 North La Salle Street
Chicago, Illinois 60601

Indiana . . . . Inheritance Tax Administrator
Department of State Revenue
State Office Building
Indianapolis, Indiana

Kansas . . . . Director of Revenue
State Commission of Revenue and Taxation
Topeka, Kansas

Michigan . . . . State Department of Revenue
Inheritance Tax Division
Lansing, Michigan

Mississippi . . . . State Tax Commissioner
Jackson, Mississippi

New York 4 . . . . . . Department of Taxation
Miscellaneous Tax Bureau
Transfer and Estate Tax Section
Building 8, Campus Site
Albany, New York 12226

New Mexico . . . . . . Bureau of Revenue
Succession Tax Division
Santa Fe, New Mexico

North Carolina . . . . . Commissioner of Revenue
Raleigh, North Carolina

Oklahoma . . . . Estate Tax Division
Capitol Building
Oklahoma City, Oklahoma

Pennsylvania . . . . . . Department of Revenue
Inheritance Tax Division
Harrisburg, Pennsylvania

South Carolina . . . . . Director of Estate Tax Division
South Carolina Tax Commission
Post Office Box 125
Columbia, South Carolina 29202

South Dakota . . . . . . Commissioner of Revenue
Inheritance Tax Division
Pierre, South Dakota

Tennessee . . . . Commissioner of Revenue
926 Capitol Blvd.
Nashville, Tennessee 37219

Texas . . . . State Comptroller of Public Accounts
Austin, Texas

Utah . . . . State Tax Commission
Capitol Building
Salt Lake City, Utah

Washington 5 . . . . . Department of Revenue
Inheritance Tax Division
Olympia, Washington 98504

West Virginia . . . . . . State Tax Commissioner
Capitol Building
Charleston, West Virginia

Wyoming . . . . Inheritance Tax Commissioner
Department of Revenue
2200 Carey Avenue
Cheyenne, Wyoming 82001

Waivers ARE NOT required in the following States: Arkansas, Colorado (1), Connecticut, Delaware, Florida, Georgia, Iowa, Kentucky (7), Louisiana, Maine, Maryland, Massachusetts, Minnesota (3), Missouri (8), Montana, Nebraska, Nevada, New Hampshire, New Jersey, North Dakota, Ohio, Oregon, Rhode Island, Vermont, Virginia, Wisconsin (6)

1. Waivers are NOT required in Colorado UNLESS the stock has a business situs or actual situs in the state.
2. In Illinois, stock of domestic corporation is exempt unless it was "used or employed in carrying on a business in the State of Illinois", affidavit of non-residency, Form 942, can be obtained from the Illinois Attorney General's Chicago office; in 1965 Illinois repealed its general requirements for waivers for transfer of securities, bank accounts and intangible personal property belonging to non-residents.
3. Minnesota no longer requires a waiver for transfers of stock of a Minnesota corporation. However, an affidavit of non-residency on a form obtained from the Commissioner of Taxation, must be filed in duplicate as provided in Minn. Stats 291.19 subd. 5.
4. Waivers are NOT required in New York except where the interest in any one domestic corporation exceeds $2,000 in value under Section 249-p of the New York Tax Law.
5. Washington inheritance tax is imposed only on estates of persons who are not residents of any state or territory of the U.S.A. (this does not necessarily eliminate all administrative requirements of a waiver).
6. Wisconsin DOES require a waiver or "consent to transfer" from the Department of Revenue where the decedent is a resident of a state which does not impose a death tax.
7. Kentucky no longer requires a waiver but an affidavit must be filed with a transfer agent stating that the non-resident decedent had no property subject to Kentucky inheritance and estate tax. The affidavit is filed by the personal representative and a copy is furnished to the Department of Revenue.
8. Missouri requires that the corporation in which the decedent owned stock be provided an affidavit of decedent's non-residency on a form approved by the Attorney General of Missouri, which may be obtained from the Bureau of Inheritance Tax, Department of Revenue, P. O. Box 27, Jefferson City, Missouri 65101

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(Revised January, 1970)

THE AMERICAN COLLEGE OF PROBATE COUNSEL

10964 W. Pico Boulevard

Los Angeles, California 90064

APPLICABILITY OF UNITED STATES ESTATE TAX AND GIFT TAX TO NONRESIDENT ALIENS

Compiled by
Richard H. Pershan, F. A. C. P. C.
New York, New York

ESTATE TAX

Property Subject to Tax

Subject to the death tax conventions summarized in Appendix A, the following property of a nonresident alien has a situs in the United States and therefore is subject to the United States estate tax

1. Real property located in the United States

2. Tangible personal property located in the United States except works of art on loan for exhibition in a public gallery

3. Shares of stock issued by a domestic corporation, regardless of the location of the certificates.

4. Debt obligations, including bonds, issued by a United States person or corporation or by the United States (except currency and, if the decedent was not engaged in business in the United States at the time of his death, obligations issued before March 1, 1941) or a State or political subdivision thereof or the District of Columbia, regardless of the location of any evidence of indebtedness, except items 6, 7 and 8 described below under "Property Not Subject to Tax".

5. If the decedent dies after December 31, 1969, deposits with a United States branch of a foreign corporation if the branch is engaged in commercial banking.

6. Interests in estates or trusts to the extent that they consist of property having a situs in the United States.

Property Not Subject to Tax

The following property of a nonresident alien has a situs outside the United States and therefore is not subject to the United States estate tax

1. Real property located outside the United States

2. Tangible personal property located outside the United States

Property Not Subject to Tax (Continued)

3. Works of art on loan for exhibition in a public gallery in the United States

4. Shares of stock issued by a foreign corporation, regardless of the location of the certificates

5. Amounts received as insurance on the decedent's life.

6. Deposits with a foreign branch of a United States corporation or partnership if the branch is engaged in commercial banking.

7. Debt obligations of a domestic corporation if any interest thereon which the decedent were to receive at the time of his death would be treated, for income tax purposes, as income from sources without the United States.

8. If the decedent dies after November 13, 1966 and before January 1, 1976, deposits with corporations or partnerships carrying on the banking business, deposits or withdrawable accounts with savings and loan associations, and amounts held by an insurance company under an agreement to pay interest thereon, if any interest thereon which the decedent were to receive at the time of his death is, for income tax purposes, not effectively connected with the conduct of a trade or business in which the decedent was engaged within the United States

9. Debt obligations, including bonds, issued by a foreign corporation or government, regardless of the location of any evidence of indebtedness

Miscellaneous Provisions

1. For estate tax purposes nonresident means nondomiciliary

2. The gross estate of a nonresident alien is made up in the same way as the gross estate of a citizen or resident but is confined to property which is

Miscellaneous Provisions (Continued)

situated in the United States. Thus, it can include jointly-owned property, general powers of appointment, revocable trusts, etc.

3. Property of which a nonresident alien made a transfer taxable under Int. Rev. Code §§2035--2038 (transfers in contemplation of death, with retained life estates or taking effect at death, and revocable transfers) is subject to tax if situated in the United States either at the time of transfer or at the decedent's death.

4. The estate of a nonresident alien is allowed an exemption of $30,000 or, in the case of Switzerland and all the countries listed in Appendix A except Canada, Ireland, South Africa and the United Kingdom, the larger of $30,000 or that proportion of $60,000 which the value of the gross estate situated in the United States bears to the entire gross estate wherever situated.

5. Charitable deductions are allowed only for transfers to American beneficiaries.

6. Deductions for funeral and administration expenses, claims against the estate, unpaid mortgages, losses, and death taxes on charitable transfers are allowed only in the proportion which the value of the gross estate situated in the United States bears to the value of the entire gross estate wherever situated. It is immaterial whether the amounts to be deducted were expended or incurred within or without the United States. Where a nonresident alien owns property situated in this country which is security for a debt for which he is liable, the full value of the property, not merely his equity, is taxable, but the debt can be deducted only proportionately. City Bank Farmers' Trust Co. v. Bowers, 68 F. 2d 909 (2d Cir.), cert. denied, 292 U.S. 644 (1934). However, where he is not liable for the debt, only the equity is taxable. Estate of Harcourt Johnstone, 19 T.C. 44 (1952).

7. No marital deduction is allowed to the estate of a nonresident alien except that the convention with France provides for a proportionate deduction.

8. The option to have taxable property valued as of a date or dates subsequent to the decedent's death (alternate valuation) is available to the estate of a nonresident alien.

9. The amount of tax on the taxable estate of a nonresident alien is:

Taxable Estate	Tax
Not over $100,000	5% of the taxable estate
Over $100,000 but not over $500,000	$5,000, plus 10% of excess over $100,000
Over $500,000 but not over $1,000,000	$45,000, plus 15% of excess over $500,000
Over $1,000,000 but not over $2,000,000	$120,000, plus 20% of excess over $1,000,000
Over $2,000,000	$320,000, plus 25% of excess over $2,000,000

10. The credits against the estate tax for (a) state death taxes, (b) the gift tax and (c) the estate tax on prior transfers which are allowed to estates of citizens or residents are equally available to estates of nonresident aliens, except that the maximum credit for state death taxes cannot exceed an amount which bears the same ratio to the credit (computed without regard to this limitation) as the value of the property upon which the state death taxes were paid, and which is includable in the gross estate, bears to the total gross estate for federal estate tax purposes. No credit is allowed for foreign death taxes.

11. A preliminary notice and an estate tax return must be filed if the part of the gross estate situated in the United States exceeds $30,000 on the date of death.

GIFT TAX

Property Subject to Tax

A gift of the following property by a nonresident alien is subject to the United States gift tax:

1. Real property located in the United States.

2. Tangible personal property located in the United States.

Property Not Subject to Tax

A gift of the following property by a nonresident alien is not subject to the United States gift tax:

1. Real property located outside the United States.

2. Tangible personal property located outside the United States.

3. Intangible personal property, wherever located.

Miscellaneous Provisions

1. For gift tax purposes "nonresident" means "nondomiciliary".

2. The $3,000 annual exclusion is available to nonresident aliens, but the $30,000 lifetime exemption is not, except as provided in the conventions with Australia and Japan.

Miscellaneous Provisions (Continued)

3. Charitable deductions are allowed only for gifts to American beneficiaries.

4. Except as provided in the convention with Australia, no marital deduction is allowed to a nonresident alien donor.

5. Gifts to third persons may not be split between husband and wife if either is a nonresident alien.

6. The rate of tax is the same for nonresident aliens and for residents or citizens.

SITUS RULES IN ESTATE TAX CONVENTIONS — APPENDIX A

COUNTRY	ACCOUNT RECEIVABLE	BANK ACCOUNT	BILL OF EXCHANGE AND PROMISSORY NOTE	BOND (CORPORATE)	GOVERNMENT SECURITY	JUDGMENT DEBT	SHIP AND AIRCRAFT
Australia (Gift and Estate Taxes)	Debtor's residence[1]	Location of bank	Debtor's residence	Debtor's residence[1]	Location of government	Where originally obtained[2]	Place of registration
Canada	Debtor's residence	Location of bank	Debtor's residence	Place of incorporation	Physical location of certificate if in bearer form place of registration, if registered	Where recorded	Place of registration
Finland	Debtor's residence	Location of bank	Debtor's residence	Place of incorporation	Debtor's residence	Debtor's residence	Place of registration
France	Decedent's domicile	Decedent's domicile	Drawee's residence[3]	Decedent's domicile	Decedent's domicile	Decedent's domicile	Place of registration
Greece	Decedent's domicile	Decedent's domicile	Drawee's residence[3]	Decedent's domicile	Decedent's domicile	Decedent's domicile	Place of registration
Ireland	Decedent's domicile	Decedent's domicile	Location of document[4]	Decedent's domicile	Decedent's domicile	Where recorded	Place of registration
Italy	Debtor's residence	Debtor's residence	Debtor's residence	Debtor's residence	Debtor's residence	Debtor's residence	Place of registration
Japan (Gift and Estate Taxes)	Debtor's residence	Debtor's residence	Debtor's residence[5]	Debtor's residence[5]	Debtor's residence[5]	Debtor's residence	Place of registration
Norway	Debtor's residence	Location of bank	Location of document	Same as bill of exchange	Same as bill of exchange	Debtor's residence	Place of registration

SITUS RULES IN ESTATE TAX CONVENTIONS

(Continued)

South Africa	U.S. if domiciled in U.S.; S.A. if ordinarily resident in S.A.	Same as account receivable	Location of document[4]	Same as account receivable	Same as account receivable	Where recorded	Place of registration
United Kingdom	Decedent's domicile	Decedent's domicile	Location of document[4]	Decedent's domicile	Decedent's domicile	Where recorded	Place of registration

1 Business debts situated in state where business is located if donor or decedent is domiciled there.
2 No provision in gift tax convention.
3 For negotiable promissory note, the residence of maker.
4 If nonnegotiable, at domicile of decedent.
5 Bonds and other negotiable instruments in bearer form excepted.

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January, 1970

EDITED TESTIMONY OF WILLIAM P. CANTWELL

My name is William Cantwell, and I am the President of The American College of Probate Counsel. The organization is a group of 1700 probate specialists from every state in the United States, and while I perhaps have an ax that I am carrying, I do not believe that it is well-honed, and I am not here for the purpose of applying it.

Our presence before you now is not to enter directly into the fray insofar as favoring or disfavoring any of the many proposals that have been placed before you, but to offer the services of our organization, with representation in each state, to advise your staff as to how any particular proposal would work within the probate system.

It seems an obvious truth to state that within a period from today into the early part of the next century, all American wealth that is capable of being transmitted will, in one way or another, pass through the probate system. Our consistent concern has been that the probate system be one in which the transmission of wealth could occur in an orderly, expeditious, and if you will have it, a reasonably-priced, mechanism. We find, as representatives of the clientele subjected to that system, that the estate and inheritance tax transactions through which probate property must pass tend persistently to dominate the working of that system and, as well, to dominate the form of disposition of property.

We are here to suggest to you three basic things. Those three things are stability, neutrality, and the rights of the probate taxpayer.

By stability I would like to associate myself with all of those comments that Mr. Melvoin made regarding the existing structure for the disposition of wealth in this country. I don't believe there is anything like an accurate count of the number of plans for estates in this country, but I have already suggested that all American wealth, one way or another, must pass through some form of probate or estate planning procedure. I would at least venture that there are outstanding some 20 million American estate plans. I believe they have been developed with a consistent respect for the state of the law since the Revenue Act of 1948, and that any radical change in the legal procedures by which those plans would dispose of wealth would place an impossible burden on the taxpayers and an absolutely unmanageable burden on the professionals expected to deal with amending those plans. I therefore would suggest, and urge, that as far as our group is concerned, dealing intimately and specializing on a day-to-day basis with the transactions through which these persons must dispose of their wealth, that the matter of the stability of the law is indeed an objective of a very high order, and that any sweeping substantive changes in the law without a very long lead time would place American taxpayers at a material disadvantage and could be totally counterproductive to whatever may be the objectives of estate and gift tax reform. It could end up as reform benefiting the professionals while exacting funds and frustration from the public and the treasury.

My second point is neutrality. I too live in an agricultural state, and I find it difficult to disassociate myself from the thought that there should be special legislation for special classes of taxpayers such as farmers and ranchers. I don't believe that there is any problem that I personally deal with that gives me more trouble than the problem of liquidity for agricultural enterprises, and yet I deal with that, and in the planning phase with my clients, I suggest in advance that they too deal with that. I think that all of the history of tax legislation which has attempted to single out particular classes of taxpayers for particular types of treatment has, in turn, ultimately become counterproductive tax legislation, for in attracting wealth into a particular form of activity because of potential tax advantages, I believe it tends to distort the economy. I believe some of the very problems we deal with here this morning with respect to agricultural enterprises have themselves perhaps been created by the attractiveness of agriculture as a form of investment for tax benefits. And therefore, while I personally would feel that the problems of the agricultural enterprise and any other small business enterprise ought properly to be dealt with, I would hope that they could be dealt with in a totally neutral form so that the tax laws neither force nor encourage any particular form of business enterprise or business activity simply because of the structure of those laws. And that is the meaning of my thought with respect to neutrality.

With respect to the matter of stability, *why* are we here concerned with estate and gift tax reform? Concededly there may be some inequities, and perhaps the agricultural problem is an inequity. However, I would suggest to you that through borrowing devices, through postponement devices, through expansion of 6161

and 6166, that the problem could probably be dealt with well. It could be aided by new valuation techniques which are different from those applied today. As to other inequities, I do not find in my practice that the administrative difficulties in administering a tax we have lived with for a long period of time are themselves unlivable. I am certainly disturbed, and I would hope that perhaps there is reform required in the matter of noncompliance in gift tax filing and meeting gift tax obligations. I am concerned that the original objectives of the 1948 Act have not been satisfactorily achieved, and that perhaps reform is necessary to accomplish this. But these conceded yet minimal areas need to be placed on a scale of values opposite my position urging stability in the disposition of the affairs of American taxpayers representing the results of a thrifty lifetime. To me the scale tips very, very heavily against any broad brush changes which would require revision of millions of estate plans, possibly accompanied by non-revenue-producing complexities of a sort which the legal profession is not equipped to meet. Our particular clients, our probate clients, are clients who are examples of the classic thrift and self-support concept of the American economy. We believe that they, certainly as much as any special class of taxpayers, have a series of rights. In my prepared paper I have suggested to you a series of areas in which we believe our probate clients do have rights and substantial concerns.

As a first in this series of questions, we are concerned that any reform your Committee might propose to the Congress should address problems of the relationship between your tax and the state inheritance tax. This question extends to the necessity for filing two tax returns, often on an inconsistent basis, which can subject taxpayers to a whipsawing relationship between the two taxing entities involved.

We are next particularly concerned with the overall valuation problem. We would suggest to you that the valuation technique used on agricultural and other real estate, as well as closely-held businesses, could stand great attention from this Committee, and might in itself go a very long way to take care of the agricultural and other small business concerns with which you are dealing. Valuation is really the genesis of the problem, and liquidity requited by valuations which are vastly inflated because of forces beyond the control of the taxpayers appear at the heart of the nature of the agricultural and the small business problem.

Another of our concerns would arise if this Committee should propose a unified tax. Where would taxpayers stand with respect to the basic problems and the horrendous administrative difficulties created by any form of carry-over basis? We are equally concerned that if a unified tax should be enacted that the existing noncompliance with the gift tax statute would be accentuated. Picture, for example, the difficulties that would ensue in attempting to make a lifetime catalog of a giving program in order to do justice under a unified tax.

In another area we are hopeful that if there should be reform, that the extremely difficult problems of joint tenancy tracing might, in some manner or another, be erased from the law by simply allowing joint tenancy to be taxed on an objective basis.

We are very deeply concerned with noncompliance with the existing gift tax statutes overall, in the joint tenancy area, and in other areas as well. There simply exists no objective technique, such as the withholding tax, to heal with joint tenancy under the existing statute, and we think a bill of rights for taxpayers, for our type of taxpayers, should protect the filing taxpayer, the compliant taxpayer, from the reduction of revenue from the noncompliant taxpayer, particularly in the gift tax area where there doesn't seem to be any particular good policing mechanism.

We would suggest that any legislation that might come forward would be legislation aimed at an ease of compliance rather than a complexity of compliance.

We would hope eventually that the federal government and the state governments might seek a method by which a single return rather than a two-return system could operate.

We would hope that the liquidity problems might be dealt with by a much more objective work-out of § 6166 and § 6161 so that the administrative intervention of enforcement personnel does not prevent the intent of those statutes.

On an ultimate basis then, what our organization, concerned with the probate clients of this country, would seek would be a recognition that just as in 1948 there was a series of abuses by virtue of the difference between community and common law states, that now there is a series of problems that need to be dealt with.

The 1976 problems seem to center around the question of inflation, the interrelated question of liquidity based on inflation, and the objective of maintaining

the potential for the small enterpsie. We should think that the time has arrived for some form of taxpayerw' bill of rights—a new version of the Revenue Act of 1948 to redress current inequities as that Act was aimed at the 1948 problems. The 1976 statute would seek to deal with the inflation, liquidity, and small business enterprise objectives.

We would hope that any legislation might carry out the thoughts that I have tried to suggest to you. First, that there be *neutrality*—in other words, that the tax statutes not dictate any more than is absolutely essential the form of a family transaction. Secondly, that you seek *stability*. That would regard as significant the tremendous investment of time, energy and personal anguish involved in those 20 million wills that are sitting waiting to be probated in lawyers' offices, and that you consider simplicity as an ultimate objective. More and more, complexity for taxpayers is becoming a factor in their attitude toward the working of their government. We seek help in making the probate procedure an expeditious procedure and not a procedure in which delays and difficulties are based on the federal tax system rather than on the local probate system, or on the delinquency of individual lawyers, which we are as opposed to as anyone.

Our offer to you is that we would like to help you determine how, in a probate sense, any proposals you ultimately adopt would work, and we offer our services for that purpose.

I have a written statement, and I would ask that it be entered into the record, and I appreciate very much the opportunity to testify.

SUPPLEMENTAL SUBMISSION OF THE AMERICAN COLLEGE OF PROBATE COUNSEL

This statement supplements the March 12, 1976, written statement, submitted in letter form, together with the oral testimony given March 17, 1976, by William P. Cantwell, Esq., President of The American College of Probate Counsel. This statement has been prepared by a duly constituted committee [1] of the College and is being made under the direction of its President (Mr. Cantwell) and President-Elect (J. Nicholas Shriver, Esq.). Following introductory points on the general philosophy of this committee with respect to estate and gift tax reform, the statement makes some suggestions for improving the operation of the estate and gift tax system.

A. PHILOSOPHICAL GUIDELINES

This history of the Federal estate and gift tax system and many of the observations which have been made during the course of the current hearings, show that there is little consensus as to whether the purpose of the system is to break up large accumulations of wealth or to raise revenue. As a practical matter, the foundation of the system probably rests upon a combination of these purposes. However, these purposes, and the efficiency of the system in achieving them, can not be the only criteria to be applied in judging the system. Other significant criteria include the *stability* of the system under which estates can be planned in reliance that major changes in the law will not render the plan useless (or worse) by the time the property owner dies; the *understandability* of the system, at least to the average attorney, so that it can be dealt with competently in carrying out the client's wishes (while an equitable system is desirable, it is not always possible to develop a simple and understandable tax structure that is equitable—striving for equity often results in complexity, creating problems of understandability to property owners and their attorneys); the *neutrality* of the system, so that actions need not be distorted to achieve tax objectives; and the *certainty* of the system (a corollary of both understandability and neutrality), a principle recognised by the Congress in keeping the Federal estate and gift laws basically unchanged since the martial deduction was brought in by the Revenue Act of 1948 and the present method of taxing powers of appointment was adopted in 1951.

Achieving certainty of application of the estate and gift tax laws sometimes runs counter to obtaining complete equity since, in striving for the latter, uncertainty is all too often created. (A key illustration of this is what happened to the provisions taxing accumulation trusts during the enactment of the Tax Reform Act of 1969.) This is more important from the standpoint of the property owner than from that of his lawyer, since uncertainty in the application of the tax laws creates additional costs for the property owner and increases his lawyer's fees. Another desirable principle is that the laws apply uniformly to similarly

[1] The committee members are listed on the last page of this statement.

situated taxpayers. However, it is not always possible to achieve these results without losing other objectives. For example, an unlimited marital deduction (or even the present fifty percent marital deduction) penalizes people who die unmarried and an argument could be made that one's marital status at death should not determine the amount of the federal estate tax; on the other hand, the elimination of the marital deduction would bring back the inequities that existed between the eight community property states and the rest of the country prior to the Revenue Act of 1948, and run counter to the social policy of easing the impact on surviving spouses of the estate tax on the estate of the first to die.

The rights of the taxpayer must also be considered in any tax system. The taxpayer (in the case of the Federal estate tax, it is the decedent's estate), if insufficiently liquid, will find that the payment of the federal estate tax imposes a great hardship, sometimes forcing the sale of family farms, ranches or small businesses or the loss of the family residence. Easing the burden of the tax where an estate's assets are relatively illiquid is an extension of the ability to pay principle since, in an illiquid situation, there is inadequate ability to pay the tax without forced sales.

Last, but not least, taxpayers should have the right to expect an efficient system of tax collection. In most cases, this should lead to the earlier closing of estates, while providing for extensions in those situations involving lack of liquidity or other hardships.

B. LIQUIDITY PROBLEMS

One of the most important problems in the Federal estate tax area involves the illiquid estate, whether it be illiquid because its principal asset is the family farm, a closely-held business or some other asset, the forced sale of which would cause considerable hardship. Many proposals have been made to deal with this problem of liquidity by giving special treatment to certain types of assets, such as farms, ranches, open space or historical sites.

We reject this approach because it violates the criteria of neutrality, uniformity and equity. It could readily lead to the creation of new estate tax shelters, while failing to cope with the problems of most illiquid estates, regardless of their assets. Instead of special treatment for certain types of assets, we recommend other changes. These are designed to relieve the hardship faced by all estates by establishing rules that set more liberal, objective standards for the grants of extensions for payment of Federal estate taxes.

1. Broaden definitions of closely-held businesses eligible for deferred payment of estate tax

(a) Section 6166 permits ten-year installment payments of estate taxes attributable to a closely-held business for up to ten years (if the value of the business exceeds either 35% of the gross estate or 50% of the taxable estate) and, broadly speaking, defines a closely-held business as one in which 20% of the value of the business is in the decedent's estate or in which there are 10 or fewer partners or shareholders. We propose that the definition of an interest in a closely-held business be broadened to deal with situations in which an estate may be unable to pay the tax because its assets consist substantially of an interest in an unliquid business which does not meet the present tests.

We propose broadening the Section 6166 definition of a closely-held business to include a business 20% or more of the value of which (or of the voting stock of which) was owned either actually *or constructively* by the decedent, or the stock of which was not traded on an exchange or in the over-the-counter market. This would expand the definition of closely-held business to cover nearly all cases where the shares of a corporation may not be readily sold at their approximate fair market value.

Constructive ownership rules attributing to the estate stock owned by siblings, descendants and ancestors (and spouses) should be applied. These would extend the Section 6166 treatment to those situations where the estate owns less than 20% of the business but, for practical purposes, the estate is no more liquid than if it owned more. This is because diffusion of ownership among family members is unlikely by itself to result in dimunition of the liquidity problem, particularly because of the difficulty in selling a minority interest in a closely-held business to an unrelated third party where other important shareholders are members of a single family.

The alternative definition of a closely-held *corporation*—that it have ten or less shareholders—should be replaced by a test as to whether or not the stock is traded

on a securities exchange or in the over-the-counter market, since this really deals with whether the estate is in a position to liquidate its shares, regardless of the number of stockholders.

(b) Another serious problem for the illiquid estate for which a deferral has been obtained may arise because a withdrawal from or a disposition of the interest in the business can, under certain circumstances, cause acceleration of the remaining installments of the estate tax, without providing the estate with sufficient liquid assets with which to pay it.

Section 6166(h)(1)(A) provides in substance that, if withdrawals from the closely-held business equal or exceed 50% of the value of such business, or 50% or more of the closely-held business is sold or exchanged, the payment of the remaining Federal estate tax is accelerated.

There appears to be no justification for an acceleration of the Federal estate tax regardless of the percentage of the closely-held business which is either withdrawn or sold, so long as the withdrawal or sales proceeds are applied substantially to pay the remaining estate tax due, and, in fact, the statute provides for exceptions in the case of a sale or exchange, where the proceeds are used entirely for the payment or Federal estate tax. But not all of the proceeds should have to be applied against the Federal estate tax to prevent an acceleration of estate tax payments. Some of these proceeds will be needed to pay state death taxes (or other debts) which fall due during the ten-year period of the Section 6166 estate tax installments.

If Section 6166 required all of the withdrawn funds or sales proceeds to be applied to the Federal estate tax, the executor who used such funds or such proceeds to pay state death taxes would then have to borrow an equal amount of funds to apply on the Federal estate tax at the next installment due date. This hardly helps to alleviate the monetary problems of the illiquid estate. We would recommend that the exception to acceleration apply if at least half of the proceeds are applied against the Federal estate tax.

A similar problems arises under Section 6166(h)(l)(B). This makes an exception from the general acceleration provision where there is a distribution in redemption of stock under Section 303. The last paragraph of subparagraph (B) provides that this exception will only apply if an amount of the estate tax not less than the redemption distribution is applied on the next installment of the Federal estate tax. This requirement that the entire distribution be applied against the Federal estate tax causes the same liquidity problem noted above, namely, that where a distribution is necessary to pay the state death taxes or other pressing debts, it is then necessary for the executor to thereafter borrow the same amount of funds to apply against the Federal estate tax, thereby compounding his illiquidity problems. Again we recommend that only a portion of the redemption distribution, such as half of it, be required to be paid on the Federal estate tax at the time the next installment is due.

We also recommend defining a "disposition" under Section 6166(h)(1)(A)(ii) and a "distribution" under subparagraph (B) so that, when notes are received in exchange for the corporate stock, the "disposition" or "distribution" would be deemed to occur only when payments are made on the notes or the notes are pledged for a loan.

2. Set objective standards for reasonable cause for deferring payment of tax, and extend the period to five years

In addition to providing for more liberal relief through permitting installment payment of estate tax over a period of years to be available to a broader class of closely-held businesses, we believe that the twelve-month extension under Section 6161(a)(1) (permitted whenever a fiduciary can show reasonable cause for his inability to pay the estate tax when due) should be available on an objective basis, rather than giving the Internal Revenue Service discretion to grant this privilege only if an examination of all the facts and circumstances discloses that a request for an extension of up to a year is based upon reasonable cause. We also believe that this extension should be for up to five years.

The Senate Finance Committee Report to the Excise, Estate and Gift Tax Adjustment Act of 1970, gives six examples of cases in which there would be reasonable cause for an extension:

The first example involves situations where farms or closely-held businesses comprise a significant portion of an estate, but not enough to satisfy the percentage requirements for obtaining a Section 6166(a) extension. Although these interests could be sold to unrelated persons for their fair market value to obtain funds to pay the estate tax, the executor could raise the funds from other sources if he had more time.

The second example deals with an estate of sufficient liquid assets to pay the tax when otherwise due, where the assets were located in several jurisdictions and not immediately subject to control of the executor, so he cannot readily marshall them.

The third example is of an estate a substantial part of whose assets consists of rights to future payments (annuities, copyright royalties, contingent fees or accounts receivable), where there is insufficient cash with which to pay the estate tax when otherwise due and a loan cannot be obtained, except upon terms inflicting loss upon the estate.

In the fourth example, the estate includes a claim to substantial assets which cannot be collected without litigation, so that the size of the gross estate is unascertainable as of the time the tax is otherwise due.

The fifth example deals with assets which must be liquidated at a sacrifice or in a depressed market, to pay the estate tax when otherwise due.

In the sixth example, the estate has insufficient funds (without borrowing at a higher rate of interest than that generally available) to pay the entire estate tax when otherwise due, provide a reasonable allowance for the family during the remaining period of administration and satisfy claims against the estate. The executor has made a reasonable effort to convert assets in his possession to cash (other than an interest in a closely-held business to which Section 6166 applies).

In all six of these cases, we recommend that an extension of time to pay the tax for up to five years be automatically granted upon representation of the existence of the problem in a sworn affidavit from the executor. This would still leave to the discretion of the Internal Revenue Service other cases where an examination of the facts and circumstances discloses that a request for an extension for up to five years (presently twelve months) is reasonable. However, in these other cases, the Code should require the Commissioner to grant such an extension unless he determines that there is reasonable cause not to grant one. Should it later become apparent that the taxpayer submitted false or insufficient information, existing civil and criminal penalties are adequate.

The liberalization in 1970 did not extend to the discretion given the Internal Revenue Service to extend for up to ten years the time for payment of any part of the estate tax in cases of undue hardship under Section 6161(a)(2). Such an extension may be granted only for a year at a time and requires more than a general statement of hardship or showing of reasonable cause to obtain it. Undue hardship means more than inconvenience. It means sale at a sacrifice price or in a severely depressed market or the disposition of an interest in a family business to unrelated persons, even though it could be sold at a price equal to its current fair market value of these people.

As pointed out above, we recommend that the time period for an extension of the estate tax payment for reasonable cause, under the criteria of Section 6161 (a)(1), be extended from twelve months to five years and that, thereafter, the undue hardship criteria of Section 6161(a)(2) be used for further extensions.

3. Lengthen the maximum extensions to 20 years

The present maximum period for obtaining extensions of time to pay estate tax under Sections 6161 and 6166 is ten years, but an extension under Section 6166 must be elected at the time the return is filed. We recommend that this election also be available if a deficiency is assessed and, furthermore, that installment payments of the tax under the conditions described in both Sections 6161 and 6166 be permitted for up to twenty years.

4. Reduce interest rate on extensions to two-thirds of that on deficiencies

Finally, we propose that in all cases where the payment of the estate tax is to be deferred under Sections 6161, 6163 (dealing with extensions for the payment of estate tax attributable to a future interest), 6166 and the new extension provisions advocated by us, the interest be reduced to two-thirds of the rate currently charged on deficiencies. For many years, until 1975, interest was imposed at only a 4% rate on extensions of time for undue hardship (Section 6161(a)(2)), because of a future interest (Section 6163), or where there was a closely-held business in the estate (Section 6166), although the regular six percent interest rate applied to twelve-month extensions under Section 6161(a)(1).

Effective June 30, 1975, the preferential rate of interest was abolished at the same time that interest rates were raised to 9% (now 7%, at least until February 1, 1978). The Senate Finance Committee explanation of the change that eliminated the preferential interest rate overlooked that estates holding closely-held businesses and other illiquid assets must not only earn profits to pay the interest

charge, but also to pay the unpaid installments of estate tax. We merely seek to further the purposes of the extension provisions as originally enacted and the liberalizations as proposed by us, by reinstating a preferential interest rate which would rise and fall in proportion to the current rate of interest for income tax purposes.

We believe that the adoption of the above proposals would go a long way to solve most liquidity problems experienced by estates. From the standpoint of sound tax policy, the uniform application of these provisions, regardless of the nature of the illiquid assets, would further the objectives of neutrality, equity, and uniformity of application of the estate tax laws, as well as providing certainty that relief would be available in most cases.

5. Create a new alternative valuation concept for hard to value assets

Great difficulties are created for estates holding hard to value assets and for the Internal Revenue Service in dealing with these assets. Current rules require appraisals, which can be expensive, can result in expensive and time consuming controversies with the Internal Revenue Service, and may result in unfairness to one side or the other when assets are sold within a reasonable period after death. Therefore, although we favor retention of the six-month alternative valuation date, we recommend that where an estate holds assets described in Section 6161(a)(1) or 6166, or real estate or tangible personal property (other than property which depreciates in value due to lapse of time or normal use—such as the family car) at the time of filing of the return, the executor should be permitted to elect a deferred alternate valuation date for such property (separate from the normal election as to valuation dates) that would permit the valuation of these assets to be postponed for a period of up to three years following the date of the filing of the return, with valuation to be fixed by actual sale or, if none, by appraisal at the end of the period. Needless to say, unless otherwise deferrable, the Federal estate tax attributable to these illiquid assets should be paid on an estimated basis and the statute of limitations as applied to questions affecting these assets tolled.

C. INTERSPOUSAL TRANSFERS

The problem of inter vivos and death-time interspousal transfers is one that has produced a number of proposals to make changes in the marital deduction. We are concerned that some of the more far-reaching ones which would provide for the unlimited marital deduction, making all interspousal transfers tax-free, would create both an unacceptably high revenue loss (at least in the near term) and run counter to the objective of having a stable tax system. The two most serious problems in this area are the artificiality of the legal presumptions involving joint tenancy, particularly between spouses, and the tax pressures to distort a client's natural desire in making appropriate dispositions for a spouse and children. This is particularly serious where the client wants to be sure that his or her children, and not a second set of children the surviving spouse may have on remarriage (or even the surviving spouse's new marriage partner) share in the estate. Such pressure exist even more strongly in second marriages where there are children from a first marriage.

1. Inter vivos transfers of joint and community property

We propose retention of the 50% marital deduction in general, but advocate a major change involving inter vivos interspousal transfers. The gift tax marital deduction, unlike the estate tax deduction, does not permit a 100% deduction for up to 50% of the estate. The gift taxpayer gets a deduction for 50% of the actual amount given to his spouse. This requires the filing of returns for relatively small gifts, a requirement that is frequently ignored, leading to disrespect for the law on the part of many people and imposing onerous filing and payment requirements on the conscientious and well-advised taxpayers.

We believe that the same policies that led to adoption of the Section 2515 exemption from a gift tax of the creation of a tenancy by the entirety or a joint tenancy with right of survivorship between husband and wife in real estate (in the absence of an election) should be expanded to many other interspousal transfers made inter vivos. Section 2515 should be extended so that all transfers into joint ownership, including community property transfers, by either spouse, regardless of the source of the funds, would be treated as exempt unless the spouses elected to have them treated as completed transfers. Thus, the umbrella of Section 2515, now limited to real estate, should be extended to stocks, bonds, savings accounts and all other types of property. Even tenancies in common should fall into this

shelter, since the tendency of people in creating all of these joint interests is to give half of an aggregate amount, so that such a rule would really rather closely parallel the present policy on joint tenancy.

Under existing provisions of Section 2515, termination of a real estate joint tenancy between spouses or a real estate tenancy by the entireties may or may not result in a gift, depending on the ratio of original contributions and the property interests acquired. This is frequently the occasion for an inadvertent gift. Extension of Section 2515 to all types of property, without any attention to the inadvertent gift problem, would exacerbate the existing problems of noncompliance in this area. As an inducement to taxpayer awareness and compliance, a new type of taxpayer election in this area is suggested below.

Unawareness is the real reason that many transfers into interspousal co-ownership form are not coupled with elections to treat the transfer to the noncontributing spouse as a gift. Existing Section 2515 requirements requiring the election to be made on a timely return operate as a trap, for when the couple finally becomes aware of the possibility that the transfer might have been a gift, it is almost always too late for a timely return. To constitute the noncontributing spouse as an owner then would require a gift of the entire one-half interest. Appreciation and inflation aggravate the problem since current fair market value would be involved in a transfer at termination of the joint interest. If that value is higher, and if the termination would involve a transfer of an asset acquired by gradual payments over a period of time, the gift tax consequences can be very severe.

As an example, consider a house bought with a purchase price of $50,000 and a $10,000 down payment. Mortgage payments in annual increments are made. Had elections been made on timely gift tax returns to treat the downpayment and annual mortgage payments as gifts, little if any gift tax would be paid. On the other hand, if the elections are not made and if a severance is effected on a sale with each spouse receiving one-half of the proceeds and the appreciated value is $150,000, the consequence is a $75,000 gift (subject to the gift tax marital deduction) by the contributing spouse to the noncontributing spouse. This can be very disadvantageous in many situations.

A relatively simple statutory change to permit the election to be made on a return, whether timely or not, would relieve the situation. It is particularly pertinent if the suggested Section 2515 change is made, for nonrealty transfers are virtually handled in this fashion now. Acquisition of a security in joint form under existing law involves a gift. The tax now remains due, based on fair market value at acquisition, under today's law, and can and should be paid on a return, whether timely or not. The taxable event was acquisition, and not anything subsequent. What is being urged here for an expanded Section 2515 is that acquisition *remain* the taxable event, with the election available to treat the transfer as a gift at *any time* after acquisition. In essence, the question of gift or no gift would remain open until the spouses close the transaction, but, when it is closed, the closure would relate back to acquisition cost and would not require a fair market value transfer at the date of closure.

2. Joint property at death

Section 2040 should be amended so that at death only half of the property held in any form of joint ownership would be taxed in the estate of each spouse, without tracing. But any property held in joint ownership for which no gift tax has been paid at creation should be removed from the adjusted gross estate in figuring the base on which the maximum marital deduction (50% of the Adjusted Gross Estate) is computed at death. This is the present approach to community property.

3. Extension of the credit for prior transfers

If the donee-spouse dies first, half of the property will be included in her or his estate, and the entire property will subsequently be included in the donor-spouse's estate. This is a problem that generally exists where gifts are made to a spouse. It can be alleviated by an extension of the existing credit for property previously taxed in the estate of one spouse, with the elimination of the present ten-year limit and the 20% credit decrease that occurs every two years. This specially extended credit rule for property previously taxed in interspousal transfers would permit a 100% undiminished credit, regardless of the number of years between the deaths of the spouses.

The unfortunate whipsaw consequences of the same property being included in the estates of two decedents (usually spouses) could be solved by extending the mitigation of the statute of limitations provisions in Sections 1311 through 1315

into the estate tax area. These provisions deal with inconsistent income tax determinations that either give the government or the taxpayer an unfair advantage which cannot be rectified because of the running of the statute of limitations. The provisions permit the reopening of the statute of limitations under certain conditions in the interest of fairness. However, they are quite complex and the extension of them to the federal estate tax will add further complexity to them. We believe that the same objective can be accomplished through the use of the above-described 100% credit for tax on prior transfers between spouses.

4. Qualitative expansion of the marital deduction and elimination of the terminable interest rule

With respect to the qualitative aspects of the marital deduction, we favor qualifying for the marital deduction any full income interest passing to the surviving spouse, regardless of whether there is a general power of appointment accompanying it. Thus, deductibility would be given in the first estate, provided that the interest is to be included in the second one. Furthermore, the surviving spouse should be allowed either to accept or reject the marital deduction tax result in the qualifying limited interest situation, such as where he or she receives only a life estate. Thus, in effect, the surviving spouse would have an option to prepay the death taxes when there is a straight life estate, but still receive the life estate.

In essence, the Section 2056 terminable interest rule would be abolished in the interest of simplicity, to make it easier for the nonspecialist to avoid problems and to avoid the whipsaw effect of the inconsistency involved in requiring inclusion in the survivor's estate in situations where the marital deduction is not always available in the estate of the first spouse. This is illustrated by cases involving overly broad powers to allocate between principal and income or to retain unproductive assets, so that not all the income requirements for a marital deduction power of appointment trust are met and cases where the power of appointment does not qualify as a general power of appointment under Section 2056 but nonetheless falls within the Section 2041 definition of a general power of appointment. Another example of cases which would be ameliorated by this change are those where there is disallowance of the deduction in the first estate because of a requirement of survivorship running beyond the allowable six-month period which actually is satisfied so that the property does in fact pass to the surviving spouse and is taxed in the second estate.

Perhaps the worst aspect of the present requirements is the compulsion they place upon a property owner. He must do something with his property that he might not otherwise wish to do. While he may be perfectly willing to provide for his spouse, he may not want to do this in a way that allows that spouse to divert the property from his children after his death. These fears may involve a fear of the surviving spouse's remarriage or where a donor has a family by a predeceased first spouse and then remarries, fear that the second spouse will not make the adequate provision for the children of the first marriage. To mitigage this situation, we propose amendments to Section 2056 that would permit a limited interest to qualify for the marital deduction.

If the decedent's spouse leaves the surviving spouse an interest which will cause the property to be includible in the survivor's estate upon death, that fact alone ought to be sufficient for a qualifying gift. If the survivor accepts broad benefits, such as a general power of appointment or outright ownership of the property, then of course the first estate is allowed a deduction, because the survivor has that quantum of ownership which requires estate taxation when he or she later dies. That rather parallels the present marital deduction, except that it substitutes for the technical terminable interest rules a basic rule which simply and directly states that the interest qualifies if the surviving spouse takes such an interest as would cause inclusion in the surviving spouse's estate if retained until death (which, of course, also means that, if the survivor disposes of it before death, it is subject to the gift tax).

A further recommendation is that the spouse dying first should be able to tender to the second spouse a terminable interest which qualifies, if the first spouse to die declares a desire to have that interest qualify. Thus, in the classic case of a life estate for the wife, with remainder over to whomever her husband directs, if the widow accepts this tender, it should be deductible in her husband's estate and her acceptance of it as a marital deduction gift will constitute a stipulation that it will be includible in her estate when she later dies. Unless her husband expressly conditions this bequest on her acceptance of it as a marital deduction bequest, however, she could take the property rights but decline the tax consequences through post mortem planning, and prepay the tax by declining to take it as a

marital deduction gift. She could still have the right to the income (she need not forfeit her rights under the will) but she only declines to take it as a marital deduction gift.

Protection of the husband's other beneficiaries is important in such a situation. This could be accomplished by having the additional tax caused by this unanticipated enlargement of his taxable estate borne specifically by the assets which caused that enlargement, that is, the assets tendered but rejected for the marital deduction. Of course, the husband may include an apportionment clause to the contrary, but Sections similar to the tax apportionment for life insurance under 2206 and powers of appointment under 2207 should be put in the Code to deal with the unplanned situations.

These proposed changes should not cause a significant loss of revenue, but would give much more flexibility to estate planning, particularly at the post mortem stage; the election could actually result in particular cases in revenue advantages because of the prepayment of taxes that would otherwise not be due until the wife's death. This election, however, would most likely be used in cases where it would be advantageous from a rate viewpoint. In any event, where it does reduce the tax, it does so by removing an inequity rather than creating one.

D. RAISE THE EXEMPTION TO $100,000 AND CHANGE IT TO A CREDIT

Another problem that is receiving considerable attention lately is the debate over whether the federal estate tax exemption should be increased, in view of inflation. We are concerned over the estimated $2 billion revenue loss that an increase in exemption to $150,000 would appear to create. We believe that many of the problems caused by inflation pushing far more people into the federal estate tax brackets will be solved by adoption of the liquidity proposals we have previously made. We also recognize that some allowance must be made for inflation, that complete relief from the estate tax and the filing requirements is desirable in smaller estates. However, we believe the revenue impact of this relief must be held down by changing the exemption to a credit.

We also recognize that if there is a material increase in the estate tax exemption, questions of fundamental social reform, rather than narrow tax reform, are raised because, if a tremendous tax loss results from exempting so many modest-sized estates that are now subject to tax, it may be necessary to make up that difference by accelerating rates (if the estate tax is to continue to produce the same amount of revenue) and, inevitably, even without a conscious and independent policy decision, a rate structure might then be adopted which would tend to break up even moderate concentrations of wealth and deter needed capital formation. This is not the sort of result that should be reached as an incidental part of estate tax revision, but, to some extent, it would be a by-product of raising the exemption (unless the exemption can be raised in the context of other revenue increases).

It would be most desirable to exempt the many estates which involve only modest amounts of wealth being passed to a spouse or children where both planning and administration are now complicated and little revenue is produced. Accordingly, to the extent consistent with revenue considerations, we recommend that many estates be exempted from the Federal estate tax where neither the returns nor the administration and planning are worth the effort. We suggest that this be accomplished by means of a credit, rather than an exemption. This credit could be used, in effect, to increase the $60,000 exemption to $100,000 by taking the amounts from the bottom rather than the top (eliminating tax on the small estates, but giving the relief in the large estates at the bottom, rather than at the top rate).

We propose that in lieu of the present $60,000 exemption ($120,000 for transfers qualifying for the marital deduction), a credit against the tax due on the first $100,000 of taxable estate ($200,000 in the case of transfers qualifying for the marital deduction) be permitted. This credit should be designed so that gross estates of $100,000 or less need not file returns. This latter point is of the utmost urgency, since if it is not done, the change will cause further unnecessary complications and costs in the administration of small estates.

E. VALUATION

Turning to the question of valuation of assets, wherever there are closely-held business interests or hard to value tangibles, estates are put to a considerable amount of additional expense and both the estate and the government spend

quite a bit of time and money in valuation proceedings. We believe that the settlement of estates could be facilitated by improvement of the present valuation methods. For example, Section 2031 presently requires that unlisted and untraded securities have their values determined by considering, along with all other factors, the value of securities of corporations engaged in similar lines of businesses which are listed on an exchange. The limitation of this comparison to corporations whose securities are listed on an exchange is a technical defect in the law. Accordingly, Section 2031 should be amended to permit comparisons with the securities of other corporations engaged in the same or a similar line of business, regardless of whether their securities are listed on an exchange.

Under Regulations promulgated pursuant to Section 2031, tangible personal property is valued at the price at which an item or comparable item could be obtained in the retail market. Thus, replacement value is the criterion for valuation rather than the price obtainable in the market or markets available for the holder of the property being valued. This approach of the Service was rejected by the United States Supreme Court in the *Cartwright* case, decided in 1973, which involved the valuation of shares of an open-end mutual fund. The price obtainable by the executor or donor in whatever markets are available to him is a fairer measure of value.

Accordingly, we recommend amendment of Sections 2031 and 2512 (gift tax) to provide that tangible personal property be valued for estate and gift tax purposes at the price obtainable by the executor or donor in the market or markets available to him. If this proposal is coupled with the previously made one permitting an election of a delayed valuation date for hard to value assets, many of the valuation disputes that now occur would be avoided and the large expense incurred by estates possessing closely-held businesses in obtaining appraisals of them for tax purposes could also be reduced, if not entirely eliminated in a large number of cases.

F. GIFT TAX FILING

There are two other areas of the estate and gift tax laws which are widespread in their effect where the present rules create both unnecessary complexity and inequities. The first of these deals with the gift tax filing requirements. The Excise, Estate and Gift Tax Adjustment Act of 1970 required for the first time that taxable gifts be reported quarterly, rather than annually as provided by prior law. This quarterly filing requirement has proven to be a major administrative inconvenience to the Internal Revenue Service and constitutes a costly nuisance to individuals who make relatively small taxable gifts in several quarters. The extra work required by the quarterly filing requirements may in many instances be far more costly than the relatively small value derived by the Treasury from a slight acceleration of gift tax revenue.

We recommend a prospective return to annual filing, at least for most donors. Only where an individual's gifts in one calendar quarter aggregates $100,000 should an individual still be required to file a quarterly preliminary gift tax return with respect to that calendar quarter. This amount appears to be a reasonable figure which would eliminate most quarterly returns without deferring the payment of any substantial amount of gift tax. Eighty-five percent of the persons filing gift tax returns would not have to file quarterly preliminary gift tax returns, yet 75% of the total gift tax paid for the year would be reported and paid with the preliminary gift tax returns.

Where quarterly preliminary gift tax returns are in fact required, gifts between spouses should be permitted to be split on a preliminary basis, with a nonbinding election until the subsequent filing of a final return for the calendar year. At that time, the spouses could elect to split their gifts or not split them, regardless of the election made in the preliminary quarterly returns. Similarly, the election to treat acquisition by spouses of a joint interest in any property as a gift would be made in the annual gift tax return rather than in the preliminary quarterly returns.

G. ESTATE TAX CREDIT FOR GIFT TAX PAID

We recommend that Section 2012 be amended so that in computing the limitation on the estate tax credit allowed for gift taxes paid in respect of property included in the decedent's gross estate, the estate tax attributable to such property should equal the reduction in estate tax if such property were removed from the gross estate. At present, the estate tax credit for gift tax paid in respect of property included in a decedent's gross estate for estate tax purposes is limited to the lesser of the gift tax paid or the estate tax allocable to the gift. Those limitations are

computed under present law by a complicated method involving the average gift tax rate and the average estate tax rate. Substitution of the highest applicable bracket rates for the average rates determined under present law would greatly simplify the computation of the credit and would reduce the number of cases in which the credit is partially lost by application of the limitations. Thus, we recommend that the computation used to determine the amount of gift and estate taxes allocable to property subject to both taxes for purposes of the limitations be changed to reflect the incremental amounts of gift tax and estate tax attributable to the doubly taxed property.

H. THE STATE DEATH TAX CREDIT

In the written statement submitted on behalf of the College by President Cantwell, he indicated that we were working on a state-by-state analysis of the economic effect of the state death credit and would submit a report, which we expected would be ready within a month, to your Committee for its consideration in connection with your deliberations. It is now apparent that this report, which we had hoped to attach to or make a part of this supplementary statement, was not as far along as we had believed in March. Therefore, it will not be ready for several more months. When it does become available, we will submit its results, together with recommendations for a closer integration of the state and federal death tax systems, based upon some form of incentives given the states to conform their death taxes to the federal estate tax, to this Committee.

I. EFFECTIVE DATES OF TAX CHANGES

Our final recommendation deals with effective dates of any and all changes that may be made to the estate and gift tax laws. We believe that all such changes should apply prospectively and not be applicable to any past transfers. The effective dates should be such as to allow a reasonable period for amendment of existing estate plans. If major structural changes (such as new taxes on generation-skipping transfers, an unlimited marital deduction, some form of taxation of appreciated property at death, a radical change in the entire death tax system by bringing in an accessions or an inheritance type of death tax or the unification of the estate and gift tax or substitution of a capital transfer tax for it) are made, we believe that an extensive period of time should be permitted for the transition to occur, in the interest of stability.

The general policy of amending tax laws only prospectively should be strictly observed in estate and gift tax revisions. Obviously, many gifts have been made and many trusts established on the basis of the present tax system and its rules, which have remained substantially unchanged since 1951. Fairness requires that significant changes not be applied to the detriment of those who relied on existing law. Specifically, if Congress decides to unify the estate and gift tax system or substitute for it a capital transfer tax, similar to that used in England, it is important, as the proposals to date have generally contemplated, that there should be a "fresh" start, with a single lifetime exemption available in full without regard to prior gifts, and without including prior gifts in computing the tax on future transfers. Similarly, if a switch to an accessions tax is made, there should be no attempt to compute and charge recipients of gifts and inheritances with any of these received prior to the effective date of the new law.

If a tax is to be imposed at death on appreciation (either a capital gains tax or an additional estate tax), or if there is to be a carryover basis, we believe that a new basis date should be provided, in order to avoid inequities caused by failure in the past to keep adequate records (which taxpayers could legitimately have considered unnecessary), similar in concept (if not in purpose) to the March 1, 1913, value used for income tax purposes, after adoption of the Sixteenth Amendment to the Federal Constitution.

If generation-skipping transfers are to be specifically taxed, the new tax rules should apply only to transfers made after the effective date. Irrevocable trusts created prior thereto, whether during the settlor's lifetime or as a result of his death, should have their dispositions exempt from these new rules.

Finally, there should be a reasonable grace period for amending wills (and revocable or otherwise amendable trusts), similar to that provided in connection with other estate and gift tax amendments that have caused major changes in the past, to allow a review of estate plans by all taxpayers and their advisers. This grace period should run for at least five years, since experience has shown that even relatively minor changes in the past have required extension of originally

granted two-year grace periods (witness what occurred to the changes in the charitable remainder trust rules and the transitional rules designed to deal with problems caused by those changes under the 1969 Tax Reform Act).

The above proposals are those of a duly authorized Committee of The American College of Probate Counsel, created by the College's Board of Regents and appointed by President William P. Cantwell, of Denver, Colorado. The Committee consists of the following lawyers:

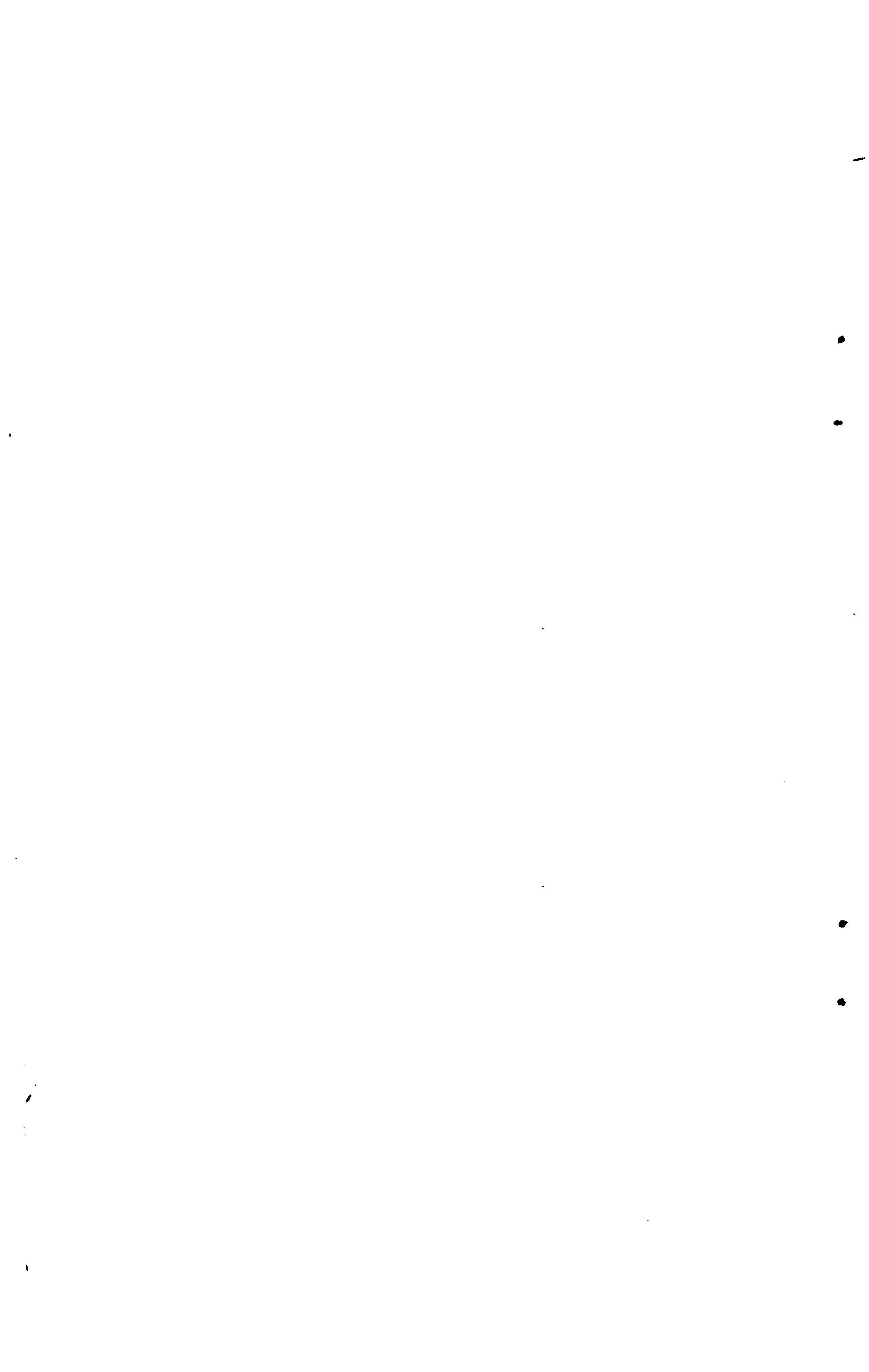
Frank S. Berall, Chairman, of Hartford, Connecticut; Luther J. Avery, of San Francisco, California; Joseph Kartiganer, of New York, New York; Arthur Peter, Jr., of Washington, D.C.; Raymond A. Reister, of Minneapolis, Minnesota; and E. Frederick Velikanje, of Yakima, Washington.

Senator MONDALE. We stand adjourned.

[Whereupon, at 12:35 p.m. the committee was recessed subject to the call of the Chair.]

APPENDIX

COMMUNICATIONS RECEIVED BY THE COMMITTEE EXPRESSING AN INTEREST IN THESE HEARINGS



Statement of Senator James Abourezk

Mr. Chairman, I want to commend you and the members of the Senate Finance Committee for your perceptive recognition of the critical importance of federal estate tax reform and for your commitment to consider legislation to deal with it.

As you know, during the 94th Congress no less than 20 bills have been introduced in the Senate and House of Representatives to deal with correcting the federal estate tax law which was written nearly 35 years ago. The Administration, too, has attempted to deal with the issue. While I certainly think that the President's proposal leaves a great deal to be desired, I commend the President for providing his views and legislative contributions.

Today, few Members of Congress dispute the need for federal estate tax reform. Senator Mondale in particular, has become somewhat of an expert in the field having held some of the first hearings on the need for such legislation last summer. The Senate Small Business Committee and the House Ways and Means Committee have played a key role in bringing the matter to the public attention. The Joint Economic Committee has also given this matter its consideration. What remains is for the Senate Finance Committee to consider the numerous legislative options available and come up with one which is both equitable and complete.

Because of the impressive list of experts which the Committee has asked to testify in this issue, I will not go into the numerous, compelling reasons for modifying the present federal estate tax law. These witnesses can purely demonstrate to the Committee the undeniable need to change the law.

What I prefer to do, Mr. Chairman, is to provide the Committee with my views on what is essential for legislation on this matter to be complete.

For the past year and a half, numerous legislative initiatives have been introduced, many with new and important provisions to consider, but none with a completely satisfactory program to deal with each of the many complexities of the federal estate tax law. In recent weeks, more and more discussion is given to dropping the thought of an estate tax exemption altogether in favor of a tax credit. The value of a credit being that it doesn't become more valuable with higher tax bracket as is the case with a deduction or exemption.

Frankly, Mr. Chairman, I think that there are strong advantages and disadvantages to both. However, I sincerely urge the Committee to talk to experts on both sides of this issue in the most expeditious yet thorough manner possible.

In my opinion, good estate tax legislation will have to encompass four main ingredients.

First, and most importantly, tax relief in the form of an increased exemption or tax credit must be provided to those farmers, ranchers and small businessmen who simply cannot pay their estate taxes today without liquidating their holdings or going into debt. From my many conversations with South Dakotans, many of them tax experts in their own right, I strongly believe that an exemption of $200,000 or a comparable tax credit on the decedents adjusted gross estate is both equitable and justified. Naturally, it is extremely important that the legislation be very tightly written so as not to create larger or more numerous tax loopholes for the very wealthy or the corporate interests for whom the benefit of this legislation is not intended. As I am sure most people realize, $200,000 is no longer a large figure. In fact, it is quite modest. In South Dakota an operation of this size would be nothing more than a small ranch. There are many areas in this country where that amount of money would buy nothing more than 150 acres of land.

Secondly, the legislation needs to address the difficult question of property valuation. Rather than making an estate appraisal at "market value", I believe that farms and ranches should be taxed only on the basis of the land's income producing ability. S. 2875, the bill introduced by Senator McGovern and I provides the best means for establishing an alternative valuation of such land. While many bills provide for alternative valuation, this bill actually provides a set of straight-forward guidelines for assessing values depending upon the real or productive use of the property if the executor decides to use this method of valuation instead of the traditional market value. I strongly encourage the Committee to consider the formula set forth in S. 2875 as the most equitable way in which to deal with land valuation in estate settlements.

Third, Mr. Chairman, I believe that the legislation ought to provide for a much more equitable and less cumbersome transfer of estates between most spouses. As you know, unless the surviving spouse can show contribution of "money or moneys-worth" toward property, it is entirely included in the estate of the deceased. Even if the spouse has contributed substantially to the work associated with the operation of a business or farm as the recipient of the decedent's property, that person must pay all of the taxes due on it. The transfer of ownership of most estates between spouses should be virtually tax free. Certainly, this must have been the intent of the Congress 35 years ago, and it should be the responsibility of this Congress to clarify that intent. Already 50 per cent of an estate can be transferred to a spouse tax free. The bills now introduced allow the tax free transfer of the 50 per cent portion plus an additional maximum monetary limitation set at various levels. S. 2819 sets the limitation at $240,000, which is the figure officially endorsed by the National Farmers Union.

However, I believe that taking into account the appropriate tax free transfer does not address the problem adequately. As I mentioned, Section 2040 of the Internal Revenue Code prevents spouses from being considered bonafide owners unless some evidence of monetary contribution can be shown. So, in spite of perhaps 40 years of toil, sharing the same dinner table, and rising and falling with each year's crop, the spouse must "buy" the farm from the IRS following the partner's death. Mr. Chairman, the Committee certainly should look carefully at provisions such as that found in S. 2879, which provides that the services of a surviving spouse which contributes to the operation of a farm or business should be considered in determining his or her interest in it as a joint tenant.

Finally, Mr. Chairman, I believe that an extension of Section 6166, the deferral provision of the IRS code, is essential. The present ten year installment program in the case of "undue hardship" has not worked. The provisions under this section must be overhauled and the fact that they have been changed to assist a great deal more in liquidity problems must be made known. I strongly urge the Committee to consider examining the interest rate and the criteria for eligibility under this section of the law.

Again, Mr. Chairman, I want to thank you for allowing me the opportunity to present my views. I sincerely hope that this Committee will have the opportunity to consider the issue fully this year. Certainly the time to change the out-dated estate tax law is upon us.

Statement of Senator George McGovern

I am the principal author of S. 2875, introduced in the Senate on January 27, 1976. It is cosponsored by other Senators and has the direct endorsement of such diverse interests in the agricultural community as the National Livestock Tax Committee, the American National Cattlemen's Association and the National Farmers Union and the National Farmers Organization. With that broad a base, I would hope that the committee would consider its provisions meritorious enough for serious consideration in its efforts to re-write one of the most clearly needed singular pieces of tax reform in the Internal Revenue Code. Though the argument can be made, and made well, that piecemeal tax reform is not in the best interests of the tax system, I feel that the time has come when all responsible legislators must recognize the long standing inequities in the Federal Estate Tax structure, a tax originally conceived to be a tax on the estates of the very rich but what is now in the light of today's values a tax often times confiscatory in nature on the estates of the middle and upper middle class, particularly on our farmers and ranchers.

The Senate Finance Committee generally estimates that from all sources, federal income is at a level of $300-plus billion. Of this amount, the committee estimates that only $4.6 billion is derived from estate and gift taxes. Though this is a significant figure, indeed, it is not one that pales the eyeballs when the same eyeballs barely blink at a $100 billion outgo to the Pentagon for national defense. Furthermore, it is not the business of the committee or the Congress to eliminate the tax but merely to raise realistic exemption levels which would perhaps result in a Treasury loss of $1.7 billions that could easily be made up on the income tax side itself if farmers get a decent price for their products and didn't have to be faced with forced sales fractionating their property upon a death in the family to satisfy an outmoded tax structure.

The 1942 exemption of $60,000 has simply lost relevance in 1976 when dollars don't mean the same thing. During the interval when the exemption remained constant, the very rich (who were expected to supply the revenue in the first place) have been able to deplete their estates during their lifetimes utilizing other provi-

sions of the IRS to minimize the exposure to taxation when the decedent finally died. The farmers, small businessmen, and professionals who saw values steadily increase were forced to use increased capital in expanding businesses and generally did not seek the advice of tax professionals, resulting in a highly disproportionate amount of the tax raising mechanism coming from estates of that group who, hardly felt exposure at all in terms of the 1942 exemption.

Farmers and ranchers have been particularly hard hit in recent years. Indeed the escalation of farm land prices that a USDA study prepared in July of 1975, called "Alternative Futures for U.S. Agriculture," concludes that in 1974, "one fourth of all farm real estate transfers are for the purpose of estate tax settlement." Farming and ranching, even after being viewed as the backbone of our food producing process, have a rich tradition in our country's heritage of being passed from one generation to the next. A good bit of the rural scene is founded on that real concept of progression of family interest in land starting with the Homestead Act of 1862 and expanded and handed down from one generation of family farmers to the next, keeping the unit intact. By the time the nation is 200 years old we find that our neglect to keep up with the times in the tax code has resulted in 25% of the fractionating of farm interests being triggered in one way or another by the need to pay a tax that could, unless we act, serve only to destroy the family farm and enlarge the agricultural interests of corporations or agri-business groups. I, for one, don't think that this is what we were elected to do.

For all these reasons let me sketch the contents of my bill for the committee:

A restructing of the specific exemption of $60,000 to $200,000 for all Americans. This should take place immediately instead of a five year phase-in program belatedly offered by the President.

A recognition of the role that women play in the business lives of their husbands by putting an absolute floor on the marital deduction of at least $100,000.

Provide for an alternative valuation of agricultural land to allow the executor to elect to submit a value based on "productivity" rather than "fair market value" as presently provided in the IRS code.

The "productivity" concept is one that I propose to discuss further because it is the one principal feature of my bill which distinguishes it from others introduced by my colleagues in both houses of the Congress.

Present IRS law requires "fair market value" in the reporting and assessment procedure. This often times results in many inequities because it is automatically assessed along the arbitrary guidelines of comparable sales in the locality in which the land is situated. These "comparable" sales often reflect an upward bias that has no relation to the productive value of the land and are essentially non-agricultural in nature—proximity to adjoining land, use for developmental or speculative purposes, or adding holdings when farm debt is substantially reduced. Thus, in my judgment, many decedents' estates are assessed in a tax bracket where the values assigned the land reflect an artificial bias not related to agriculture when the intent of the heirs is to continue to farm. For these reasons I feel that a formula should be developed to place values on farm land in terms of its inherent ability to produce.

This is easily accomplished according to sound and acceptable agricultural economics. All agricultural economists agree that cash rent is the best basic point of departure in establishing value and that prevailing interest rates are the best capitalization factor. The most acceptable formula in determining rent is R (rent) = L (land) × I (interest rates). When our unknown becomes L (land), we merely invert the formula to read L=R/I. Since three year averages often tend to produce more realistic figures, I propose to authorize the Executor to utilize the "Productive Formula," L=R/I in determining land values for decedents' estates. My staff has prepared some projections in central corn belt states and has found that average cash rent for a three year period is $52.90 per acre. They also found the three year average for Federal Land Bank mortgages to be 7.91 percent. The productivity formula thus results in the average productive value of land in this area to be $669 per acre, against an average fair market value sale during the same period of $845 per acre. This produces a dollar reduction in value of $176 per acre or a percentage reduction of about 21%. Assuming figures to remain constant we conclude that productivity values would reduce the value of estates anywhere from 21 to 25 percent across the nation. To prevent windfall profits I would recommend that the land be required to be used agriculturally for at least five years after decedent's death.

Complementing the procedures I have outlined above is a paper by Calvin A. Kent, Ph. D., of the University of South Dakota, entitled "Determination of Capitalization Rates for Mass Appraisal of Farm Land Under the Use Value

Approach," published in 1975 and arriving at similar conclusions. I ask that the text of Dr. Kent's paper be made a part of the record of these proceedings and printed in conjunction with my statement.

I further ask that the position of the National Livestock Tax Committee published in January of 1976 accompany my statement and that a New York *Times* news story by Roy Reed appearing in the February 16, 1976,* edition of that paper accompany my statement and be made a part of the record.

DETERMINATION OF CAPITALIZATION RATES FOR MASS APPRAISAL OF FARM LAND UNDER THE USE VALUE APPROACH

(Prepared for Senator Curtis Jones, Chairman, Interim Committee on Taxation and Lyle Wendell, Secretary, Department of Revenue, by Calvin A. Kent, Ph. D., Director, Public Finance Project, November 10, 1975)

One of the more definite trends in property taxation in the United States has been the abandonment of the ad valorem system of taxation and the adoption of use valuation for farm land. Beginning in Maryland in 1955, thirty-seven states now employ the use valuation method for agricultural land.[1] Under this system the value of farm land is established based on its agricultural productivity and earning capacity rather than on comparable sale prices.

The reasons for this change in assessing procedures has been detailed elsewhere.[2] What most of these laws require is the determination of land value by capitalization of a net income stream. To accomplish this, two steps must be taken. First, net farm income must be established either by analyzing either cash rents, share rents or owner operated returns.[3] Second, this cash income flow must be discounted by the appropriate interest rate to obtain an estimate of value for agricultural purposes.

This paper discusses the second step in the use valuation procedure—the determination of the capitalization rate. One of the principle findings resulting from a survey completed for the Interim Taxation Committee of the South Dakota Legislature on use-value assessment practices in other states, was that there is nothing approaching uniformity among those states in the setting of capitalization rates. Most often the methods established by law or administrative rule to set capitalization rates correspond only roughly if at all, to appropriate assessing practices as given in the most widely accepted textbooks.[4] There has not yet developed a cogent analysis of how capitalization rates are to be developed for use in mass appraisals of farm land.

In several of the states surveyed, the laws were so generally phrased that virtually any system for setting capitalization rates might pass as acceptable. In Maryland no capitalization rate is provided by law or any method of deriving one, but 5 percent has been used.[5] In New Jersey there is no legally established standard but 10 percent was used in 1974 as it was felt to reflect ". . . the cost for borrowed money and a return for the farmers own labor."[6] The Iowa code gives the responsibility for determining the capitalization rate to the State Board of Tax Review which is to set it at ". . . a rate representing a fair return on investment."[7] For 1975 a fair return in that state was 6½ percent.[8] By way of contrast to the vagueness of most state laws, the Colorado statute requires an 11½ percent rate.[9]

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*Reprinted at p. 6 of this volume.

[1] R. L. Flinchbaugh and Mark Edelman, "Use-Value Assessment Case Studies", Cooperative Extension Service, Kansas State University, Manhattan, February 1975.

[2] R. J. Gloudemans, *Use-Value Farmland Assessment—Theory, Practice and Impact*, (Chicago: International Association of Assessing Officers, 1974) and T. F. Hady, "Differential Assessment of Farmland on the Rural-Urban Fringe", *American Journal of Agricultural Economics*, February 1970.

[3] For a discussion of these three approaches to determine net farm income see, "The Valuation of Open Space Property", Assessors Handbook, California State Board of Equalization, Assessments Standards Division, June 1975.

[4] Walter R. Kuehnle, et al. *The Appraisal of Real Estate*, 6th ed. (Chicago: American Institute of Real Estate Appraisers, 1973) pp. 347–70 and *Assessing and the Appraisal Process*, (Chicago: International Association of Assessing Officers, 1974) pp. 80–85.

[5] John C. Keene, "Differential Assessment of Real Property in Maryland: A Case Study", The Council on Environmental Quality, Washington, D.C., June 1975.

[6] *Eleventh Report of the State Farmland Evaluation Advisory Committee*, Trenton, New Jersey, October 1974, p. 12.

[7] Iowa Code 441.21 (1)a.

[8] "Procedures for Capitalizing Agriculture Income—1975", Iowa Department of Revenue, no date.

[9] Colorado Division of Property Taxation, "Assessment and Property Tax Laws", *Assessors Handbook*, 1972.

METHOD OF DETERMINING CAPITALIZATION RATES

The literature cited gives three basic methods of establishing the capitalization rate. These are discussed in turn.

Sales analysis.—The method most frequently used by fee appraisers is to, "go to the market".[10] A detailed analysis of the net dollar returns being obtained on nearby farms which have recently sold is first developed. These net incomes for each farm are then divided by the price paid for those farms. A set of ratios are then obtained comparing net returns to sale prices. The appraiser selects from these ratios the rate he feels is most comparable to the one which would be obtained in the market for the subject property. Despite the obvious problems of selecting comparable properties, Professor Suter from Purdue has said, "The approach is a most realistic one in that the capitalization rate obtained is that required to attract all of the capital necessary to transfer ownership.[11]

This approach is employed in some of the use value states. For example, the Hawaii rules and regulations read, "The assessor shall use a rate of return to the land that is representative of normal market conditions. In the absence of such rates, a rate of capitalization of six (6) percent may be used." [12] In Kentucky the law reads that agricultural value, ". . . means representative sales prices of comparable land purchased for agricultural or horticultural use with consideration being given to the purposes of purchase such as farm expansion, improved accessibility and other factors unduly influencing the sales price." [13] While South Dakota does not currently employ income capitalization, sales of farm properties are a principle component in determining agricultural use value. [14] Iowa's system is unique in that farm land is valued 50 percent on market value in current use and 50 percent on use value as determined by capitalized income.[15]

Most states have found this method unsuitable for one of two reasons. The first is that in states using this method only sales for agricultural use can be developed as comparables. There are many reasons for buying farm land other than the desire to receive a current income stream. These include but are not limited to: (1) Desire to gain the status of landowner; (2) opportunity to live in the country and avoid the social ills of the city; (3) desire to live near relatives or reclaim a family homestead; (4) gaining of income tax advantage; (5) opportunity to provide a head against inflation; (6) spreading of fixed costs by more efficient use of machinery.[16]

The assessor is asked to perform the impossible by selecting the motives which spurred the buyer in determining which sales are bona fide for agricultural use.

The second reason why this method is not widely used, is that sales comparison approaches are prohibited. Most states with preferential assessment have injunctions similar to California's, "The capitalization rate to be used in valuing land pursuant to this article shall not be derived from sales data . . ." [17] These prohibitions appear logical if the purpose of use valuation is to avoid the high taxes that result when market comparisons are used, then farm sales as a method of determining the capitalization rate are inconsistent with that objective. Use of this method is more likely to produce market than agricultural use appraisals. As was found in Oregon, "If the income approach were to be used, utilizing the average rate of return for comparable properties, the result would leave the farmer right where he started." [18]

Summation or Built-up Rate.—The second approach used to set capitalization rates is to develop an interest rate by adding or summing to a "safe" rate of return

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[10] See W. D. David, "Appraisal of Rural Real Estate" in *Encyclopedia of Real Estate Appraising*, revised ed. (Englewood Cliffs: Prentice Hall, 1968) pp. 529–576 and Robert C. Suter. *The Appraisal of Farm Real Estate*, (Danville, IL: Interstate Publishers, 1974) pp. 243–291.

[11] Suter, p. 266; see similar statement in Davis, p. 548.

[12] Rules and Regulations of the Director of Taxation Relating to the Assessment of Agricultural Lands and the Imposition of the Deferred Tax Under Section 246–10, Hawaii Revised Statutes, Article V, Section C. Hawaii Department of Revenue, p. 8.

[13] Kentucky Revised Statutes, 132 : 010 (9).

[14] For an explanation see F. C. Westin, Maurice Stoute, D. L. Bannister, C. J. Frazee, "Soil Surveys for Land Evaluation", *Assessors Journal*, October 1974, pp. 16–31, and C. A. Kent, "Use Valuation of Agricultural Real Estate in South Dakota", Interim Committee on Taxation, Legislative Research Council and South Dakota Department of Revenue, July 1975.

[15] Iowa Code. 441.21 (1).

[16] Suter, p. 249.

[17] California Statutes Chapter 66, Article 1.5, Section 423(b).

[18] C. H. Mack and T. W. de Looze, *Property Tax Exemptions*, Oregon Department of Revenue, December 7, 1973, p. 8.

additional percentage points to compensate for risk, management of the investment and property taxes. In addition, some analysts suggest an additional amount be added for non-liquidity recognizing that the sale of farm property could not be handled as swiftly or with as much guarantee of an available market as could transfer of common stocks or bonds.

This method does not receive high marks from those in the appraising profession. The American Institute of Real Estate Appraisers comments that the summation method: ". . . provides a theoretical presentation to justify or explain why a rate used in the valuation of real property is in excess of the "safe" rate. Nevertheless, because of the intangible character of the components, it is not considered a valid procedure through which a specific rate may actually be derived."[19]

The basic textbook published by the I.A.A.O. makes a similar observation.[20]

Despite the general agreement among appraisal experts with the statement of Suter that, "Developing a built-up rate may be a make-believe antic,"[21] this method has become the most widely adopted among the states that value farm real property by capitalization of net income flows. The most elaborate of the built-up systems is that used in California where the law specifies that the capitalization rates shall contain:

(1) An interest component to be determined by the board and announced no later than September 1 of the year preceding the assessment year which was the yield rate for long term United States Government Bonds as most recently published by the Federal Reserve Board, rounded to the nearest one-quarter percent.

(2) A risk component which shall be a percentage determined on the basis of the location and characteristics of the land, the crops to be grown thereon and the provision of any lease or rental agreement to which the land is subject.

(3) A component for property taxes which shall be a percentage equal to the estimated total tax rate applicable to the land for the assessment year times the assessment ratio.

(4) A component for amortization of any investment in perennials over the estimated economic life when the total income from land and perennials other than timber exceeds the yield from other typical crops grown in the area.[22]

While there seems to be little controversy over designation of the yield on long term federal bonds as a "safe" rate upon which to begin construction,[23] the risk component has been more troublesome. Ronald B. Welch, former Assistant Executive Secretary of the California State Board of Equalization summarized the experience in that state. "Our worst problem in California, however, is the determination of the risk component. There is only one acceptable way to solve this problem—the comparison of net incomes and sales prices to obtain a rate that includes interest, risk, and perhaps investment-management components. But the use of sales data is proscribed by our law. Consequently, no one knows or possibly could discover the "right" risk component. The assessor can make his guess. Then the county board of equalization can supersede the assessor's with its own guess if the assessment is appealed. A little later the property might be selected in the State Board of Equalization's Intercounty equalization sample. Then the State Board's Intercounty Equalization Division could make its guess. If the county assessor didn't like the resulting appraisal, he could appeal it to our Office of Appraisal Appeals. If the Office of Appraisal Appeal's guess is unacceptable to either the county assessor or myself, it can be appealed to the Board members themselves. The only one who can outguess the Board is God himself.[24]

To compensate for the problems of calculating the risk component, several states have turned to using the interest rate charged by the Federal Land Bank serving their area in lieu of both the "safe" rate and risk adjustment. In Virginia the interest rate component is, ". . . an average coupon (interest) rate applicable on all bonds which the Federal Land Bank (FLB) serving Virginia reports as outstanding on July 1 of each year of the several crop-years in which the use

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[19] Kuehnle et al., p. 850.

[20] *Assessing and the Appraisal Process*, p. 87.

[21] Suter, p. 272.

[22] California Statutes, Chapter 6.6, Article 1.5, Section 428(b).

[23] Since the Federal Government issues a variety of bonds with maturities of 5 or more years, all of which are called "long term", the California statute suffers from some ambiguity in definition.

[24] Ronald B. Welch, "Assessment of Farm Land at Agricultural Use-Values", Paper presented at the Fortieth Annual Meeting of the National Association of Tax Administrators, St. Paul, Minnesota, June 12, 1972.

value being determined is based."[25] The use of federal bond yields was rejected in that state as those rates, ". . . represent the most secure investment alternative if an agricultural enterprise is liquidated. But the rate does not reflect the risks and other factors associated with the income stream expected to result from an agricultural investment."[26] Allegedly such risks and other factors are adequately considered by the Federal Land Bank.

In Oregon the law requires that agricultural lands be capitalized at the, "typical capitalization rate used for appraising nonagricultural commercial land in the area in which the agricultural land is located."[27] The statute then gives the Department of Revenue the power to set the rate and suggests a more definitive standard to be used. Specifically, the capitalization rate shall be, ". . . not less than the current rate of interest charged by the Federal Land Bank on first mortgages of farm land in the county in which the agricultural lands are located."[28] In Texas the capitalization rate is set at 10%, ". . . or an amount equal to 2% greater than the average variable interest rate specified by the Federal Land Bank in Houston . . . whichever is greater."[29] The additional 2% is presumably further risk allowance.

The Washington statutes set the rate of interest to include rates charged at other financial institutions making agricultural loans in addition to farm credit agencies of the government.[30] These rates are to be averaged over the past five years.

The states using the summation method differ also in whether the rate to which the other components will be added should be a rate on a given date or an average rate reflecting several years. While most states employ a single rate (usually the one prevailing on assessment day), a few states have followed the lead of Virginia and Washington which require averaging. If crop yields, expenses and product prices are to be averaged to avoid the effects of unfavorable temporary conditions, then averaging of interest rates on securities also seems appropriate.

In addition, the states vary as to whether or not a property tax component is to be added to the capitalization rate. While it may be argued that this is not necessary if property taxes are taken as an expense in arriving at net income, this argument must be rejected. Taxes are what is to be calculated and using property taxes as an itemized deduction assumes that past taxes were proper and correct.[31]

If the summation approach is used then the effective tax rate should be added to the interest rate. The effective tax rate is the estimated (or previous year's) mill levy times the actual percentage of market value being used as taxable value. Two mistakes are frequently made by the states in this regard. First, they fail to include a tax component at all in the capitalization rate; and second, the tax rate is determined by using the *legal* percentage of market value to be used as taxable value rather than the actual percentage.[32] This rewards those living in districts which practice the greatest underassessment.

Band of Investment Theory.—In the opinion of this writer the best method to be used in developing a capitalization rate is the band of investment theory. This method synthesizes both mortgage and equity rates. Along with its other deficiencies, the built-up method considers only the necessary interest that must be paid on borrowed money and neglects the return which the investor expects on this own dollars (equity) which he has invested in his farm. Suter has commented, ". . . the rate of interest paid on a farm mortgage or installment land contract is not necessarily the same as that return which a farm owner or investor will willingly accept on his equity."[33]

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[25] J. Paxton Marshall, "Procedure for Determining Use-Value of Agricultural Land in Virginia with Estimated Use-Values for Certain Jurisdictions", *Manual of the State Land Evaluation Advisory Committee, Classification, Assessment and Taxation According to Use of Real Estate Devoted to Agricultural, Horticultural, Forest and Open Space Purposes.* Richmon, Va., December 1974, p. 16.

[26] Marshall, p. 24. In addition, Virginia does add an additional risk factor for *some* lands with a high probability of excess rainfall and poor drainage. This allowance is extremely small and is explained in the Marshall article.

[27] Oregon Revised Statutes, paragraph 308.345 (3).

[28] Oregon Revised Statutes, paragraph 308.345 (4).

[29] Article VIII, Constitution of the State of Texas, Section 1–d(3).

[30] Revised Code of Washington, 84.34.065 (2).

[31] *Assessing and the Appraisal Process*, p. 88.

[32] Washington emphasizes this mistake by specifically requiring that "the component for property taxes shall be a percentage equal to the estimated millage rate times the legal assessment ratio." (Revised Code of Washington, 84.34.065 (3)).

[33] Suter, p. 268.

The capitalization rate is then developed as a weighted average, the weighting representing the respective percentages of total value covered by borrowed money (mortgage) and the farmers own monetary investment in the land (equity). For example, if the prevailing mortgage rate is 9 percent for agricultural land and the buyer must put at least 20 percent of the purchase price down in cash to obtain the loan, then the calculation of the capitalization rate begins as follows:

	Percent of value	Interest rate (percent)	Product
Mortgage	80	9	0.07300
Equity	20	?	?
Composite rate			?

Note: Percent of value times interest rate equals product.

What is missing is the appropriate return to be used for the owner's equity. The hallowed doctrine of opportunity costs reveals that this rate should be equal to what the buyer could have received if he had placed his money in another investment of similar risk rather than producing farm land.[34] Suter has advanced that, "The current rates of interest being paid on certificates of deposit come closer to most farmer's opportunity cost of money."[35] This simply is not so as band C.D.'s represent less risk and greater liquidity than farm equity capital.

A better method is to use the returns to be made by purchasing common stocks (equities) in the market. While one can accept the notion that the risks of stock market speculation are not identical in either cause or magnitude to the risks of farm operations, both do involve wide fluctuations and risks over which the purchaser has no control. Despite the fact that the risks are not strictly comparable, using the yield on equities is to be preferred over the comparatively riskless return on Certificates of Deposits.

In the past it has been virtually impossible to obtain usable information on stock market equity yields. Recently University of Chicago finance professor Roger Ibbotson and bank economist Rex Sinquefield compiled a study on the total returns to common stocks and other money market instruments.[36] Their study included returns on traded equities over the 1929–1974 period. Both market returns and real returns (adjusted for inflation) were given.

Their study indicates that an investor in equities should have been able to expect over the period 1929–1974 a return of 7 to 8 percent in uninflated dollars. The range rises by approximately 2.5 percent if market rather than real returns are to be used. Projecting their findings from 1975 to 2000, their conclusion is that the investor can anticipate a market return of 14 percent and a real return of 7.6 percent.

On the basis of the Ibbotson-Sinquefield analysis, it is now possible to finish the computation of the capitalization rate begun above. The real rather than the nominal rate is used since one of the factors justifying lower farm land taxes is to insulate the owner from the impact of inflated farm land values.

	Percent of value	Interest rate (percent)	Product
Mortgage	80	9	0.072
Equity	20	8	.016
Composite rate			.088

Note: Percent of value times interest rate equals product.

SUMMARY

In capitalization net farm income streams into agricultural values, this paper has suggested that the "band of investment" approach be used. The sales com-

[34] *Assessing and the Appraisal Process*, p. 16.
[35] Suter, p. 268.
[36] The study has not yet been published but the results are summarized in P. R. Merrian, "Breakthrough Study on Stocks, Bonds between 1926–74 Out At Critical Times", Pensions and Investments, July 7, 1975, pp. 84–88 and A. F. Ehrban, "The Long-Term Case for Stocks", Fortune, December 1974, pp. 99–102.

parison approach is rejected because it produced market rather than use values. The summation method is too theoretical and the risk factor cannot be justified or accurately determined.

The problem faced by the assessor is to develop a method of capitalization that is both accurate and simple. The nature of mass appraisal does not allow a different capitalization rate to be determined for each farm property even though this would be the most accurate alternative.[27] The recommended approach begins with a contact of the Federal Land Bank serving the jurisdiction to determine either the average or current rate on first farm mortgages. The reason for using the Federal Land Bank is that its rates are uniform, well known and reflect both risk as well as a "safe" yield. Peculiarities in local lending practices at commercial institutions reduce the usefulness of interest rates obtained from them.

The next step is to determine what the division of value is to be between mortgage and equity. This can be done by determining the equity required by the Federal Land Bank of their "typical" borrower. The return to equity can be ascertained from the Ibbotson-Sinquefield study. To this composite rate the effective property tax rate for the jurisdiction should be added to produce a satisfactory, uniform capitalization rate.

EXAMPLE FOR SOUTHEASTERN SOUTH DAKOTA

The following example shows how the capitalization rate could be developed for a county in Southeastern South Dakota. The Federal Land Bank indicated that their average mortgage rate over the past five years was 8.5 percent. They require from their "typical" borrower one-third equity. The real return on investments from stock market equities was 7.6 percent. The effective property tax rate was 1.28 percent (40 mills X 32 percent assessment-sales ratio.)

CAPITALIZATION RATE DETERMINATION

	Percent of value	Interest rate (percent)	Product
Mortgage	66⅔	8.5	0.05661
Equity	33⅓	7.6	.02531
Composite rate			.08192
Effective tax rate			.01280
Capitalization rate			.09470

Note: Percent of value times interest rate equals product.

This figure should be rounded to 9.5 percent. By using different time periods the capitalization rate could be changed. But the system does result in a uniform rate that can be easily ascertained and that is based on actual farm lending practices and anticipated returns on invested capital.

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PRESIDENT FORD RECOGNIZES FEDERAL ESTATE PROBLEMS OF STOCKMEN; NLTC BOARD SUPPORTS MCGOVERN BILL PROPOSING SOLUTION TO PROBLEM

In recent major addresses, President Ford recognized the severe Federal Estate Tax problem faced by estates of farmers and ranchers in retaining the farm or ranch as a viable economic unit after paying the Federal Estate Tax. Proposed by President Ford as a solution to this problem was remedial legislation which would permit the estates of small farmers and ranchers to pay the Federal Estate Tax over a 25-year period, with no interest during the first 5 years and 4% interest for the next 20 years.

Viewing President Ford's recognition of this problem as significant and encouraging, the National Livestock Tax Committee (NLTC) Board of Directors at a special meeting concluded that the legislative solution proposed by the President would not solve the problem. The NLTC Board voiced its support for the principles contained in Senate Bill 2875 which was recently introduced in the U.S. Senate by Senator George McGovern (D. SD.), and which was spon-

[27] Kuehnle, p. 365.

sored by Senators Hart (D. CO.), Abourezk (D. SD.), Leahy (D. VT.), Moss (D. UT) and Stafford (R. VT.). While being similar to bills previously introduced in the Congress, S. 2875 provides a specific formula for valuing real property for Federal Estate Taxes.

Under the McGovern Bill, an executor of a stockman's estate could elect to have real property used in the deceased's farming or ranching operation valued for Federal Estate Taxes based upon its productivity. This would be accomplished by dividing the average gross cash rental (less state and local real estate taxes) for comparable land for the 3 years immediately preceding death by the average interest rate of all new Federal Land Bank loans for this same 3-year period. To qualify for this election, substantially all of the real property would have to have been devoted to farming or ranching for 60 months preceding the stockman's death. If the real property were disposed of (other than by involuntary transfers) within 5 years after the stockman's death, then a recapture would be imposed which would be the difference between the Federal Estate Tax based upon fair market value and the value determined by reference to its productivity.

A similar valuation approach is provided in the McGovern Bill for real property devoted to woodland (including land used for commercial production of trees and land and for recreational purposes) and to scenic openspace. Additionally, the McGovern Bill would, for *all* estates, increase the Federal Estate Tax exemption from $60,000 to $200,000 and amend the marital deduction provision to provide a minimum deduction of $100,000 on property passing to a surviving spouse.

You are each urged immediately to write or personally contact your Senators and Congressmen and ask them to support S. 2875. In this election year and with President Ford's recognition of the problem, now is the time to act in order for the industry to obtain needed remedial legislation.

NLTC OPPOSES LAL AND MANDATORY ACCRUAL ACCOUNTING FOR FARM CORPORATIONS

Affirming the position taken before the Committee on Ways and Means of the U.S. House of Representatives, the NLTC Board of Directors at a special meeting voiced its opposition to the LAL and Mandatory Accrual Accounting for Certain Farm Corporations and Partnerships provisions of the 1975 Tax Reform Act. These provisions are discriminatory, would increase already burgeoning costs, would be difficult to administer and to comply with, would add undue complexity to present tax laws, and are not needed to curb alleged abuses in the livestock tax area. NLTC feels these so-called abuses can be eliminated by: (1) limiting farm losses to capital at risk; and (2) taxing *all* limited partnerships registered with the Federal Securities and Exchange Commission as corporations.

You are each requested to contact your Senators and solicit their support of NLTC's position.

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STATEMENT OF THOMAS J. REESE, LEGISLATIVE DIRECTOR, TAXATION WITH REPRESENTATION

REFORM OF ESTATE AND GIFT TAXES

Mr. Chairman and Members of the Committee: My name is Thomas J. Reese. I am the legislative director of Taxation with Representation, a 17,000 member public interest taxpayer's lobby founded in 1970.

Taxation with Representation has a six point tax reform program which is a product of months of discussions within our National Committee. Many of the Nation's outstanding tax attorneys and public finance economists are members of that Committee, and their overwhelming approval of our program is a clear indication of broad professional support for these six reforms. It is designed to place before Congress those proposals that we believe should be given the highest priority in any legislative consideration of tax reform. Its elements are:

Taxation of unrealized capital gains at death or gift.

Estate taxation of generation skipping transfers.

Repeal of percentage depletion for all minerals.

Provision of a federal interest supplement large enough to insure that states and localities will voluntarily issue taxable rather than tax exempt bonds.

Repeal of the Domestic International Sales Corporation (DISC) provisions of the Internal Revenue Code.

Allocation of deductions between taxable and tax exempt income.

I will concentrate my testimony today on two aspects of this reform program that we believe will be of special interest to the Committee during its hearings on estate and gift taxes. The first of these is the taxation of generation skipping transfers, the second concerns taxation of capital gains at death or gift.

TAXATION OF GENERATION SKIPPING TRANSFERS

Taxing the transfer of wealth from one generation to another has long been recognized as sound procedure.

Death and gift taxes are levied on taxpayers who, almost by definition, no longer need the money; consequently, the tax is about as painless an any tax can be.

Death and gift taxes can be an important source of government revenue, and they have minimal impact on incentives and risk taking.

Estate and gift taxes serve an extremely useful social purpose in breaking up large concentrations of wealth, thus helping to curb the emergence of a self-perpetuating aristocracy of wealth whose goals and outlook are incompatible with democratic ideals. Estate taxes are paid by only 7 percent of decedents which means the most wealthy people in America.

Finally, these taxes help to make up for the deficiencies of our loophole-ridden income tax, by insuring that wealth—including that accumulated through manipulation of income tax loopholes—nevertheless bears some federal tax at least once a generation.

Unfortunately, our existing system of estate and gift taxes largely fails to achieve these objectives. The present tax system goes too far in protecting the interests of the immensely wealthy, while failing to deal fairly with persons of modest means who wish to provide for their immediate family and dependents. There are many causes of this situation, but probably the most glaring loophole is the failure to tax so-called "generation skipping trusts".

How generation skipping trusts work

Under the laws of most states, an individual can establish a trust which benefits not only his immediate family but also his more remote descendants. Typically, these trusts last about a century, and span two or three generations. That is why they are called "generation skipping trusts". Children, grandchildren, and even great grandchildren can receive all of the income from the trust property, and a healthy portion of the principal. They can borrow against the property, decide how it will be invested, determine who will receive it upon their deaths, and in general behave during life as the true owners of the property. But, at death, the tax collector disregards these facts, and permits the property in generation skipping trusts to escape estate taxation, not just once, but in two or even three successive generations.

As a result, control of great wealth can pass from one generation to the next without payment of any estate or gift tax. Meanwhile persons of more modest means are forced, for a variety of economic reasons, to leave their property to their immediate family.[1] That property is taxed again, and again, as it passes from one generation to another.

An example will make clear how generation skipping trusts work. Suppose that two individuals each have a taxable estate of $10 million, after all exemptions and deductions have been claimed. The first, Mr. Roe, leaves his entire estate to his children. The Roe Estate will owe a death tax of approximately $6 million. Assume that the Roe children invest the remaining $4 million, and that they, in turn, leave the inherited principal to their children, and so on. Thus, the Roe family estate bears a tax once a generation, and it is gradually reduced in amount, unless replenished by the work of succeeding generations.

The second individual, Mr. Doe, places his taxable estate in a generation skipping trust. Like Roe, he pays an estate tax, *but succeeding generations pay nothing* even though they receive all of the income from the testamentary trust and enjoy substantial control over the principal. This is shown in Table 1, below:

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[1] Estates of small and moderate size are typically left to one's wife and children, since decedents of moderate means cannot be sure whether circumstances will require their wife and children to make use of the entire estate to pay medical bills or deal with other family emergencies. Decedents do not begin to make liberal use of generation skipping trusts until family wealth becomes so enormous that no conceivable emergency could seriously deplete it. At that point, a decedent can establish long-lived trusts, secure in the knowledge that the trust income alone will adequately provide for any emergency.

TABLE 1.—EXAMPLE OF OPERATION OF GENERATION SKIPPING TRUST WITH $10,000,000 TAXABLE ESTATE

Generation	Roe family tax	Doe family tax
Donor's	$6,000,000	$6,000,000
2d generation	1,800,000	0
3d generation	850,000	0
4th generation	500,000	0

The use of generation skipping trusts is further illustrated by the financial data that was made part of the public record during the recent hearings on the nomination of Nelson Rockefeller to be Vice President. Over a ten year period, Mr. Rockefeller received $38 million, or 83 percent of his taxable income, from family trusts. Furthermore, 79 percent of the $218 million net worth of Mr. Rockefeller, his wife, and his children is in the form of interests in trusts. Thanks to the generation skipping tax loophole, most of this wealth will not be subject to estate tax well into the 21st Century, if then.[3]

The proposal: A surtax on generation skipping transfers

Taxation with Representation recommends that transfers of wealth (whether directly or in trust) that can pass to a generation younger than the donor's children—and hence skip a generation—be subject to a surtax in addition to the regular estate and gift taxes. The surtax is intended to approximately equalize the tax paid by the donor with respect to transfers which skip generations with the tax his children would have paid if the transfer had been made to them.

The tax would be levied as follows: At the death of the donor, the surtax would be applied to transfers which the donor had made during life or at death and which skipped (or which yet could skip) a generation or more. The surtax would be imposed at a rate equal to 60 percent of the donor's marginal estate or gift tax rate. Since the highest marginal rate for the estate tax is 77 percent, the highest generation skipping surtax would be about 46 percent of the amount passed on to remote generations. Since amounts paid in regular estate tax to the government cannot be passed on to remote generations, the surtax would be imposed on the net tax, after subtraction of the estate tax. Thus, in our earlier example, if Mr. Doe bequeaths his entire $10 million taxable estate to a remote generation, he would pay $6 million in regular estate taxes and a generation skipping surtax of about $1.8 million.

Even under the Taxation with Representation proposal, there will remain some tax advantage in transfers in trust which benefit not just children, but grandchildren and perhaps great grandchildren as well. But the administrative simplicity of the generation skipping surtax proposal would be lost if an attempt were made to relate the surtax to the potential tax liabilities of these remote generations. Moreover, most avoidance of estate and gift tax occurs through use of trusts that skip only a single generation. For both these reasons, the Taxation with Representation proposal does not seek to establish absolute equality between the tax situation of the Doe and Roe families, as set forth in Table 1. Instead, it preserves administrative simplicity, while at the same time eliminating the most outrageous aspects of the existing generation skipping loophole. The reform will raise approximately $300 million from the very wealthy.

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[3] For data on the Rockefeller hearings, see *Tax Notes,* September 30, 1974, p. 7ff; also, *House Judiciary Hearings on the Nomination of Nelson A. Rockefeller*, 93rd Congress, 2nd Session, p. 25ff (1974); Sen. Rules and Admin. Committee, *Report on the Nomination of Nelson A. Rockefeller of New York to be Vice President,* Sen. Ex. Rep. No. 93–34, 93rd Congress, 2d Session, p. 24 (1974).

TAXATION OF CAPITAL GAINS AT DEATH OR GIFT

Under present law, long term capital gains benefit from three major tax advantages. First, the tax on capital gains can be delayed at the option of the taxpayer, year after year, until an asset is finally sold. In contrast, income from wages is taxed yearly or more often, through withholding. Second, gains from the sale of capital assets held more than six months are taxed at not more than half the rate applicable to ordinary income. Third, if appreciated capital assets are held until death, *the capital gains tax is simply forgiven* on the appreciation to that point. All of these benefits for capital gains are outrageous, but the complete forgiveness for assets that pass through an estate is the most outrageous of all.

Failure to tax capital gains at death is grossly inequitable, deters capital formation and is therefore bad for the U.S. economy, and is a threat to our democratic social structure:

It is inequitable because persons of small or moderate means who are forced by financial necessity to sell capital assets during life are required to pay a tax on any gain they may realize, but the tax is forgiven in any case of those whose wealth is so great that they can live comfortably without selling any of their assets during their lifetime. Thus, poorer persons must pay a tax that the rich escape entirely. This is certainly a gross inequity.

The failure to tax capital gains at death also impedes efficient capital formation by locking individuals into low yield investments. It does this by encouraging individuals to hold on to low yield property—instead of selling it and reinvesting where yields are higher—because they know that their heirs will not have to pay capital gains tax on unrealized appreciation with respect to those assets.

Finally, failure to tax capital gains at death is one of the key elements perpetuating the aristocracy of wealth that arose in this country after the Civil War. Since persons of great wealth can pass assets from generation to generation tax free, there is no prospect that the enormous disparities of wealth that now characterize our nation will gradually be reduced, unless and until unrealized capital appreciation is taxed at death or gift.

1. Tax inequities resulting from failure to tax capital gains at death or gift

The estate of a prominent member of the DuPont family, who died a few years ago, furnished a graphic example of the inequities produced by present law. The individual in question owned a substantial portion of Cecil County, Maryland, which he began to purchase in the 1930's at depressed prices. Those who sold their farms to him were required to pay capital gains taxes on the proceeds of sale, to the extent that the sales price for their land exceeded the original cost or other basis. Subsequently, the land increased greatly in value. Yet the federal government forgave the capital gains tax on this large appreciation, because the individual in question was wealthy enough to hold his land until the time of his death. Thus the farmers who sold out during life were forced to pay capital gains tax, but the multi-millionaire who purchased their farms totally escaped tax on the subsequent appreciation in the value of the acquired land. Similarly, the federal government also forgave the capital gains tax on the banking and chemical company stock that formed part of the same individual's estate.

This example illustrates the typical pattern under existing law: those who are forced by financial necessity to sell capital assets during life are required to pay a tax on any gain they may realize, but those whose wealth is so great that they can live comfortably without selling their assets know that no capital gains tax will ever fall due on any appreciation in the value of assets that they pass along to their heirs.

This differential tax treatment of poorer individuals, as contrasted with wealthier persons, is illustrated in Table 1. This table compares the situation of two widows, one of moderate means, the other wealthy, both of whom are faced with the necessity of paying substantial medical bills during their last illness. The first, the Widow Jones, is forced to sell appreciated assets to cover those medical expenses. She is therefore required to pay a capital gains tax of up to 35 percent on the appreciation in the value of her stock. The second, the Widow Smith, owns a much larger amount of the same stock, and she is able to pay doctor bills out of her dividend income, without selling any of her shares. She pays no capital gains tax at all, nor do her heirs, since they get the advantage of the hypothetical "stepped up

basis" at the time of death. The result is that those of moderate means, like the Widow Jones, must pay capital gains tax, but those who are wealthier, like the Widow Smith and her heirs, escape tax entirely.

TABLE 1.—INEQUALITY IN TAX TREATMENT OF CAPITAL ASSET HOLDERS WHO MUST SELL BEFORE DEATH, AS CONTRASTED WITH THOSE WHO CAN AFFORD TO HOLD ASSETS FOR TRANSMITTAL TO HEIRS

	Widow Jones (moderate means)	Widow Smith (affluent)
Personal situation	Must sell stock which has appreciated $10,000 to pay medical bills during last illness.	Dividends on larger amount of similar stock are adequate to pay medical bills during last illness.
Capital gains tax payable	Must pay up to $3,500 in capital gains tax	None.
Capital gains tax payable by heirs.	None	None.

The proposal to tax capital gains at death or gift corrects this inequity by imposing a tax on the amount by which the Widow Smith's stock has appreciated, as of the time of her death. Consequently, like the Widow Jones, she will owe up to $3,500 in capital gains tax for each $10,000 by which her stock has appreciated in value.

A second inequity that is corrected by imposing a capital gains tax at death relates to the unequal treatment under present law of taxpayers who seek to provide an estate for their heirs. In general, existing law discriminates against those who must provide an estate out of earned income, such as wages and salaries, and in favor of those who are already wealthy, especially those who have inherited their wealth.

Contrast, for example, the situation of Mr. White, who is a salaried corporate executive, and Mr. Black, who inherited substantial wealth in the form of land and corporate securities. Suppose that each wishes to provide an additional estate amounting to $100,000 for a child. White decides to take a second job to earn this amount; Black decides to earmark the appreciation in the value of his land and stock. Under present law, the government will take up to half of White's earnings in income tax, thus making it twice as difficult for him to provide an estate for his heirs, but it will not impose any similar tax on the appreciation in the value of Black's land and stock. Thus, the income tax law puts a substantial barrier in White's way, if he seeks to create an estate for his heirs, but no similar barrier is created in the case of Black. This is illustrated in Table 2:

TABLE 2.—INEQUALITY IN INCOME TAX TREATMENT OF TAXPAYERS SEEKING TO PROVIDE FOR THEIR HEIRS

	Mr. White (salaried executive)	Mr. Black (inherited wealth)
Personal situation	Has 1 job and takes a 2d to provide for child's bequest.	Owns land and corporate stock. Lives on rents and dividends.
Earnings situation	Earns $100,000 in additional wages from 2d job for child.	Land and stock increase $100,000 in value; increase is earmarked for child.
Additional income tax payable.	Up to $50,000	None.
Remainder for transmission to heirs.	$50,000	$100,000.

Taxation of capital gains at death or gift will help to correct this inequity by imposing a tax on the appreciation of Mr. Black's stock when he dies or makes a gift of the stock to his child. The tax imposed would be levied at capital gains rates, thus resulting in a tax of up to $35,000. Black would therefore still be somewhat better off than White, because we tax capital gains at lower rates than ordinary wages, but the shocking inequality produced by existing law would be sharply reduced.

2. The "lock in effect" resulting from failure to tax capital gains at death or gift

One of the basic advantages of the free market economy is that capital tends to flow into those uses where the rate of return is the highest. This helps to expand production in those areas where expansion is most needed, and insures that we are making best use of scarce capital resources. But this basic economic mechanism

cannot operate if there are barriers to the free flow of capital. Among the most serious of these barriers is the "lock in effect" resulting from failure to tax capital gains at death or gift.

In substance, present law presents an individual with the following choice: he can sell a relatively unproductive capital asset and reinvest where the rate of return is higher, but in that case he will have to pay an immediate capital gains tax of up to 35%. Or he can hold on to his relatively low yield asset until death, in which case no capital gains tax will ever be due, from anyone. Under these circumstances, it is not surprising that many individuals, particularly in the upper age and wealth brackets, hold on to capital assets for tax reasons, even though the yield on those assets is relatively low. In effect, they are "locked in" to their present investments by the tax law.

This freezing of economic assets obviously harms individuals by forcing them to accept lower yields than they could otherwise enjoy. It also harms the economy by impeding the flow of capital into those areas where the need is greatest and where, as a consequence, the rate of return on investment is generally highest.

The taxation of capital gains at death or gift would sharply decrease the lock in effect. There would be no incentive to hold onto assets in the hope of escaping capital gains tax completely. Instead, a tax would be due whether an individual sold assets now or held them until the time of his death. The decision whether to sell or to hold would be based to a much greater degree on economic rather than tax factors, with consequent benefits for the American economy.

3. The revenue loss attributable to failure to tax capital gains at death or gift

During 1975, the federal government lost approximately $2.4 billion in revenue as a result of failure to impose a capital gains tax on assets passing at death or by gift. This is a revenue loss large enough to have financed the combined outlays of the Departments of Commerce and State during 1975, with something left over. Obviously a revenue loss this large must be ended, especially when there are no offsetting gains derived from continuation of this loss.

4. The proposed treatment of capital gains at death or gift

To remedy the problems just described, persons holding appreciated capital assets at the time of their death would be treated as if they had sold those assets just prior to death. The resulting gain would be taxed in the final income tax return of the decedent. The tax rate would be the same as that now applicable to assets sold during life. Similar rules would apply in the case of transfers by gift. A deduction for the income tax paid would be allowed in determining the amount of property subject to the estate or gift tax. Thus, the taxable estate or gift would be "net of income tax paid," as is now the case of those who accumulate their estates out of ordinary wages or other income, or out of capital assets that are sold prior to death. Capital assets that are taxed at death under the proposal would continue to acquire a stepped up basis at death, as under present law. In the case of gifts, a stepped up basis would be substituted for the existing carryover basis provision.

To facilitate adoption of the new system, various transitional rules can be devised, but care should be taken to insure that these rules do not result in loss of all or most of the immediate revenue gain that will result from adoption of the proposal to tax capital gains at death or gift.

To assist in payment of the capital gains tax in cases in which estates lack liquid funds, the stock, redemption and installment payment provisions of Sections 303, 6161, and 6166 of the Internal Revenue Code will be available.

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Basic fiscal principles

Underlying these two tax reform proposals are basic fiscal principles that we believe should have wide application as you consider tax reform legislation. These same principles are the foundation stones for the work of Taxation with Representation. Briefly summarized, they are:

The tax system should be used primarily to raise revenue. The use of tax subsidies to influence business and personal decisions should be a last resort, not the first solution proposed for social problems.

Direct government expenditures, which are subject to periodic accounting and review, are almost always a less expensive way of attaining public goals than are tax subsidies.

Tax deductions, credits, and exclusions usually confer their greatest benefits on those individuals and firms that are in the best financial condition, and give little or no help to those really in need.

Most deductions, credits, and exclusions erode the tax base and increase the tax burden that must be borne by others. This shifting of tax burdens is an important source of unfairness in the federal tax systems.

Fairness requires that persons with similar incomes and assets should be taxed alike. Fairness also requires that those who have more should pay more than those who have less.

A tax system is unsuitable for a democracy if it cannot be understood by the taxpayers themselves. And a tax system whose needless complexities waste and time and energy of thousands of accountants, lawyers, economists, and ordinary citizens demands simplification.

BAD "REFORM"—A $200,000 EXEMPTION

There are a number of changes in the Estate and Gift tax laws which have been masquerading as "reform" which Taxation with Representation strongly opposes. Specifically we oppose increasing the estate tax exemption for either all taxpayers or for farmers and small businessmen.

A number of people have recommended increasing the estate tax exemption to $200,000. The principal argument in favor of increasing the exemption is that inflation has eroded the value of the exemption so that $200,000 today is worth about what $60,000 was when that figure was established a generation ago. Treasury estimates the revenue loss from increasing the exemption to $200,000 at about $2 billion annually, nearly half the total of estate tax collections of $4.2 billion in 1972.

Dealing with inflation

It is true that inflation causes capricious changes in the intent of Congress. Regular inflation adjustments could be made by tying exemptions and tax brackets to a price index.

However, the proposed change to an exemption of $200,000 assumes that we want to restore the conditions of a generation ago, an assumption that is hasty at best. The proposed change is best evaluated in terms of its effect on the existing world of 1976. We must ask what the distribution of the benefits of the proposal will be under today's conditions, what the best level for the estate tax exemption is, and what changes we want in the estate tax law as it now exists.

There are several major deductions from the "gross estate" to get the "taxable estate." Besides the existing $60,000 exemption, one subtracts administration and funeral expenses, indebtedness, taxes due, charitable bequests, and the marital deduction (which usually amounts to half the gross estate). For this reason, estates are not normally taxable until they are well in excess of $100,000 and rates increase from 3% for the first $5,000 in the taxable estate to 77% for over $10 million. Thus, a $200,000 gross estate will frequently pay an estate tax of only 3% on a taxable estate of $5,000.

Supporters of an increase in the exemption point out that the number of estate filings increased 31% from 1969 to 1972. This sounds like a big increase, but a look at some other data will help put these figures in perspective. There were roughly two million adult deaths in 1972. About 175,000 estates, or 9%, filed estate tax returns (up from 7% in 1969), and only 121,000, or 6%, filed taxable returns. Only a quarter of wealth held by those who die each year is subject to estate tax. Thus 94% of decedents and 75% of all decedents' wealth would not be affected by the increase in exemption. The 6% of decedents who would benefit are those with the largest net wealth, since they are the only decedents who are taxable. Furthermore, because the estate tax is progressive, the absolute amount of benefit from any increase in the exemption increases with the size of the estate.

Effect of proposal

The effects of a $200,000 exemption can be illustrated as follows.

The proposal increases the exemption by $140,000. Decedents with $60,000 or less in their gross estate (who are 94% of all decedents) do not benefit, since they are not subject to tax now. Under current law, a decedent with over $200,000 of gross estate, and $140,000 of taxable estate is in the 30% marginal tax bracket

for a total tax of $32,700. A $200,000 exemption would completely eliminate this tax, for a benefit to the heirs of $32,700. A decedent with a million-dollar taxable estate is just leaving the 37% marginal tax bracket. The proposed reduction of this taxable estate is worth $140,000 times .37 or $51,800. Two-thirds of the $15 billion in total taxable estates for 1972 were in marginal brackets of 28% to 39%, so these three cases can be regarded as typical of the savings in the bottom two-thirds of all taxable estates.

Although absolute dollar benefits increase with size in this way, it must be pointed out that the reduction of tax as a percent of tax liability or as a percent of the entire estate decreases with the size of the estate. It would be possible to enact a tax credit of comparable value that would give the same benefits to all estates with tax liability of at least the credit amount. Thus a tax credit of $20,000 is worth nothing in the first case set forth above, and would be worth $20,000 in the second and third cases. This form of tax reduction as a percent of tax liability or as percent of the estate would decrease faster with estate size.

In general, estate taxes are intended to prevent the massive accumulation of personal wealth. The purpose of the exemption is to relieve certain estates from taxes. The amount of exemption, then, depends upon what society views as unusually large personal wealth. Since most opinions about the redistribution of wealth have changed in the last generation, we prefer a real exemption of $60,000 to a real exemption of $200,000.

FORD ESTATE TAX PROPOSALS

We are also opposed to any increase in the estate tax exemption for farmers or businesses. Attached you will find an article by Brant S. Goldwyn from *Tax Notes*, February 2, 1976 which analyzes in detail the Ford estate tax proposals.

Mr. Chairman, that concludes my testimony.

FORD ESTATE PROPOSALS ANALYZED

(By Brant S. Goldwyn)

President Ford has proposed a change in estate taxes that he claims will help preserve family ownership of small farms and businesses. For estates worth $300,000 or less, all estate taxes would be postponed for five years. The estate would then have 20 years to pay the tax, plus interest at 4% a year. The benefits would be scaled down for estates over $300,000; estates exceeding $600,000 would not qualify for this plan.

The Administration claims that the family farmer and the small businessman are prevented from passing their business on to their heirs because of burdensome estate taxes. The argument is that, because of inflation, small businesses which formerly excaped the estate tax are now worth much more on paper, without a corresponding increase in earning power. Their assets are mostly in the illiquid form of land, buildings and machinery, rather than stocks or bonds. This is referred to as the "liquidity problem." The only way that sufficient cash can be raised to pay the estate tax on the business' inflated value is to sell the entire farm or business. Such "forced" sales supposedly run against the grain of a society which enshrines the independent small businessman and the family farmer.

SUBSTANTIAL LIBERALIZATION

Under current law, Section 6166 of the Internal Revenue Code permits payment of the estate tax to be made in installments over 10 years for a qualifying "closely held business." Interest due is 7 percent. The Ford proposal represents a substantial liberalization, especially with the five-year grace period and 4 percent interest rate on the unpaid balance. While the administration calls this a "postponement" of taxes and not a reduction, the net effect has been calculated as a 45 percent reduction in estate taxes. (The value of deferral is equal to the interest that can be earned on the unpaid taxes.)

Are families forced to sell their business to pay estate taxes? Despite the rhetoric of the White House, members of Congress and small business spokesmen, many experts believe that estate taxes do not have such an effect.

For example, many agricultural economists and others do not feel that "forced sales" of farms is a problem. Studies of Iowa farms showed that most estate taxes were paid without selling any substantial part of the farm. United States Department of Agriculture economist Fred Woods, writing on this subject in

1973 and 1974, concluded that, while farms were paying more estate taxes, death taxes were "not yet a serious problem for most types of farms," and "were not unduly oppressive with respect to rural landowners . . ." Woods said that what was needed by those farmers with a liquidity problem was "better estate planning within the framework of existing law rather than changes in the tax law."

LIQUIDITY PROBLEMS

In many cases liquidity needs could be met by insurance. Smaller farms are protected by the current estate tax deductions; larger firms usually had sufficient credit to refinance their property. Some of the farmland could be sold without making the farm too small to take advantage of economies of scale.

The Ford proposal offers maximum benefits for business worth up to $300,000, and partial benefits for those worth up to $600,000. Certainly, an intuitive definition of wealth would not consider someone with a $300,000 estate to be poor or in need of federal assistance.

It is true that most farm estates are not liquid. In 1970, 78 percent of farm assets were in land and machinery, according to USDA figures, versus 22 percent of the value of all estates filing 1970 estate tax returns. But a farm worth $300,000 is not a small farm. According to United States Department of Agriculture calculations, the average farm as of January 1, 1974 had assets of $168,000 and a net equity of $142,000. USDA divides farms into 7 different classes according to amount of sales. Only Class 1A, with annual sales (not assets) over $100,000, had an average net equity in excess of $300,000. (See Table 1.)

TABLE 1

Class No. and sales	Number of farms	Percent of total farms	Average net equity	Maximum estate tax	Average estate tax paid	Estate size (thousands)
6—Under $2,500	707,000	25	$44,000			
5—$2,500 to $5,000	494,000	17	61,000			
4—$5,000 to $10,000	246,000	9	79,000	$1,600	$480	$70–$80
3—$10,000 to $20,000	325,000	12	117,000	8,750	4,500	100–120
2—$20,000 to $40,000	588,000	21	177,000	25,800	11,050	150–200
1B—$40,000 to $100,000	355,000	12	281,000	57,000	23,930	200–300
1A—Over $100,000	115,000	4	685,000	189,450	116,180	500–1,000

Source Data up through column on average net equity of farms is from the U.S. Department of Agriculture and reflects year of 1973. Remainder of data is from 1972 Statistics of Income, Estates, published by the Internal Revenue Service.

While IRS figures don't indicate how many taxable estates included farms or other businesses, the above figures indicate that the average estate tax is not a large percentage of smaller estates.

Of the $4.7 billion collected from the estate tax in 1973, only $86 million, less than 2%, came from estates valued at $120,000 or less. Almost 50% of the estates that filed estate tax returns were worth under $120,000; 63% of U.S. farms fit into a class where average equity is below $120,000. The bulk of estate taxes were collected from estates worth over $120,000. Farms in classes 2 and 1B, with an average net equity of $177,000 and $281,000, respectively, would get the full benefit of the Ford proposal, even though they are in the wealthiest third of U.S. farmers. It thus appears that any estate tax savings would go mainly to farmers that already are well off.

Comparable figures on the average equity of non-farm businesses don't seem to be available. Corporations won't be discussed since they don't pay estate taxes. According to the IRS, for tax year 1971, there were approximately 10 million sole proprietorships, but no asset figures are available for this category. IRS does have some figures on "partnership" assets. Table 2 shows the average gross assets for partnerships. These figures actually overstate the value of such businesses for estate tax purposes. The estate tax is paid on net assets, which is gross assets minus liabilities. Moreover, since these figures are for partnerships, any one partner would own less than the entire business. Thus, a partnership with gross assets of $100,000 may have liabilities of $10,000 and be equally owned by two partners, so that each partner's equity would be $45,000; $45,000 would be included in the gross estate of each partner for estate tax purposes.

SMALL BUSINESS STATISTICS

The following Table 2 shows that 73% of all partnerships in 1971 had gross assets under $100,000. Therefore the White House proposal, with maximum benefits for estates of $300,000, would aid most partnerships, not just the smallest.

TABLE 2.—NONFARM PARTNERSHIPS, 1971

Gross assets	Number of partnerships	Percentage of partnerships	Cumulative percentage
0	58,500	10.4	10.4
$1,000 to $10,000	111,500	19.9	30.3
$10,000 to $25,000	83,000	14.8	45.1
$25,000 to $50,000	79,000	14.1	59.2
$50,000 to $100,000	77,600	13.8	73.0
$100,000 to $250,000	74,200	13.2	86.2
$250,000 to $500,000	34,200	6.1	92.3
$500,000 to $1,000,000	20,700	3.7	96.0
$1,000,000 to $5,000,000	19,000	3.4	99.4
Over $5,000,000	2,900	.5	99.9
Total	560,000		

Source: "IRS Statistics on Business Income Tax Returns," 1971.

The likelihood that an heir would want to continue the family business is lower in a non-farm situation. The heirs often lack either the interest or the entrepreneurial skill needed to maintain the business. Sale is therefore a probable result of the owner's death no matter what the estate taxes are. Moreover, one accountant felt that small businesses which were sold usually were purchased by other small operators.

Treasury estimates the revenue loss from the White House proposal to be: 1st year—$2.5 million, 5th year—$12.5 million, 10th year—$19 million, decreasing thereafter. Loss of interest from the lower rate would be: 5th year—$2.5 million, 10th year—$5 million, 25th year—$10 million. The two figures should be added to give the total revenue loss for any year. The estimate reflects the difference between present law and the new proposal and does not include the costs of the present 10-year deferral provision.

OPPOSITE EFFECT POSSIBLE

Returning to the farm situation, a 1975 publication by the University of Illinois suggests that rather than help the small farmer, proposals like the President's may actually do the opposite and increase concentration in the farm sector. Several conclusions are relevant:

1. If part of a farm must be sold to pay estate taxes, the acreage may be attached to an undersized unit and add to its efficiency. For agriculture as a whole, there may be no net loss of efficiency.
2. Some division of large holdings may improve equality of opportunity for those desiring to enter farming. Any concession in favor of current owners works toward moving of land into the hands of a separate landowning class. Granting greater latitude in paying death taxes would act to keep farming in somewhat larger units than would otherwise prevail.
3. The heirs frequently are not operating farmers.
4. Selective concessions for agricultural estates, such as a preferential valuation or estate tax exemption would attract well-to-do nonfarmers and tend to transfer ownership and control away from operating farmers. Moreover, to apply these preferences only to "qualified" farmers could result in overwhelming and costly administrative problems. For instance, making residency on the farm a condition might actually eliminate some bona fide farmers. According to Fred Woods of the USDA, only 72% of farm operators reported living on their farms as of 1969, and another 20% had lived on their farms less than five years. Thus, such an approach may not be feasible to help the "family" farmers.

CONGRESSIONAL PROPOSALS

Congress has expressed great interest in estate taxes and many ideas that could go further than the White House have been suggested. One popular proposal

has been to raise the general estate tax exemption, from $60,000 to $150,000 or higher. The revenue loss would be substantial—$2 billion if the exemption were raised to $200,000. Most of this money would go to the wealthiest people in America. Another proposal would be special breaks only for farmers, such as raising the exemption or lowering the land value assessment. As discussed by the University of Illinois, this would encourage non-farmers to invest in farming for tax shelter purposes. Furthermore, giving special concessions for farmers, but not for others with estates of similar sizes, clearly violates the principle of equity. Some economists believe that it would retard the highest and best use of land.

An alternative being considered by Sen. Packwood, R-Oreg., member of the Finance Committee, would be to substitute a credit for the not yet proposed estate tax exemption. This would give equal monetary benefits to estate taxpayers at all income levels, rather than an exemption, which is more valuable to wealthy taxpayers. Such a change would be more equitable. The amount of the credit depends on one's view of who should pay the estate tax. Packwood is considering a $25,000 credit, which would result in no tax on estates up to $114,000 and an estimated revenue loss of $400 million a year.

OTHER ISSUES

While the effect of estate taxes is debatable, there are changes proposed that clearly seem desirable. Current law does allow the estate tax to be postponed over 10 years. Unfortunately, many estates don't do this because of certain restrictions. The executor of the estate is personally liable for the tax, and a costly bond must be posted. The alternative, supported by Treasury and others, is to substitute a lien on the illiquid assets, the farm or other property, for the bond and the executor's personal liability. Interest rates on deferred taxes now will be tied to the prime rate rather than being set as a fixed rate. Interest had been at 9%; on February 1 it became 7%. The Ford proposal of 4% seems to be a subsidy for those who defer estate taxes. Any rate substantially below market rates will encourage people to postpone estate taxes. As a compromise, some have proposed to charge the rate that the government pays when it borrows money, currently about 5%. While fairer, this still involves a subsidy to people deferring estate taxes. It is fair to allow estate taxpayers to defer taxes, to give them more time to raise the money, but a low interest rate does not seem necessary. The Treasury's 1969 Tax Reform Study supported setting the interest rate at a neutral level which doesn't penalize or subsidize those who defer taxes.

There are other issues concerning estate taxes which were not touched by the White House. The most controversial is the failure to tax capital gains at death. This costs the government over $15 billion a year. As a matter of equity, capital gains at death should be taxed. Once this is done, other changes in the estate tax, such as reducing rates or instituting a tax credit might be appropriate. While some spokesmen claim that taxing capital gains at death would do in the small businessman, the fact is that most of the revenue gain would come from the wealthiest taxpayers. The University of Illinois' study suggests one result might be to reduce land speculation and investment by non-farmers by bringing the value of farmland more in line with its income possibilities as a farm rather than for speculation. The lower tax rates on capital gains is more attractive to high income investors.

MARITAL DEDUCTION

Another facet of the estate tax which touches on the small businessman is the marital deduction. Currently this is 50% of the estate, so that the inheriting spouse pays no tax on estates worth $120,000 or less. The 1969 Treasury study stated that transfers between spouses are not appropriate for taxation, especially where the surviving spouse has minor children. The policy could be either to increase the marital deduction or to make it 100% and not tax such transfers at all. This obviously would help maintain the status quo in a farm business ownership.

Small businessmen are hurt by other parts of the tax code. Farm shelters are attractive investments for well-to-do nonfarmers who are allowed to write off current farm expenses against non-farm income. This drives up the cost of land and other materials used by farmers and depresses the market for their goods. Small businessmen, whose companies may be more labor intensive, can't use the investment tax credit and other provisions designed to encourage business.

The views expressed in this article are those of the author and do not represent a position on legislation by Tax Notes or its publisher, Tax Analysts and Advocates. Tax Notes strives to present a variety of views on tax policy and welcomes articles presenting opposing views on policy options.)

STATEMENT BY STANLEY S. SURREY, HARVARD LAW SCHOOL, REGARDING REVISION OF FEDERAL ESTATE AND GIFT TAXES

INTRODUCTION

Sponsorship of testimony by outstanding tax professionals is one of the ways in which Taxation with Representation seeks to promote the public interest. The group's objective is to broaden the range of viewpoints and opinions available to tax policy makers. It seeks, in particular, to facilitate the presentation of testimony on tax matters by economists, tax lawyers, and accountants who have no axe to grind. This statement is one in a continuing series of public interest presentations.

Sponsorship of testimony by Taxation with Representation does not mean that the opinions expressed by a witness are necessarily those of the members, officers, or directors of the group. It does indicate, however, that the group regards a witness's views as worthy of serious consideration by those concerned with the improvement of the federal tax system.

BIOGRAPHICAL DATA

Stanley S. Surrey is a Professor of Law at the Harvard Law School. He was Assistant Secretary for Tax Policy in the Treasury Department in 1961–1969.

SUMMARY OF STATEMENT

Estate and gift taxes are in need of complete revision.

The Committee should have its staff provide data on the distribution of wealth in the United States, by total net assets and types of assets. Without these data consideration of transfer tax issues is unrealistic.

The important needed structural changes involve:

(1) Unification of the present gift tax and estate tax into a unified transfer tax.

(2) Adoption of provisions which would end the present escape from tax of wealthier families through "generation skipping" transfers.

(3) An increase in the marital deduction.

(4) An end to the very large escape of appreciation in asset value from income tax in the case of assets transferred at death, the solution being the imposition of income tax at death on the appreciation with a deduction of the tax from the gross estate.

The transfer tax exemption level should be lowered—not increased—since appropriate relief is given the surviving spouse through the marital deduction and appropriate relief can be provided for dependents.

Transfer tax rates should start at a higher level than at present and the progression made more rational.

ADDRESS AND TELEPHONE DATA

Further information regarding the views expressed in this statement can be obtained by writing professor Surrey at the Harvard Law School, Cambridge, Massachusetts, 02138. His business telephone is 617-495-4635.

STATEMENT

This statement will first briefly describe the present structure of the federal estate and gift taxes in the United States and then consider the significant current policy issues respecting those taxes.

I. PRESENT FEDERAL ESTATE AND GIFT TAXES

The federal estate tax is levied on the tranfer of the estate of a citizen or resident decedent and is, structurally, an estate tax rather than an inheritance or accessions tax. The taxable estate consists of the world-wide gross estate of the decedent less

the allowable exemption and deductions. The gross estate includes all assets of the decedent held at death plus transfer during lifetime which are regarded as incomplete because of any interest retained by the decedent—e.g. revocable trusts, transfers with a retained life estate—and completed transfers made within three years of death if made in contemplation of death. The deductions include debts of the estate, transfers (without limit) to charitable organizations, and property transferred to a spouse (the so-called marital deduction) under conditions that the property will either be consumed by the spouse or includible in the spouse's estate and subject to a limit of one-half the gross estate after subtraction of debts. The exemption is a flat $60,000. Thus, a net estate of $120,000 left to a spouse is free of tax—$60,000 exemption and $60,000 marital deduction.

The rate schedule starts at 3% of the taxable estate, rises rather rapidly to 30% at $100,000, to 39% at $1 million, 67% at $5 million and a maximum of 77% at $10 million. The rates are applied to the full value of the taxable estate, including the amount needed to pay the estate tax itself. Credits against the estate tax are allowed for foreign estate taxes, United States gift tax on lifetime transfers included in the gross estate, and state death duties to a limited extent.

The federal gift tax is applied, on a cumulative basis, to transfers by gift during life. The rates are three-quarters of the estate tax rates and are applied to the value of the gift but, unlike the estate tax, not to the gift tax itself—i.e. the gift is not grossed up. There is a lifetime exemption of $30,000 per donor and an annual exemption of $3,000 per donee. Only one half of a gift to a spouse is included. Also, if one spouse makes a gift, the spouses may elect to treat the transfer as a joint gift; thus, $6,000 given in one year to a child by a father is fully exempt under this election. Gifts to charitable organizations are deductible without limit.

While the gift tax is cumulative, in that the taxable bracket of a current gift is determined by totalling all prior gifts, this cumulation ceases on death and hence the amount of completed lifetime gifts does not affect the estate tax bracket. The two taxes are thus essentially separate.

The federal estate tax raises $4.4 billion in revenue; the gift tax $.6 billion. Estate tax is paid by about 5% of decedents, with only .2% of decedents having taxable estates over $500,000; the latter account for 60% of the estate tax. While the total revenue of these transfer taxes is low in relation to other taxes (the alcohol tax yields $5.4 billion), the transfer taxes are levied on the very wealthy and hence contribute to the overall progessivity of the tax system. Thus, to ascount for 60% of the income tax we would have to cover returns over $13,000 or 18.8% of all income tax returns, as compared to the 4% of the estate tax returns.

The United States has no national annual wealth tax. The Constitution requires that an annual wealth tax, being a "direct tax," would have to be apportioned among the states in accordance with population. Such apportionment would defeat the purpose of the tax. Therefore, unless ingenuity finds a way around this barrier or the Constitution is amended (as it was to permit the income tax), the United States is not free to enact an annual wealth tax. Hence, the estate and gift taxes are the only national taxes on wealth. (There are state and local taxes on real property and in some cases on tangible or intangible personal property).

II. STRUCTURAL

The federal transfer taxes have remained essentially unchanged for more than a quarter century. Elsewhere the federal tax scene is marked by constant and often turbulent legislative action, but there has been scarcely a ripple in the transfer tax field. Clearly taxes untouched for such a long period are prima facie in need of repair and the transfer taxes are no exception. Several in depth studies in the 1960's by the American Law Institute, the Brookings Institution and the Treasury Department all point to the need for serious changes. The following is a brief description of some of the issues that should be considered in a major revision. Structural issues will be discussed first and then rate and exemption level issues.

Unification of Gift and Estate Taxes.—A major inequity in the existing estate and gift tax system is the manner in which the system favors lifetime gifts over testamentary dispositions. Whether lifetime giving should be favored at all is a matter than can be debated. But even assuming that some favoritism should be shown, the existing system provides this favoritism in an irrational and inequitable manner.

The existing favoritism is a result of three separate factors. First, the existing gift tax is calculated from a separate rate schedule distinct from the rate schedule applicable to the estate tax. Second, the gift tax rates are lower than the estate

tax rates. And third, the tax base is different. Each of these factors works differently, favoring different classes of donors in different ways. As will be shown, however, the net result of these factors is that, from a tax saving standpoint, the larger the state, the more advantageous transfer by gift becomes.

Since the taxation of gifts is based on a rate schedule completely separate from the estate tax rate schedule, total wealth transfers by an individual may be divided between lifetime transfers and testamentary transfers with each type of transfer taxed independently on a schedule beginning at the lowest rates. The aggregate transfers made by an individual can thus be split between two rate schedules and therefore taxed at rates unrelated to the individual's total transfers of wealth. The total tax will depend on how much of the total amount transferred is subject to the gift tax and how much is subject to the estate tax. Because neither the brackets nor the rate progressions of the estate and gift taxes are equal, the extent of this advantage varies from bracket to bracket. Once the maximum bracket is reached in the gift tax, there is no further saving from this factor. Hence, the saving due to this aspect of the transfer tax structure is limited for the very largest estates. The maximum possible tax saving in absolute dollar terms that can result solely by reason of splitting transfers between gifts and testamentary transfers is $1,700,000 for those with an aggregate estate of $20,000,000 or more. This amount of saving is solely that attributable to the splitting factor and assumes that the next two factors discussed are not present.

The second, and perhaps most obvious factor favoring lifetime gifts over death transfers is that the gift tax rates are 25 percent lower than the estate tax rates in each bracket. This factor applies equally to all sizes of estates and, therefore, grants the same degree of favoritism to gifts by all taxpayers.

The third factor favoring lifetime gifts is that the tax bases for the estate and gift taxes are different. This factor is somewhat more subtle in its operation and therefore is frequently overlooked, but for the very wealthy it provides the most significant saving for lifetime gifts. The base to which the estate tax is applied is the aggregate property owned by the decedent before diminution by that tax, whereas the base for the gift tax is the net amount transferred to the donee. For example, if a decedent leaves an estate of $10,000,000 to a child, the estate tax will be about $6,000,000 computed on the base of $10,000,000; the child will receive a net bequest of about $4,000,000. If, on the other hand, the same taxpayer decided to make the maximum transfer he could make to the same beneficiary (using, for purposes of illustration, estate tax rates for the gift tax as well in order to focus solely on this feature of the gift tax), he would make a lifetime gift of roughly $6,500,000 and incur a gift tax of about $3,500,000, thereby consuming all of his assets. By transferring property during his lifetime then, he would be able, solely because of the difference in the tax base, to increase the net amount given to the beneficiary from $4,000,000 to $6,500,000, an increase of over 60 percent.

This result obtains because the estate tax rates are applied to the aggregate estate of $10,000,000 whereas the gift tax rates are applied to the net transfer, which in this example is $6,500,000. To put it another way, the estate tax is imposed on the aggregate transfer before tax and the tax is then "withheld" from it much as income tax is withheld from the aggregate wages before tax of an individual. The gift tax, however, is imposed only on an "after-tax basis" on the transfer exclusive of the amount of the tax itself; again using the income tax analogy, the gift tax is imposed only on "take-home pay." Where the tax bracket of the transferor is very high, the fact that the gift tax itself is not included in the base makes an enormous difference. Because the tax rates themselves increase as the size of the transfers increase, the failure to include the tax in the base, i.e., the failure to "gross up," is of increasing advantage as the amount of a transferor's assets increases. For example, a decedent leaving an estate of $500,000 pays an estate tax of $145,000, thereby transferring $355,000 to his heirs. By disposing of his entire wealth by lifetime gifts, he would, solely by reason of the failure of the gift tax to gross up, increase the net amount passing to the transferee to about $375,000, or an increase of $20,000 over the net amount which would pass at death. This is an increase of less than 7 percent. On a $10,000, 000 transfer, however, the increase, as indicated earlier, would be over 60 percent. (In the calculations made for illustrative purposes in all of these examples, estate tax rates are also used for the gift tax in order to isolate the effect of the failure to gross up.)

The solution for this situation, included in the 1968-1969 Treasury Department Proposals for transfer tax revision, is "unification" of estate and gift taxes. Under this proposal the existing estate and gift taxes with their separate schedules would be replaced by a single unified transfer tax with a single schedule of rates and exemptions. In determining the applicable tax rates on property transferred at death, all transfers made during lifetime would be taken into account. For example, if an individual made $100,000 in taxable gifts during lifetime and paid taxes on them and thereafter left an estate of $500,000 at death, assuming no deductions or exemption, the tax applicable to the $500,000 transferred at death would be computed at the rates beginning above $100,000. Stated differently, the lifetime and deathtime transfers would be aggregated so that the total tax at death would first be computed on $600,000, and then the amount of transfer taxes paid during lifetime would be credited against the tentative tax so computed, leaving the balance as the tax due on the estate.

Another aspect of this proposal is that in computing the tax on a lifetime transfer, the transfer would be grossed up so that the lifetime transfer tax would be computed on the same tax base as deathtime transfers are now computed. For example, if an individual in the 25 percent transfer tax bracket made a net gift to his son of $7,500, the tax would be $2,500 or 25 percent of $10,000, the amount of the net transfer plus the tax. The gift would be considered as amounting to $10,000 and the tax of $2,500 would be considered as having been paid out of it.

There would be a single exemption available in place of the separate estate tax exemption and gift tax exemption.

All of the troublesome controversy concerning transfers in contemplation of death would be eliminated, since it would make no tax difference whether the transfer were a lifetime gift or a death transfer.

The most frequently voiced criticism of this "unification" proposal is that it would discourage lifetime gifts. Whether the proposal is seen as discouraging lifetime gifts or simply as not affirmatively encouraging them depends on one's starting point. The existing system contains significant positive encouragements to lifetime giving. Therefore, if the existing system is viewed as a norm, the proposed changes would, by comparison, discourage lifetime gifts. On the other hand, one may more accurately state that if the proposed changes were adopted, the new system would grant no encouragement to lifetime gifts but at the same time would not discourage them either. That is, the effect of the transfer tax system on making a gift or not making it would be neutral.

While it is true that a transfer tax becomes payable sooner if a gift is made than if the transfer is by will upon death, it is also true that if a lifetime gift is made, the tax is based on current values rather than on future values, and the latter can generally be assumed to be higher. Also, in many cases, depending on the type of gift, the future income from the property will be taxed at the donee's lower rate brackets rather than at the donor's bracket.

One important aspect of the tax influence on lifetime gifts has not been addressed by any of the critics. The aspect referred to is the inequitable and discriminatory way in which the present system encourages such gifts. No one has yet come forward to justify a system that encourages gifts by very wealthy donors by granting them tax reductions many times greater than those granted to the less wealthy. If the making of gifts is a socially desirable act to be encouraged as a matter of federal tax policy—a premise open to substantial question—then it seems that it should be encouraged to the same extent for all. The only way to provide for an equitable encouragement of gifts is to adopt a unified transfer tax system with gross-up for lifetime transfers and then allow some percentage discount in the rate applicable to gifts as compared to death transfers. The amount of the discount would depend on how much encouragement to lifetime gifts was thought desirable.

The argument usually advanced to support tax incentives for lifetime gifts is that it is to the advantage of society to have property moved into younger hands, for the young will tend to be more venturesome with such capital and thus improve the economic climate by increasing the mobility and risk-taking capacity of that capital. More persuasive, however, is the counter-argument that the government is not appropriately concerned with the rate of transfer of wealth from parents to children and should leave such matters to family decision, or at least that it is not so concerned as to provide tax incentives to affect whatever may be a family's natural inclinations in such matters. In any event, whether the consequence above asserted for lifetime gifts is true or not in a particular case at least depends to a large extent on the subject matter of the gift and on its form.

Most lifetime gifts are of marketable securities placed in trust, and they are made at a time when the donor is quite elderly. A gift to a trust extending for a long period of time seems little different in terms of economic mobility and risk-taking than continued ownership by the donor. The beneficial donee in this case does not have control of the property and its management is likely to be at least as conservative as it was in the hands of the donor. If one is in favor of encouraging lifetime gifts, it would surely be worth analyzing just what kinds of gifts are to be encouraged. Perhaps outright gifts are more to be encouraged than gifts in trust.

To say that the existing system is preferable to the proposed unification because it encourages lifetime gifts and the proposal does not, is thus to ignore both the basic problems at which the revisions are aimed and the questions which must be explored in a consideration of whether the tax system should be deliberately structured so that it operates in a nonneutral way to encourage lifetime gifts. In this regard, it is difficult to conceive of a legislature adopting a policy of encouraging lifetime gifts through a direct subsidy approach. Suppose, for example, someone were to propose that the federal Government pay grants directly to those wealthy parents who make gifts to their children while the parents are alive, with the largest federal grants going to the wealthiest parents. Presumably the suggestion would never seriously be considered as a legislative proposal. Yet that is precisely the effect of the existing estate and gift tax system when the tax savings accorded to lifetime gifts under that system are translated into direct subsidies.

Generation Skipping Transfers.—There is an aspect of equity in estate taxation that is not present in the income tax and that involves a notion of periodicity. If a given amount of wealth is, in one situation, subjected to the state tax on three occasions over a one-hundred-year period, and another accumulation of wealth of equal amount is taxed only once every hundred years, it seems obvious that the two accumulations are treated inequitably as compared to each other. While complete equity in the frequency of imposition cannot be achieved in the estate tax since its imposition depends on death, which is unpredictable, it is nevertheless clear that notions of fairness require some approximation of time equivalence. Some illustrations may help.

If an individual with an estate of $10,000,000 (ignoring deductions, etc.) leaves it to his two children equally, the estate tax will be about $6,000,000 and his children will each get $2,000,000. Assuming that the children then live on the income from their inheritances without affecting principal, each of their estates will pay an estate tax of about $750,000 when the property passes to their children, so that the latter will, in total, inherit $2,500,000 of their grandfather's wealth. If, on the other hand, the grandfather is well advised and leaves his money in trust paying the income to his children with the remainder to his grandchildren, he will pay an estate tax of $6,000,000 the same as in the first case, but the estate tax on the death of the children will be entirely avoided. The grandchildren will therefore take $4,000,000. The amount passing to the grandchildren will thus be over 50 percent greater in the second case than in the first, although the effect of the two transactions over the two generations is otherwise essentially the same. This effect can be considerably magnified by using transfers which keep property in trust for more than one generation and thereby avoid the tax on more than one intervening death.

Skipping one or more generations for estate tax purposes does not involve skipping generations as far as enjoyment of the assets is concerned. An intermediate trust beneficiary while alive may enjoy the income, control investments, obtain principal needed for his support, be able to withdraw the greater of $5,000 or 5 percent of the principal annually during his lifetime, and be able to give principal to others by gift or will—all without incurring estate or gift taxes except as to the moment of death, i.e. $5,000 or 5 percent of the principal.

Not only is there clear discrimination between estates of equal initial size in this situation, but there is also a crippling effect on progressivity. This effect occurs because the generation-skipping transfers described are generally available only to large estates. Smaller estates generally cannot take advantage of this type of transfer because of the need of the intervening generations for the principal. Since the tax-saving possibility in generation-skipping transfers is available primarily to larger estates and is increasingly available the larger the estate becomes, it results in reducing the progression of real effective rates or in eliminating entirely progressivity over large segments of the estate tax.

Proposals have been made to eliminate this generation-skipping defect of the present structure. Thus, the 1968–1968 Treasury Department Proposals would

impose a substitute tax on transfers that skip one or more generations. This substitute tax is designed to ensure that there would be the same total tax on such a transfer as there would be if the transfer had been made to the intervening generation and then by the intervening generation to the ultimate donee. The tax would apply whether the transfer were in trust or outright. The substitute tax would not be a penalty imposed on the generation-skipping transfer, but rather—as the name implies—a tax to take the place of the actual tax that would otherwise be skipped. There are several methods available for computing the substitute tax due under various circumstances. If a member of the intervening generation is alive at the time of the transfer to a donee in the subsequent generation, the member may elect to treat the transfer as if he had received the property himself and had retransferred it to the transferee. For example, if a donor (or a decedent-testator) transfers property to a grandchild and a parent of the grandchild-donee is alive at the time of that transfer, the donee's parent may elect to treat the property as received by him and retransferred by him to his child (the grandchild-donee). In this case, the donor would pay the normal transfer tax that would be due to a gift to his grandchild's parent and the latter, in turn, would report on his transfer tax return a gift to the grandchild-donee. If, in this situation, the donor were to reimburse his grandchild's parent for the tax resulting from the election, such reimbursement, of course would be an additional taxable transfer.

Under this proposal, a generation is considered skipped whenever the donee is more than one degree in family relationship below the transferor, and the substitute tax would apply whenever one or more generations were skipped. If the gift is to a non-relative, the substitute tax would apply if the donee is more than 25 years younger than the transferor.

If the transfer, rather than being outright, were made in trust, the intervening generation—the parents of the donee—could, but would not be required to, make the election at the time of the transfer; the election could be made at any time prior to the death of the survivor of the transferee's parents. In the interim, transfers out of the trust to the remote generation would be considered generation-skipping transfers. Once a parent of the transferee makes the election, he would be considered to be the settlor of the trust for purposes of applying the substitute tax. The amount of the gift for purposes of calculating the tax due from the electing parent would be based on the value of the trust corpus at the time of the election.

The election system would produce the same tax result that would obtain if the transfers were actually made to the member of the intervening generation and then retransferred by him. However, it is essential that this system be elective because the election does impose a tax liability on a member of an intervening generation who never, in fact, receives the property outright. To handle the situation where no election is made, the Treasury proposal contains a provision designed to achieve essentially the same result, but the provision is, of course, less exact.

Where no election is made, the substitute tax is imposed on the donor at the time of the gift at a rate equal to 60 percent of the donor's marginal rate. Sixty percent of a marginal rate is approximately equal to the effective rate on the transfer. Therefore, by calculating the substitute tax at 60 percent of the marginal rate an attempt is made to approximate what the effective rate of tax would be if the skipped generation had made the transfer. The measure, however, is necessarily inexact. This method of calculation would also be used when there is no living parent of the donee, i.e., when no member of the skipped generation is alive. However, in this situation, the donor may elect either to use the 60 percent method or to use the actual marginal rate applicable to the estate of the last parent of the donee to die. This election may be made by the transferor or by his executor or other representative where applicable.

Where the transfer is in trust and no election has been made to pay the substitute tax, the tax will become payable by the trustee when distributions are made to the remote generation, at a rate of 60 percent of the transferor's marginal rate (or at the actual marginal rate of the intervening generation's transfer tax bracket if there is no surviving member of that generation eligible to make the election). This situation would continue until the tax is paid on the total corpus, at which point the trust would be treated as having been created by the intervening generation so that the subsequent distributions would not be taxable unless they are to a generation remote from the skipped generation, for example, great-grandchildren of the donor.

There have been other, less complete, solutions proposed to cure the generation-skipping problem. One is to grant a special discount or reduction for outright

transfers by parents to their children. Another is to eliminate the elective aspect of the Treasury proposal and confine the proposal to the substitute tax on the settlor-decedent.

It is clear that any satisfactory solution to generation-skipping will involve complexities since the situation itself, certainly as respects long-term generation-skipping trust arrangements, is inherently complicated. Those arrangements are complex matters, for the draftsman must often project himself almost a hundred years into the future and try to perceive and handle all contingencies. It is asking far too much that such a complex situation be dealt with in comparatively simple fashion by the tax law.

When a sophisticated aspect of estate planning is involved and that aspect is one far removed from the ordinary transfers of assets from one generation to the next, the tax policy governing that aspect must also be sophisticated. Tax policy must permit the arrangements to be used for whatever non-tax purposes they may serve, but it must not permit them to be avenues of tax escape. Less complex tax solutions may be welcome, but those who desire to use these complicated arrangements cannot argue that because there will be *complexity* there must be tax *immunity*.

The other arguments against the generation-skipping proposal seem largely strategic retreats. Thus, it is said that generation-skipping trusts involving two generations are rare and there is no reason, therefore, to upset everyone for a few cases. This argument, of course, can be turned upside-down since only the few affected would be upset. Others would admit to the desirability of taxing the arrangement when two generations are skipped, but not one generation, though no explanation is made of why one untaxed skip should be permitted or why in effect the estate tax should apply only every other generation. Others point to cases in which a decedent's children may be dead so that the natural beneficiaries of his estate are his grandchildren, or to cases in which the decedent simply does not like his children, and ask why a generation-skipping tax should be imposed in these cases. But these situations and others like them lie at the fringe of this problem. By far most generating-skipping transfers occur where both children and grandchildren are alive, where both are liked by the decedent, and where the children share in the enjoyment of the property during their lives. The basic tax rules must be constructed to deal with these normal situations, and the pattern of those rules should not be decided by the fringe cases. Nor should the fringe cases be treated in a different fashion, once the basic decision is made to impose a tax on the time pattern of every generation.

Marital Deduction.—A corollary to the proposition that estates should be taxed once a generation is the proposition that, generally speaking, they should not be taxed in total more than once a generation. This view is partially accommodated in the current estate and gift tax system by allowing a marital deduction for property left to a spouse in an amount up to 50 percent of the adjusted gross estate and for one-half of an individual's inter vivos gifts to a spouse. Death transfers to a spouse, in order to qualify for the marital deduction, must be outright or must provide for a life estate with a general power of appointment. This requirement assures that the property left to the wife, for example, and deductible from the husband's estate, will be includible in the wife's estate upon her subsequent death if it has not been consumed.

The estate tax marital deduction, however, is limited to one half of a taxpayer's adjusted gross estate. In those cases where the surviving spouse will not consume more property than that qualifying for the marital deduction in the decedent spouse's estate, the marital deduction with the 50 percent limit works satisfactorily, i.e., the total amount of property subject to estate tax in the two spouses' estates will be the amount passing to the next generation. In those cases where the surviving spouse will consume more than the marital share, however, the estate of the first spouse to die is taxed on property that will not ultimately pass to the next generation. This is obviously a problem that arises primarily in the case of smaller estates. Moreover, decedents leaving these smaller estates frequently provide that more than one half of their estates shall go outright to their spouses. If less than this excess over one half of the property is consumed by the survivor under this arrangement, a portion will be subject to two taxes in passing to the next generation.

Moreover, the rules requiring that transfers, in order to qualify for the marita deduction, either be outright or provide for a general power of appointment, will frequently force a decedent to leave assets to his wife under an arrangement which non-tax factors may indicate is inadvisable.

The proposals in this area are all in the direction of enlarging the marital deduction, by increasing the amount of the deduction and expanding the type of transfer to a spouse that will qualify. Thus, under the 1968–1969 Treasury Department proposal, the existing 50 percent ceiling on the marital deduction would be eliminated and a deduction would be allowed for the full amount transferred to a spouse up to the full value of the estate. Lifetime transfers between spouses would be free of tax, any gift by either spouse to a third person could be treated as made by either spouse for purposes of calculating the tax. Such gifts could be treated as made equally by each spouse, or unequally, or treated as made entirely by either one or the other.

Another aspect of this proposal would be the expansion of the kinds of transfers which qualify for the marital deduction. Instead of requiring that the transfer be outright to the spouse or that the spouse have a life estate coupled with a general power of appointment as under present law, any transfer of the present ownership, enjoyment, use, or income to a spouse would qualify for the marital deduction so long as the transferor's spouse consents to having the eventual termination of that interest treated as a taxable transfer. Where the transferor's spouse has less than complete power of disposition or control of the property, the tax imposed on termination of the spouse's interest would be collectible only out of the property itself and would not be a personal liability of the spouse.

Furthermore, an election would be given to permit any transfers which qualify for the marital deduction to be taxed at the time of the transfer. If exercised, this election would eliminate taxation upon the termination of the spouse's interest in the property. In this way, the transferor or his personal representative may regulate the amount includible in each estate and thereby achieve whatever saving might be available by dividing the taxation of the transfer between two estates, even though all of the property is left in a way which would otherwise qualify for the marital deduction.

There seems to be relatively little objection to a proposal to increase the marital deduction. This general acceptance is not surprising since that proposal would benefit many taxpayers and would not directly raise anyone's taxes. The estate tax today is levied on the accumulated wealth that a person has left at his death; any savings that he consumed during his life are not subject to the levy. A person who accumulated until middle age, for example, and thereafter consumed his savings is not subject to the estate tax on the consumption. If the husband is the first spouse to die and the consumption is by his widow, it would seem that the same principle should apply and the estate tax should be levied only upon the accumulation remaining after the combined consumption of husband and wife.

However, some criticism has been made of an unlimited marital deduction as too favorable to married decedents. The main consequence of the present limit on the marital deduction, given the difference in life expectancies of men and women, falls on the family where the wife will consume all of the estate and hence the tax on the husband's half as it goes to the wife results in a tax on property not in fact left to the next generation. The family cannot under present law plan out of this consequence. Hence, since this is only a problem for the smaller estates, the suggestion is made by some that the marital deduction be increased to one-half of the estate (as today) plus $100,000. Under this suggestion, a husband could, say with a $25,000 basic exemption (see the later discussion), leave $250,000 to his wife free of tax (one-half of $250,000 or $125,000 plus $100,000 plus $25,000).

Where there is double taxation in the same generation today, that is where more than one-half is left to the wife and she does not consume the excess, the family pays too much, compared to the view that the husband-wife combination should not be taxed on more than their total wealth. But the families in this position, those with the larger estates, can and do plan out of this situation under the present law by splitting the husband's estate on his death and thus placing a limit on what goes to the wife. Moreover, the basic Treasury proposal would make this planning easier by permitting the executor to elect not to qualify property for the marital deduction. If there were an unlimited marital deduction, the families with large estates would still plan not to use the full amount permitted, since the wife would not consume the excess, and would still split the husband's estate. An unlimited marital deduction would here merely influence the calculation of the split since the *deferral* of estate tax that the deduction would permit at the husband's death must be balanced against the payment of a larger tax on the wife's death. Under this balancing, more would be given to the wife than under splitting today in order to take advantage of the deferral possibilities. In this view, there appears to be no policy reason to add *deferral* on top of the splitting effectuated by the parties.

The placing of some limit on the marital deduction does not run counter to the principle that wealth not be taxed in total more than once in a generation. Under the above suggestion of a limited marital deduction but one more generous than the present deduction, some tax would be paid when husbands with larger estates died, rather than some of their tax share, so to speak, being deferred until the wife also died. Parenthetically, the complexities of the present marital deduction lie not in the limitation to one-half—the defect of that limitation is the imposition of tax when the wife consumes all the estate in her life—but rather in the rules governing the eligibility of property for the deduction. These complexities are removed in the basic Treasury proposal by allowing an income interest of the wife to qualify. Hence, the suggestion of some quantitative limit on the marital deduction does not mean any added complexity compared with an unlimited deduction.

Other Matters.—There are a number of other matters which should be considered in transfer tax revision. These include a widening of the definition of the gross estate to cover items omitted today under special preference rules, such as life insurance paid for by the decedent but as to which he had transferred the incidents of ownership and employee pension annuities payable to beneficiaries named by the decedent; the question whether a limitation should be placed on the charitable deduction; liberalization of the rules governing the time of payment of the tax due on death, especially to help family farms and closely held family businesses; proposals to go further to help these family farms by applying special valuation techniques to them that would reduce taxable value below going market value and then providing in effect for recapture of estate tax if the property is sold at a high value. Or perhaps a farm owner could covenant with an appropriate governmental or private unit to use the land only for farm purpose and thus reduce its value. The covenant might also be made by the estate. The important point here is that the problems raised regarding family farms and small businesses, which are only a very small part of the assets subject to estate tax, should not distort the rules that should apply to estates with readily liquid assets, which constitute the great bulk of taxable estates. Thus, the recent proposal of President Ford to solve the "farm problem" by giving *every* estate a $150,000 exemption at a revenue cost of over $1 billion is simply wrong and out of focus. This proposal quantitatively allows a very small farm tail to wag a very expensive estate tax dog.

The most serious defect in our federal tax structure today is an income tax defect associated with death. This defect is the failure of the income tax to reach the appreciation in value of assets transferred at death. Our income tax system does not tax the annual appreciation in value of an asset. Yet it is clear that such appreciation is "income" and that the person benefitting from such appreciation has the same ability to pay tax on it as does the recipient of income in the form of salary or dividends. In most cases—particularly where marketable securities are involved—the taxpayer could reach out his hand and obtain the income, i.e., sell the asset and thereby acquire the actual funds. But if he stays his hand, our income tax stays its demand and the income—the increase in value—goes currently untaxed. In more technical terms, the income tax for a variety of reasons will await the time when the income is "realized." In some cases the person may not be readily able to sell the asset; in some cases valuation may be troublesome; other problems might arise in the taxation of accrued but unrealized gains.

The aspect here relevant is not the decision to leave such unrealized gains currently untaxed, but rather the consequences of that decision under the present system.

One might suppose that the decision not to tax the unrealized gain would result only in a postponement of the tax and not its complete forgiveness. And indeed, if and when the asset is sold and the gain is realized, that gain will then be taxed even though it in fact may be attributable to prior years. The tax will be based on capital gains rates rather than on the higher ordinary income rate, but that aspect of the income tax system turns on other issues. But suppose a sale is steadily postponed and the owner dies, so that he cannot himself sell the asset. Is the postponement then to mean complete forgiveness? Our income tax structure today has just that effect—it turns postponement into forgiveness by not including the appreciation in the decedent's final income tax return while at the same time allowing the heirs to take as their income tax basis, i.e. their tax cost on a later sale by them, the asset's fair market value at the time of the decedent's death. The appreciation ipso facto becomes capital and beyond the reach of the income tax. This change from postponement to forgiveness has two far-reaching consequences.

From a revenue standpoint, it results in a large escape from the income tax and a consequent serious revenue loss under that tax. As far as equitable considerations are concerned, it has the effect of seriously discriminating between those families who can build their estates through such untaxed appreciation and those who have to build them out of after-tax dollars.

The Treasury 1968–1969 proposals state that in the aggregate, for 1966, the untaxed appreciation passing through the estates of those who filed estate tax returns was about $7 billion, out of total estates of $21 billion. (An additional $4.5 billion passed from decedents not required to file an estate tax return.) For the group of individuals whose annual economic income (including annual appreciation in asset values) exceeds $100,000, the annual appreciation that is untaxed—and in the end escapes income tax at death—is about equal to all other income, both taxable and exempt, combined. For individuals with over $1,000,000 of annual economic income (including annual appreciation in asset values), the effective rate of income tax was about 10%. The consequence in the end of not subjecting these large accumulations of income to the income tax is clearly to provide a broad avenue of escape from that tax for the wealthiest families—an avenue that is in addition to, and separate from, the escape that results from the use of a preferential capital gain rate for realized appreciation in value. From an economic standpoint, the present treatment presumably produces some asset holding patterns that would not otherwise obtain, as elderly investors become locked into the retention of appreciated assets to avoid the income tax that would result on a sale during lifetime.

The complete illogic of the present system can be illustrated in many ways. The following example should suffice: Assume that each of two individuals, A and B, obtains throughout his adult life a salary of $40,000, all of which is used for current consumption and for the payment of income tax thereon. Assume that each also has an investment account used for saving. In the case of A, all of the yield is in the form of dividends and interest, averaging $50,000 a year and subject to the income tax at, say, a 50% rate. A's 40 years of after-tax accumulation in this account comes to $1,000,000. B has his investment account in growth securities with no current yield and with no lifetime realization of the appreciation. Assume that B's average annual appreciation is $50,000, the same amount as A's before-tax yield. B's accumulation over 40 years aggregates $2,000,000. By hypothesis, the two individuals have comparable consumption patterns, i.e., they live in the same kind of house, eat the same kind of food, take similar vacations. The difference is that B's savings, and hence his estate, are built from unrealized and untaxed appreciation, while A's saving and his estate are built out of after-tax income. B has been able to build up the larger estate because the income tax system stayed its hand. But once B has died, there is no reason for that system to continue the postponement and leave the appreciation forever untaxed. The factors which stayed the tax initially when the appreciation accrued are clearly no longer pertinent. B's assets must now be valued for estate tax purposes and some presumably will have to be sold to pay that tax.

It is certainly no answer—though some continue to assert it as if it were—that the appreciation is not wholly untaxed inasmuch as B must pay an estate tax on the appreciation. The pertinent tax under consideration is the income tax which B escapes. As the Treasury proposals state: "The estate tax will fall on both A and B so it is not relevant to say that B ought not to pay any income tax on his accumulation of wealth "because he pays an estate tax." A has paid income tax on the money that he earned to build an estate and an estate tax. B avoided income tax on his wealth increase and only an estate tax is paid on it."

Suppose B had decided to sell all his securities in order either to embark on a new investment plan or to increase his consumption, but unfortunately died soon after the sale. B would then have paid his income tax on the appreciation so that his savings are now "after-tax" as are A's savings, but B's estate will also pay an estate tax on the savings. No one has seriously attempted to justify on any logical ground why B should go untaxed under the income tax if he had decided not to sell and had then died holding the appreciated assets. There are other arguments advanced to perpetuate the present illogic and inequity, but these can be considered after the Treasury proposal has been described.

There should be an end to this tax escape. Large sums are involved. Thus, the capital gain preference on lifetime sales of capital assets (inclusion of only one half of the gain) is estimated to involve about $5 billion a year. The estimate of tax lost at death (i.e. the revenue that would be obtained if a tax were imposed on the appreciation in taxable estates at ordinary income rates) is placed at around a $7 billion figure. (The figure would be lower with the exemption under the

Treasury proposal.) This makes the total capital gain preference—on lifetime sales and at death—around $12 billion. (The above estimate is before the effect on transfer tax. Since any income tax imposed at death would be a deduction from the estate tax base, there would be a decrease in estate tax payable. This is, of course, also true as to any increase in lifetime income taxes, and revenue estimates here are also—and properly so—always on a before-estate tax basis.)

The 1968–1969 Treasury Department proposals recommended that the appreciation be taxed under the rules applicable to sales of assets. Losses would also be allowed. There would be appropriate averaging rules. Decedents would be presumed to have a minimum basis equal to the estate tax exemption, so no income tax would be imposed on the appreciation where total value was less than the exemption. Appreciation in value of personal or household effects having a value less than a stated minimum would be excluded. Transfers to a spouse would be exempted, but would have a carried-over basis. Appreciation in value of assets transferred through generation-skipping arrangements would be reached. There would be transitional rules designed to phase in the tax gradually. Lifetime gifts would also subject the donor to a tax.

Most of the objections to the proposal for income taxation of the appreciation in assets transferred at death are either specious or are directed at debating points that are minor indeed when considered in the perspective of the stakes involved. Thus, some critics persist in contending that the unrealized capital gain at death does not escape taxation since the estate tax rates apply to the full asset at death—and in so contending never bother to point out that those estates built up from "after-income tax" dollars also pay the estate tax. Others state that it is unfair to tax the appreciation at death since the asset may later decline in value—but conveniently overlook the fact that the estate tax itself is applied, often at much higher rates than the capital gain rate, to those same values at death, despite, but conveniently overlook the fact that the estate tax itself is applied, often at much higher rates than the capital gain rate, to those same values at death, despite the possibility that they may decline. Of course, the assets may, on the other hand, appreciate still more in value, but any subsequent value changes are properly treated as gain or loss to the heirs. Some critics make much of the contention that the executor may not have adequate records to show the income tax basis of the appreciated assets. But most of the assets involved will be marketable securities and their basis can usually be reconstructed in the cases where it is not recorded. Moreover, improved record-keeping, if improvement is necessary, will come about. The situation must be kept in perspective: we are considering over $10 billion in appreciation each year, and the taxation of a significant part of this gain, if otherwise appropriate, can hardly be faulted because some records are found wanting. Some say that death is not a "sale" and we tax only sales of capital assets. We can hear these words but they mean nothing in themselves. All they are is a restatement of the issue. Finally, in this category is the argument that such income taxation on appreciation at death has not been imposed before in this country This observation of course is correct—and is the reason why change is now needed. It may be observed that Canada, in adopting a capital gains tax for the first time, took note of our experience and did not repeat the mistake of allowing appreciation in the value of assets passing at death to escape the income tax.

There is also the objection that an income tax applied to appreciation at death would be unconstitutional. This statement is not the place for a lengthy legal discussion of this issue. Those interested in the precedents that can be marshalled are referred to the opinion which was submitted to Congress by the Treasury Department in 1963, in which it was concluded that the step would be constitutional. Suffice it to say here that we doubt that most lawyers viewing the legal issues objectively would wager against the tax being upheld by the courts.

Others raise the argument that the appreciation in the value of the transferred assets mirrors inflationary change so that taxation is unfair. But this contention would apply as well to lifetime sales, and indeed it is one of the principal contentions pushed by opponents of any capital gains tax. Our tax system has rejected the contention and does include capital gains in income, though at a preferred rate. There is no reason after rejecting the contention when lifetime sales are involved to turn around and accept the contention when the asset is transferred at death. The aspect of inflation is a separate matter, relating to the treatment of capital gains in general, and cannot be turned to as a defense for a zero rate of taxation on capital gains. Indeed, careful analysis by Roger Brinner and others has shown that the longer an asset is held the less is the portion of the appreciation that reflects inflation and the larger is the portion that reflects increase in asset value.

There are more pragmatic critics who see that the sheer unfairness and illogic of the present system are beginning to be understood by both Congress and the public at large. They also recognise that, as a consequence, the time for change appears to be at hand; and hence an orderly retreat is more appropriate than a diehard defense of the present system. They therefore agree that the present system is wrong. However, they urge that the corrective course is not to tax the appreciation at death but rather to adopt a carry-over of basis system under which the decedent's basis would become the tax basis for the heirs. But this suggestion does indeed represent no more than ground yielded in retreat, rather than a solution possessing any real advantages over the Treasury proposal. Moreover, the carry-over basis suggestion involves serious disadvantages. To turn back to our example of individuals A and B, the former with an after-tax estate and the latter with untaxed appreciation, why should B's advantages persist even after his death and result in his family having a larger inheritance simply because he has thus far escaped an income tax? And why should his heirs be able to keep that larger inheritance until they sell the property? Whatever the validity of the reasons that underlie the policy decision not to tax B's accrued but unrealized appreciation during his lifetime—e.g., that he may not be able to sell the asset, that it may be hard to value the asset, that he may not have the cash to pay the tax without a sale of the asset—those reasons no longer obtain at B's death when the imposition of an estate tax required valuation and most likely a sale of at least some of the assets in order to pay the tax. Moreover, further postponement of the tax can only harden the lock-in effect, for under a carry-over system B's heirs would face the prospect that sale by them would result in tax liability while continued holding would not. Under the Treasury proposal, there is a carry-over basis to the spouse, but this is in keeping with the unlimited marital deduction under the transfer tax for the transfer to the spouse.

It is important in this connection not to lose sight of the overall situation. The problem is one of determining the amount of tax that should be levied on a decedent's wealth when he dies. The Treasury proposals would require a final income tax tally on a decedent's hitherto untaxed appreciation in asset values. This would result in a settling of accounts as between estates with much untaxed appreciation and those with little such appreciation. Death is the appropriate occasion for these final accountings. There is no reason to hold some of the books open and, at some future occasion when the heirs sell the assets, to close the books on the appreciation. The untaxed appreciation was experienced by the decedent, and his death is the appropriate occasion for closing that account.

Others have suggested that a flat rate additional separate tax be imposed at death on the asset appreciation that exists, with this tax being in addition to the estate tax. Such an arrangement, however, lacks any basis in theory or tax principles and is not the way to proceed. It makes impossible any rational relationship between the income tax and the estate tax. In addition, as Professor David Westfall has observed, there are many technical difficulties with the arrangement. Moreover, the essential foundation for the suggestion—that a capital gains tax at death is regressive—is faulty. Thus it is argued that a system of income tax on the gain at death would be regressive because the larger the estate the lower the net amount of income tax which would have to be paid. The Federal Government would, it is said, in a sense by paying part of the income tax since the capital gains tax at death would be a deduction from the gross estate in computing the estate tax. Of course in that way of looking at the relationship the larger the amount of wealth in the estate the more the Government would be paying of the income tax at death. But that is true of the entire income tax. It is true as to all income and all capital gains during life that the income tax on these items is omitted from the estate tax base because the amount of income tax, having been paid during life, is not owned by the decedent at death. Consequently, the statement that the imposition of a capital gains tax at death would have the above effect is true of the entire interrelationship between the income tax and the estate tax. The decedent is simply not as wealthy, to the extent income tax has been paid or would be due at death, and hence his estate is thereby less to that extent. Hence, any arrangement based on the asserted "regressiveness" of income taxation of appreciation at death is based on a misleading premise.

A last point urged by some critics—and really the only relevant one—is the possible effect of this proposal on estates consisting of closely held businesses or farms with significantly appreciated values. The real issue here is that of the liquidity, or rather the possible illiquidity, of such estates in that income taxation at death could aggravate any difficulties that may be present in finding the funds

to pay the taxes occasioned by death. But this point also must be kept in perspective. By far the major share of those estates in which asset appreciation is a significant part consist largely of diversified stocks and securities; such estates do not present this illiquidity problem. Criticism based on illiquidity in estates where closely held businesses are involved should not, therefore, be permitted to cloak opposition to the change over the broad area where that aspect is not present. Any liquidity difficulties that may exist in these special cases should be dealt with directly, just as in the case of the estate tax itself.

All in all, a correction of present income tax treatment of appreciated assets at death is one of the most important issues in tax reform in the United States. The proper correction is income taxation at death of the appreciation in asset value.

III. RATE AND EXEMPTION LEVELS

Most of the discussion on transfer tax revision in the United States has centered on the structural aspects described above. The question of rate and exemption levels has been relatively muted. The 1968–1969 Treasury Department proposals, in order to focus attention on the structural issues, were designed to hold revenues constant. The American Law Institute revision suggested a downward adjustment of rates. Congressional discussion of exemption levels has been largely confined to proposals to increase the present $60,000 estate tax exemption on the simplistic ground that price-level changes automatically warrant a much higher exemption. Thus there is little consideration given to the criteria that are relevant to the determination of rate levels and exemption levels.

Are there any guidelines that can assist to shape quantitative decisions on these matters? Let us start with *exemptions*. The present estate tax exemption is $60,000, and this figure restricts the coverage of the estate tax to 5 or 6 percent of adult decedents. This in itself suggests that a lowering of the exemption, even a significant lowering, would still keep the transfer tax a rather exclusive levy. Suppose we started the other way and first asked what exemption level is required to keep most small or minor or average estates—the precise adjective is not needed—outside the scope of the tax. In answer to such a question, some have suggested a figure in the area of $25,000. We can next ask, are there persons receiving property from a decedent who are entitled to claim that a higher figure should be used? Thus, what about the interests of a surviving spouse, most likely the wife? But here the marital deduction provides protection for her interests. Clearly an unlimited marital deduction does so in full. Even a marital deduction with the limits suggested above—one half of the estate plus $100,000—would seem to provide the needed protection. The latter deduction, with a $25,000 exemption, would permit a tax-free transfer of $250,000 to the wife, and less than 1 percent of widows enjoy that much wealth today. So, given the marital deduction suggestions, the interests of a surviving wife do not require a higher exemption than $25,000.

What about surviving children? Here it has been pointed out that in all probability the surviving children of decedents possessing more than $25,000 of wealth are likely themselves to be adults and even adults well along in life. Most decedents—four-fifths—are in the age bracket of 60 years or over. With the head of the family at ages 55–64, only 20 percent of married couples (1960 Census) had children under 18 years; at age 65 or over, only 3.5 percent. While adult children may welcome inheritances, their claims are not usually founded on the need or hardship that can arise when the provision of support is suddently removed, as would be the case for a surviving wife or minor child. We can therefore shift the inquiry to minor children. The Treasury proposals included special treatment for orphan minors in the form of a special exemption, or deduction from the estate, of $3,000 multiplied by the difference between 21 and the orphan minor's age in years. This proposal has prompted further exploration of special treatment for minors, and resulted in suggestions broadening the approach. Thus, some have suggested that the special exemption cover minor children, whether or not orphans, and any other persons who were claimed by the decedent as a dependent for a period of years preceding his death. In the case of elderly dependents and those not minors, the structure of the exemption would have to be related to life expectancies or perhaps use an arbitrary figure not out of line with results for other dependents. The special exemption thus here operates as a cushion to counter the removal through death of the decedent's support.

Under this overall approach the exemption can be structured in the light of the purposes an exemption should serve under a transfer tax. First, there would be a basic exemption to separate the estates that it is desirable on administrative

grounds to keep outside the scope of the tax, thereby permitting attention to be concentrated in the appropriate area. However, in fixing this basic exemption, attention has to be paid to the pattern of wealth distribution in the United States, so that the figure does not screen out those whose estates, though appearing small in absolute terms when viewed from above, are large relative to the wealth, or really lack of it, possessed by those below. Second, special exemptions would be devised to protect those previously dependent on the decedent for their support, so as to cushion for a period the loss of that support. Minor children are an example, as are parents or relatives actually dependent on the decedent. Surviving spouses would, however, not be in this category in view of the effectiveness of the marital deduction in providing protection for the wife.

When we turn to the matter of *rates*, any legislative discussion of the proper level of transfer tax rates (and exemptions) should—but generally does not—take place against a background of the pattern of wealth distribution and of the social policy toward that pattern. In the United States 1 percent of persons is estimated to hold 21.9 percent of the total net worth held in 1969 by the total adult population (122 million) (the estimate for 1953 was 27.5 percent). 35.7 percent of total net worth is held by those having more than $60,000, 4.3 percent of the total adult population. This latter group owns 27 percent of the total real estate, 60 percent of the corporate stocks, 76.5 percent of state and local bonds, 40 percent of the business assets. (Data from Smith, Franklin and Witon, *The Distribution of Financial Assets* (1973), the Urban Institute and Pennsylvania State University).

A look at the distribution of wealth in the United States would reinforce the view of a starting rate much higher than the very low rates of today, which begin at 3 percent and do not reach 25 percent for a single person until $110,000 ($50,000–$60,000 bracket plus $60,000 exemption) where only about two percent of adult decedents are found. An effective rate of 25 percent is not reached until an estate of around $500,000, where less than one percent of adult decedents are found. These factors have led some to suggest rate scales starting at 20 percent after a basic exemption of $25,000 (and keeping in mind the marital deduction and special exemption for dependents), rising to 30 percent at $50,000, to 50 percent at about $500,000 and up to 80 percent at $5,000,000.

It is easy to lose perspective in co sidering the estate and gift taxes. In one aspect they resemble the income tax, for they have a basic exemption and then a progressive rate scale. As a consequence, one is apt to approach the estate and gift taxes with individual income tax attitudes, such as be careful about making exemptions too low, be careful about the height of the starting rates, be careful about the pace of progression. But such income tax attitudes derive from the fact that the present income tax has a wide coverage of the population in the United States. About 80 percent of the population of 21 years or over file income tax returns and nearly all of these—or 75 percent of the same population—pay an income tax. These income tax attitudes have real meaning and force under such circumstances. Indeed our income tax starts today at poverty levels, and unless care is given, as it was in 1971 and 1975, to see that the combination of the low income allowance (minimum standard deduction) and personal exemptions (plus a special credit in 1975) is raised periodically, the starting point could fall below those poverty levels as the price level increases.

But the starting point of "wealth", the distribution of wealth, and consequently the universe occupied by the estate and gift taxes are all far different. In such a universe, income tax attitudes can easily lead one astray. Thus, the present estate tax is imposed on the estates of decedents with net assets of over $60,000. Yet only about 5 or 6 percent of adult decedents leave estates of that size; only about .2 of 1 percent of adult decedents leave taxable estates of over $500,000. Everything that thus takes place in the estate tax concerns less than 5 or 6 percent of adult decedents, while everything that takes place in our individual income tax concerns 80 percent of the adult population. The concentration of wealth in the United States is clearly more marked than the concentration of income.

There is a vast difference between speaking of the "little man" under the individual income tax and the "small estate" under the estate tax. Yet proponents of a low estate tax carry over to the "small estate" the protectionist attitudes involved in the reference to the "little man". The "small estate," it is true, is less than a dwarf in the scale of large estates, but viewed from the perspective of almost all of our population the "small estate" represents wealth beyond the realities of most everyone. Unless that perspective is kept constantly in mind, the estate tax will never be an effective tax on the transfer of wealth in the United States.

IV. CONCLUSION

The large study of inherited wealth in our society under modern conditions has yet to be made—the amount of the wealth; the patterns under which it is created and transmitted—from whom to whom; its uses; its consequences; the institutions it affects; and so on. Such a study must focus on the factors which permit large fortunes to be created and passed on from one generation to another despite nominally high income and transfer tax rates. This focus would undoubtedly throw light on the contrast between, on the one hand, structural weaknesses and preferential provisions in these taxes and, on the other, those nominal high rate structures. The study will have to be done. In the meantime, enough is known to demonstrate that the present estate and gift taxes in the United States along with the income tax escape of the appreciation in assets transferred at death, are not only weak instruments to reach the transmission of wealth, but are also extremely uneven and inequitable in their impact among the families that possess wealth. These taxes and the related income tax escape at death are thus prime candidates for long-needed revision.

STATEMENT BY CARL S. SHOUP, EMERITUS PROFESSOR OF POLITICAL ECONOMY COLUMBIA UNIVERSITY

BIOGRAPHICAL NOTE

Carl S. Shoup is Emeritus McVickar Professor of Political Economy, Columbia University. He received his B.A. in Law, Stanford University, 1924, and his Ph. D. in Economics, Columbia University, 1930.

Professor Shoup directed a study of gift and death taxes for The Brookings Institution, published in 1966 ("Federal Estate and Gift Taxes"). He has written a number of books, including a treatise, "Public Finance" (Chicago; Aldine, 1969) and has served as consultant to the United States Treasury on tax policy and as head of tax missions to Japan, Liberia, and Venezuela.

SUMMARY OF STATEMENT

The Federal estate and gift taxes need to be integrated into one cumulative transfer tax. At present, the estate of a wealthy donor starts at the bottom rate bracket, no matter how much wealth he has transferred already as lifetime gifts.

An integrated gift-estate tax was recently enacted by the United Kingdom. This tax appears to have become generally accepted as a permanent part of that country's fiscal system.

In drafting the new tax, the United Kingdom Treasury relied heavily on a United States Treasury Department study published in 1969 by the House Committee on Ways and Means and the Senate Finance Committee. That study spells out the technique necessary for integrating the gift and death taxes.

ADDRESS AND TELEPHONE DATA

Professor Shoup's address is Sandwich, N.H., 03270.

STATEMENT

After explaining briefly why the present Federal estate and gift taxes need to be integrated, this statement describes the recently enacted capital transfer tax of the United Kingdom.

1. Need for an Integrated Estate and Gift Tax

The United States Federal estate tax and gift tax are quite separate. A decedent's estate starts at the bottom bracket of the estate tax, no matter how much wealth he has transferred during life as gifts. The resulting total of the gift tax and the estate tax varies erratically, according to how the giving has been split between transfers during life and the transfer at death.

A coherent system can be achieved by adding the taxable estate to the cumulated total of gifts made during life. This total would be used to compute the estate tax payable, after making allowance for gift tax already paid. If desired, gifts made during life could be granted a lower schedule of rates, without destroying the principle of cumulation.

2. Background of the United Kingdom Capital Transfer Tax [1]

A few weeks after the Labor Party returned to power, early in 1974, the new Chancellor of the Exchequer announced that a capital transfer tax would be introduced. By this he meant that Britain would enact a gift tax for the first time, and would link it with the existing estate tax. The two taxes would be integrated, and would be known simply as "the capital transfer tax." Moreover, trust and interests in trusts would face more occasions for tax liability than hitherto.

The United Kingdom has had a long history of taxing transfers at death. Inheritance taxes, which are levied on the heirs, were favored before 1894; and for 55 years more there was a mixture of inheritance and estate taxation. There followed a period of estate taxation only.[2] During all this time there was no gift tax at all. To be sure, some lifetime gifts did get caught in the death tax net: gifts made within a certain number of years before death were automatically included in the taxable estate. Still, tax reform pressures for a gift tax had been building steadily.

The new Labor Government also had a special reason for introducing a gift tax. It was planning to enact an annual tax on an individual's net wealth, like those that had existed for some time in certain European countries,[3] but with stiffer rates and fewer exclusions. The Government feared that, without an immediately imposed gift tax, a typical wealthy family would move rapidly to split its wealth among its members by lifetime gifts, in order to avoid the higher brackets of the net wealth tax's progressive rate schedule.

The United Kingdom Treasury was charged by the Chancellor with the task of coming up quickly with an integrated gift-estate tax. Since there had apparently been little occasion to do much research in this field, by the U. K. Treasury, its officials turned to the best available studies and proposals for such a tax. A study upon which the U. K. Treasury relied heavily was one that had been made a few years before by the United States Treasury Department and published in 1969 jointly by the House Ways and Means Committee and the Senate Finance Committee.[4]

The capital transfer tax was enacted early in 1975, retroactive to March 27, 1974, as to the taxation of gifts and trusts. Enactment came only after the Government's proposal had been debated at length and heavily amended.

Despite this stormy passage, and perhaps because of the amendments it gave rise to, the tax seems now to be accepted as a permanent part of the British tax system. The Conservative Party does not urge repeal, and in the event of returning to power will evidently retain the tax in much its present form.[5]

3. Tax Rate Schedules for Lifetime Gifts and for Estates

The capital transfer tax includes a gift tax of the type long used in the United States. However, and quite differently from the United States law, the tax rates applicable to the donor's estate depend on the total of his lifetime gifts. His estate is put on top of his cumulated gifts, to determine just where, in the progressive rate scale, taxation of the estate shall start. The greater the sum of the decedent's lifetime gifts, the higher up in the rate schedule his estate starts to be taxed.

For example, let the lifetime gifts total £50,000 (roughly $100,000 at current exchange rate). The first pound sterling of taxable estate pays at a bracket rate of 35 per cent. In contrast, if lifetime gifts total to, say, £100,000 ($200,000), instead of only to £50,000, the first pound of taxable estate pays at a bracket rate of 50 per cent instead of 35 per cent. At the extreme, if lifetime gifts come to more than £2,000,000 ($4,000,000), the first pound of taxable estate pays at the top bracket rate of 75 per cent.

For lifetime gifts, however, the rate schedule is lower than for the transfer at death. These two disparate schedules are hooked together in the following way. Take, for instance, the case of lifetime gifts that total to £50,000. The last £10,000 of this amount is taxable at only 15 per cent. We have just seen that if the next

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[1] This description is taken largely from G. S. A. Wheatcroft and G. D. Hewson, "Capital Transfer Tax" (London: Sweet & Maxwell, 1975). See also Hilda Wilson, "Capital Transfer Tax: A Panoramic View," "British Tax Review," 1975, No. 2, pp. 73–78.

[2] See A. R. Prest, "Public Finance in Theory and Practice" (London: Weidenfeld and Nicolson, 1974), fifth edition, p. 325.

[3] Carl S. Shoup, "Public Finance" (Chicago: Aldine, 1969), p. 358.

[4] "Tax Reform Studies and Proposals," United States Treasury Department. Joint publication by House Committee on Ways and Means and Senate Finance Committee, 91st Congress, 1st session, February 5, 1969: "Gift and Estate Tax Proposals," in VIII, pp. 351–409.

[5] This statement, and those in the second paragraph preceding, are based on information obtained by the present writer in conversations with United Kingdom tax lawyers, accountants, economists, taxpayers and others at the International Tax Conference held at Nairobi in February, 1976.

pound transferred (the 50,001th pound) is passed at death, it falls in a bracket where the death tax rate is 35 per cent. There is a sizeable jump in the bracket rate from 15 per cent to 35 per cent.

Only when lifetime giving totals to £300,000 do the two rate schedules then come together. Both tax the 300,001th pound at 60 per cent, and so on up, uniformly (in pounds sterling: 500,000–1,000,000, 65 per cent; 1,000,000–2,000,000, 70 per cent; above that, 75 per cent).

This linking of the two schedules is facilitated by having the gift tax rate schedule apply, not as it does in the United States, to the gift net of tax, but to the gross gift, that is, the amount received by the donee, plus the tax. This is the same as the procedure under estate taxes everywhere: the estate tax rates apply to the estate before the tax itself is extracted. So, what the lifetime donee actually receives is "grossed up" to include the tax—unless indeed he, the donee, agrees to reimburse the donor for the gift tax.

To make it easy for the donor to see just what rate applies to what he would usually consider as being the gift, i.e., what the donee gets, the rate schedule in the law has been translated into a "net" basis rate schedule, in the Wheatcroft-Hewson "Capital Transfer Tax".[6] This net basis is of the same type as that which appears in the United States gift tax law, but of course it deals in odd amounts, in the U.K. case, since it is derived from a round-figures rate schedule, in the law, for "grossed-up" gifts. (A gift that turns out to have been made within three years of death, however, is counted as part of the estate.)

For example, the first three lines of the Wheatcroft-Hewson table read as follows:

Value of net gift (£):	*Tax*
0 to 15,000	0.
15,000 to 19,750	5.26 percent of excess over £15,000.
19,750 to 24,375	£250 plus 8.11 percent of excess over £19,750.

In contrast, the gift tax rate schedule in the law starts as follows:

Value of gross gift (£):	*Tax*
0 to 15,000	0.
15,000 to 20,000	5 percent of excess over £15,000.
20,000 to 25,000	£250 plus 7.5 percent of excess over £20,000.

Accordingly, the U.K. gift tax rate schedule is rather heavier than a U.S. observer might at first think it, if he has in mind the U.S. type of gift tax schedule. The rates of the U.K. gift tax are only one-half those of the U.K. estate tax, up to £100,000, but on a net-gift basis such rates are more than half the estate tax rates.

4. Trusts

The new capital transfer tax slams the door shut, with resounding finality, on a long history of generation skipping of tax, through trusts. Not even an accumulating or discretionary trust can now provide a way out. A discretionary trust is one that allows the trustees, at their discretion, to distribute income or capital to any one (or none) of a more or less specified group of persons. No one of these potential beneficiaries, therefore, has a "beneficial interest in possession." The new law taxes the capital value of the trust, or the corresponding part of the capital value, when a distribution is made; and if there is no distribution, the law deems that the capital is distributed once every ten years. Thus the whole trust property becomes taxable.

The once-in-ten-years tax is, to be sure, only 30 per cent of the tax that would have been payable on an actual distribution. Ten years, however, is of course far shorter than the normal span of a generation.

Meanwhile, a still lower tax rate is being held out as an inducement to liquidate these discretionary trusts fairly soon (before April 1, 1980).

Wheatcroft and Hewson observe that "In effect, the bulk of private property in the country is subjected to a floating charge to tax, which, unlike estate duty, cannot be easily avoided or minimized. . . . In particular, the discretionary trust, which was much used for tax planning before capital transfer tax, seems likely to be of little use in future." [7]

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[6] "Capital Transfer Tax," p. 9. Table 3.
[7] "Capital Transfer Tax", p. 6.

The U.K. estate tax had already closed some avenues of avoidance by the use of trusts that are still available under U.S. law. For example, a decedent's estate included the capital value of any trust property ("settled property") in which he was "beneficially entitled at his death to an interest in possession." [a] A life tenant is an illustration of this. Now, with the new provisions, the U.K. tax is far stricter than that of the United States.

a. Countries with a net wealth tax included, in Europe, Denmark, Finland, Germany, Luxembourg, the Netherlands, Norway and Sweden, and, outside Europe, Sri Lanka (Ceylon), Colombia, and India.

5. Exemptions

The first £15,000 of transfers by any one donor is tax free; this is the same size of exemption as under the old estate tax. If the donor makes no lifetime gifts, the first £15,000 of his estate is tax free; if he gives £15,000 or more during his life (in addition to the exemptions noted below), none of his estate is tax free. This amount, roughly $30,000, is much lower than the combined exemption of $30,000 for lifetime gifts and $60,000 for an estate.

The U.K. law provides a modest exemption for small gifts: £100 ($200) per donee per year (the similar U.S. exemption is $3,000 per donee per year). In addition, however, the U.K. donor is given and exemption of £1,000 per year, with a carryover of one year.

On transfers between spouses, the U.K. tax is more liberal than the U.S. law, for it allows unlimited exemption of such transfers, during life or at death.

The U.K. law contains several other reliefs, exemptions, etc., that cannot be treated in the space available here, including important reliefs for agricultural property and woodlands.

6. Significance

It seems not too much to say that the new U.K. capital transfer tax is one of the most significant innovations in the history of tax policy. If the tax is continued over several decades, as may be expected, and if it is vigorously enforced, as seems quite likely, it should markedly decrease the degree of inequality in the distribution of wealth, with some consequent, if smaller, effect on the inequality of incomes.

What these effects in turn will mean for the supply of capital is not clear, one way or the other, but if they come to be thought too severe, the rate schedule can of course be lowered somewhat without changing the structure of the tax.

The great merit of the capital transfer tax is its more nearly equal treatment of those equally circumstanced. The tax element will no longer be so often the dominant factor in decisions on how to dispose of one's property. In particular, the new tax evidently shows that generation skipping can in fact be blocked almost completely.

The U.S. Treasury would do well to send a team of experts to Britain, to consult with tax officials, lawyers, accountants, investment bankers, and taxpayers to get a closer view of the probable effects of the capital transfer tax, and to ascertain how it might be adapted, on the basis of the 1969 U.S. Treasury study, to the United States environment.

Statement of John K. McNulty, Professor of Law, University of California, Berkeley

Biographical Note

John K. McNulty is a Professor of Law at the University of California, Berkeley, School of Law (Boalt Hall). He received his A.B. degree from Swarthmore College in 1956 and LL.B. from the Law School of Yale University in 1959. During 1959 through 1960 he served as law clerk to Mr. Justice Hugo L. Black of the U.S. Supreme Court. He then practiced law in Cleveland, Ohio from 1960 to 1964, when he took a position on the law faculty at the University of California, Berkeley, where he has remained until this time. He has served as Visiting Professor of Law in Summer Sessions at the University of Texas Law School and Hastings Law School. For a time, he also was "of counsel" to a major international law firm.

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[a] "Capital Transfer Tax", p. 4. The lower, lifetime gift rate schedule applies to "settled property transactions except on death," and the higher, estate tax rate schedule applies to settled property taxed on the death of the beneficiary. *Ibid.*, p. 6.

Professor McNulty has published a number of books and articles on various tax subjects. Among them are McNulty, Federal Estate and Gift Taxation (In a Nutshell), West Publishing Company, 1973; Kragen and McNulty, Federal Income Taxation (Cases and Materials), 2nd edition, West Publishing Company, 1974; McNulty, Federal Income Taxation (In a Nutshell), West Publishing Company, 1972. His other publications include "Tax Policy and Tuition Credit Legislation: Federal Income Tax Allowances for Personal Costs of Higher Education," 61 California Law Review 1 (1973). In addition to his private practice and consulting with law firms, Professor McNulty has also served as a consultant with a number of government and private agencies, including the California Constitutional Revision Commission, the California Legislature's Tax Reform Group, and The Rand Corporation regarding tax and other matters.

SUMMARY OF STATEMENT

Reform of the Federal Estate and Gift Taxes could best be achieved by repealing those taxes and at the same time making gifts and inheritances taxable as income, under the Federal Income Tax. The result would be a fairer tax, one geared directly to the ability to pay of the person who receives the gift or bequest. It would result in a simpler tax system, and one that would be less costly to comply with and to administer. In addition, the revenue yield and the equity of the federal income tax would be improved by including in its base gifts and inheritances which in fact are items of income and should be taxed as such.

Therefore, I recommend that §102 of the Income Tax be repealed or amended in such a way as to make property received by gift, bequest, devise or inheritance included within the definition of gross income, under § 61(a) of the Income Tax, with appropriate averaging provisions and supporting legislation as necessary.

DISCLAIMER

The following statement is solely the responsibility of the author. It should not be construed as representing the views of the University of California or its School of Law at Berkeley or of Taxation With Representation.

ADDRESS AND TELEPHONE DATA

Further information regarding the views expressed in this statement can be obtained by writing to Professor John K. McNulty at 389 Boalt Hall, University of California, Berkeley, California 94720. Alternatively, he can be reached by telephone during business hours at Area Code 415, telephone 642–1928.

STATEMENT

My name is John K. McNulty and I am a Professor of Law at the University of California School of Law, Berkeley, California (sometimes familiarly known as Boalt Hall). I specialize in teaching and researching the subjects of Federal Estate and Gift Taxation, Federal Income Taxation, International Taxation and Tax Theory and Public Finance. I am presenting this statement at the invitation of "Taxation With Representation." I am not affiliated with, or sponsored or acting at the behest of, any private firm or organization and am speaking on my own behalf.

Simplification and Estate and Gift Tax Reform

The proposal I should like to put before the Committee is one whose principal characteristic, and principal virtue, is its own simplicity and the simplification effects it would have on the Federal Tax laws. Rather than amending the present Federal Estate and Gift Taxes so as to cure some of the particular defects often noted in these laws, which amendments or reforms would be likely to make the law more complex in an effort to make it more fair or more effective, my proposal consists mainly of repealing existing laws, as described in the following paragraphs.

Taxation of Gift and Inheritances as Income; Repeal of the Federal Estate and Gift Taxes

I urge the Committee to consider the following structural reform as a means of simplifying and improving the taxation of gratuitous transfers of wealth at death or by lifetime gift. The proposal consists of repealing §102 of the Internal Revenue Code of 1954, as amended, which excludes property acquired by gift, bequest,

devise or inheritance from the Federal Income tax law's definition of income, and also repealing (or radically reconstituting) the Federal Estate and Gift Tax laws. The result would be to tax inheritances and gifts as income to the recipients, under income tax law. This proposal, in its basic form, would not add anything to existing law on the books, but instead would repeal a great many sections of the Internal Revenue Code, comprehending the Federal Estate and Gift Taxes as well as most or all of § 102. Some amendments in the income tax law probably would be necessary, however, to deal with particular problems to which I will advert at a later point in this statement.

Why Tax Gifts and Bequests As Income?

Why should the recipients of gifts and inheritances be taxed on those receipts as income? One answer lies in the fact that gifts and inheritances *do* constitute income to the recipients, both in an economic and in a legal and Constitutional sense of the word "income." Economists have long defined income as any accretion to wealth or any net receipt. The famous Haig-Simons definition of income defined income as the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and end of the period in question. This means that property received by gift or bequest is income since it can be spent or, if not, will increase the net worth of the recipient. See H. Simons, "Personal Income Taxation," pp. 56 ff., and pp. 134 ff. (U.Chi.Press, 1938).

Judicial definitions of "income" as used in the 16th Amendment and in § 61(a) of the Internal Revenue Code have gradually expanded the concept of income to the point that it now includes any instance "of undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion." See Com'r v. Glenshaw Glass Co., 348 U.S. 426 (1955). Thus, to economists and to persons in the street, property received by gift or inheritance represents additional power to save or to consume and thus amounts to "income" in both the technical and the everyday sense of the term. Moreover, recent and responsible tax reform proposals have recommended that the income tax include gifts and bequests. See, e.g., 3 Report of the Royal Commission on Taxation (The Carter Commission Report, Canada) 1966, Ch. 17.

For a great many years, gifts and inheritances have been excluded from the Federal Income Tax's definition of gross income by statutory exclusion, presently found in § 102 of the Internal Revenue Code. The exclusion may historically have stemmed from a fear that the term "income" as used in the 16th Amendment did not comprehend gifts and inheritances, but rather was limited, in the language of early United States Supreme Court opinions, to "gain, derived from capital, from labor, or from both combined." See, e.g., Doyle v. Mitchell Bros. Co., 247 U.S. 179 (1918), quoting from Stratton's Independence v. Howbert, 231 U.S. 399 (1913). The exclusion for gifts and inheritances has continued beyond the time when these constitutional doubts have receded, for a variety of reasons. One reason may have been to "keep the Tax Commissioner out from under the Christmas tree." That is to say, considerations of administrative expediency and psychological factors and matters involving ability to pay may have suggested that the receipt of a gift or bequest should not be a taxable event. Another reason that the income tax has been content to exclude gifts and inheritances undoubtedly lies in the fact that such transfers were taxed by the Federal Estate and Gift Taxes, the transfer taxes that form a part of the federal tax system. Those transfer taxes, in turn, provide substantial exemptions or annual or lifetime exclusions, so that birthday gifts and Christmas gifts and other small transfers need not be reported. Larger transfers sometimes must be reported, though no tax need be paid. And only transfers that are quite significant in amount are subject to reporting and to tax. Repeal of the Federal Estate and Gift Taxes would lead to reconsideration of the exclusion contained in the income tax law. My suggestion starts from the other direction and suggests repeal of § 102, which would in turn imply repeal of the federal transfer taxes.

What Are Some of the Advantages of Taxing Gifts and Bequests as Income?

To tax gifts and bequests as income would be to expand the base of the income tax and to comprehend in that tax, with its graduated rates, annual computation, and other structural characteristics, items of accretion to net worth that belong in the base of the income tax because, just as much as income earned from personal efforts or investments, such items do provide financial gain to the recipients and increase their ability to pay tax.

To tax the receipt of gifts and bequests as income changes the identity of the taxpayer from our present system. Under present Federal transfer tax law, the donor of a lifetime gift or the decedent who transfers property at death is the taxpayer. The tax owing is computed by measuring the amount of the gift, in conjunction with other gifts made by the taxpayer during life or at death, and imposing a tax upon this base, subject to certain exemptions and exclusions. In other words, the amount of tax owing is measured by the capacity of the donor to confer a gratuitous benefit upon the donee. State inheritance taxes have much the same characteristic, although the rate of tax more often varies with the identity of the recipient, with higher rates of tax being applied to transfers made to unrelated persons or more distant relatives, and lower rates applicable to transfers made to a surviving spouse or dependent children, for obvious reasons of social and economic policy, as well as equity.

The proposal to tax gifts and inheritances to the recipient rather than to the transferor means that the amount of tax paid will be geared to the taxpaying ability of the recipient rather than that of the transferor and would be determined by the income tax rates and other rules, rather than the rules of the Federal Estate and Gift Taxes. In some respects, this proposal resembles the proposal for an "Accessions Tax," which, however, would determine the amount of tax owing by the recipient according to the amount of donative transfers received by that person during his or her life, without regard to the other income or wealth of the recipient.

The proposal that gifts and inheritances be taxed as income, to the recipient, would adjust the tax owing to the ability to pay of the recipient, taking into account that recipient's income from all sources. This proposal has the advantage of fairness, at least to those who view the federal income tax as the fairest tax in the federal taxing system and as one that somehow gets at ability to pay better than any other tax, whether at the state or local or federal level (except perhaps a theoretical wealth or expenditure tax, or a hypothetically comprehensive and all-inclusive income tax, none of which is administratively feasible or likely to be enacted in the foreseeable future).

Another advantage consists of the fact that the rate of tax on gifts would be the same as the rate on bequests, which would be a change from the disparity in rates of the present transfer taxes, a disparity that gives rise to much tax planning, controversy and administration and compliance costs.

Still another advantage may lie in the redistributive effects of the proposal. Although it would be premature to advance a definite conclusion about distributional effects, a likely surmise would be that taxing gifts and bequests as income would lead to less concentration of wealth and wider distributions of property given during life or at death, and to lower income taxpayers, compared to the effects of present transfer taxes.

What Are Some of the Real, or Supposed, Disadvantages of Taxing Gifts and Inheritance as Income? What Solutions May Be Found?

One supposed disadvantage of taxing gifts and inheritances as income is that a taxpayer might, once in his or her lifetime, receive a large gift or bequest all of which would be taxable in one year and subjected to the graduated rates of the income tax law. If this were to happen, the result might be to put a very heavy tax burden on such a recipient compared to someone else who receives the same amount in gifts or inheritances over a number of years, and thus is in much the same overall position as the first taxpayer. Or it might be too heavy when compared to the burden on a third taxpayer who has income from other sources but that income is spread over a period of years and thus taxable at lower marginal rates than it would be if lumped within one year.

The present answer to the "bunching" argument lies in the provisions of the Internal Revenue Code which allow "income averaging" over a period of five years. If gifts and inheritances were taxable as income and also made eligible for such averaging, the problem of the bunched receipt in one year would substantially be ameliorated. If the present income averaging rules were not regarded as sufficient for this purpose, more extended averaging might well be afforded to gifts and bequests, or the present income averaging rules themselves might be extended to cover a longer period of time.

Another possible disadvantage of taxing gifts and inheritances as income might be thought to be the necessity for reporting birthday gifts and holiday transfers and many other small exchanges that would heavily burden the taxpayers to report or which would largely go unreported and thus untaxed. The answer to such an argument is to include in the income tax law an annual exclusion or a lifetime

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exclusion of a certain amount. As a result, the tax authorities would not have to "sit beneath the Christmas tree" or make liars out of taxpayers who inadvertently or otherwise failed to report the small transfers that take place, particularly within a family context, and which are not presently taxable under the Federal Gift and Estate Taxes. The addition of some special exclusion or exemption in the income tax law would be to inject a small additional complexity in that law. However, the benefits derived in the form of repealing the lengthy Estate and Gift Tax laws and imposing a fairer tax on donative transfers and improving the integrity of the Income Tax itself by extending it to an item of income that for many years has been exempted, more than outweigh the slight disadvantages in amending § 102 and possibly the income averaging provisions.

It is likely that some additional statutory enactments would be necessary in order to cope with the multifarious and complicated transactions that taxpayers have learned to construct as ways of minimizing or avoiding the present federal transfer taxes, the Estate and Gift Tax laws. Serious thought would have to be given to the problem of trusts, revocable transfers, gifts disguised as loans, transfers with retained powers of alteration or amendment, annuities, life insurance, powers of appointment, future interests and the many other problems dealt with by §§ 2033–2042 (and beyond) of the Estate and Gift Tax law and §§ 2511–2524 of the Gift Tax law. It would be overly optimistic to imagine that those transfer taxes could be repealed and nothing substituted for them when gifts and bequests are made taxable as income. However, the nature of the new structure – the taxation of gifts and bequests as income rather than as transfers taxable to the transferor—would mean that the legislation necessary to prevent escape or undue deferral or shifting of tax would be less expensive, as would the administrative promulgation of regulations and the enforcement of compliance under present law.

Some other questions undoubtedly will arise, such as whether a special exclusion should be afforded to surviving spouses or children. These and other similar questions can be analyzed and answered, but for present purposes are left unanswered. Problems of "what's a gift" or bequest exist now because of the exclusion in § 102, just as they would if gifts were taxable as income. Many of the other implications of the proposal are examined in Chapter 17 of the Carter Commission Report, mentioned earlier.

Preventing Tax Avoidance and Unfairness

The Federal Estate and Gift Taxes are well known as taxes that need not be paid, if competent tax advice is available, or whose burden can substantially be minimized by clever (and perfectly honest) tax planning. The result is that they are taxes that produce very little revenue and taxes whose burden falls quite unevenly upon taxpayers in similar positions, depending upon their ability to obtain and use tax planning advice and their capacity for engaging in intricate or tax-shaped transactions, sometimes at the expense of what they seek to accomplish as a personal or financial or economic matter. The costs of complying with the present transfer taxes, or avoiding or minimizing them, are very substantial; they support a whole industry of tax advisers (lawyers, accountants, bank trust officers and others) and involve the Internal Revenue Service and taxpayers in a great many hours of planning, record-keeping, compliance and administration. The Federal courts are tied up with tax cases and the state probate and other courts with cases whose principal purpose is to produce a desired Federal tax effect. Private dispositions of wealth are deterred or accelerated or otherwise distorted by the transfer taxes. While a system of taxing gifts and inheritances as income would not be fully free from these compliance and administrative costs, it is very likely that the costs would be much lower.

Revenue Losses or Gains?

Estimates of the revenue gain or loss that would result from the proposal to tax gifts and inheritances as income are not reliable and readily available. However the amount of revenue raised by the present federal death and gift taxes can be calculated and is known. The revenue loss from the "tax expenditure" resulting from the failure of the income tax to tax gifts and bequests can be estimated, by the procedures used in the so-called "Tax Expenditure Budget," such as that provided for the Committee on Ways and Means and the Committee on Finance by the staffs of the Treasury Department and the Joint Committee on Internal Revenue Taxation and dated July 8, 1975. The Tax Expenditure budget of that date did not treat the exclusion of gifts and bequests as a tax expenditure, though quite properly it might have. Professor Surrey acknowledges that the exclusion could be listed as a tax expenditure and that most economists would so list it, but states that at present most people's concept of income does not include gifts and

bequests, though the economists' definition might come to be accepted. See Surrey, *Pathways to Tax Reform*, p. 18, p. 286 at n. 6, (Harv. U. Press, 1973). In an event, the methods used for estimating federal tax expenditures, as the critics of a tax expenditure budget and the Treasury Department itself have agreed, are in some ways insufficient. Most particularly, if gifts became taxable as income, it is possible that either fewer and smaller gifts or more and larger gifts would be given, as a result of the incentives or disincentives created by repealing the Estate and Gift taxes and repealing the exclusion in the income tax. Therefore, to compute the revenue loss is not simply a matter of looking to see the amounts that were given by inter-vivos gift or bequest under the present transfer taxes and the attributing them to certain classes of donee taxpayers or an average donee taxpayer and estimating the amount of revenue that would result if the income tax rates, rather than the death and gift tax rates, had been applicable to the amounts transferred. Nevertheless, tax expenditure analysis is one means of making some estimate of the amount of revenue loss or gain that would result from the structural change suggested here.

CONCLUSION

The structural reform that would result from taxing gifts and bequests as income to the recipients and repealing the transfer taxes on decedents and lifetime donors would produce a simpler federal tax law, a tax law less costly to administer on the part of the government and to comply with on the part of taxpayers. It would produce a fairer tax, because it would coordinate the tax burden with the ability to pay of the person upon whom the tax is imposed.

At present, it is impossible to say who bears the burden of the Federal Estate and Gift Taxes, because no one can identify who would have received the funds that are paid in death or gift taxes to the Federal Government. Those funds might have been consumed by the decedent or donor during life, they might have been been given to the beneficiaries who did receive some gifts or bequests (after taxes), or they might have gone to still other beneficiaries who were cut out of the will or gift-making scheme of the donor because of anticipated transfer tax liability.

If gifts and inheritances are taxed as income, the burden of the tax collected from the recipient certainly would seem to fall upon that recipient and no one else. In some complicated ways, economists may suggest that the burden will have effects on other people, because the taxes paid by the recipients will reduce their own ability to consume or to save and invest and thus will have effects not only on their own welfare but also on the people who would benefit from the savings or consumption by the recipients of the funds made unavailable by the income tax. In this complicated sense, the income tax always has allocational and redistributive effects of a secondary nature, Putting them to one side, it would seem clear enough that the burden of the tax would fall upon the nominal taxpayer, the recipient of the gift or bequest.

The amount of the tax would be geared to the income of the recipient, perhaps averaged over a five-year period or a longer period. The income of such a recipient may not be a perfect measure of that person's ability to pay tax, but it seems to be the best measure our tax system has yet given us. It will be made still better by including in it, gifts and bequests—the items here at issue. One of the defects of the present income tax in its measuring of ability to pay is its failure to include property received by gift or bequest in the tax base. Therefore, a taxpayer's rather small amount of earned income can be taxed at low rates even though he or she also has received, in that same year or in other years, very large amounts of property by gift or bequest. The result is that the income tax is less fair than it would be if gifts and bequests were added to the base of the tax.

Consequently, the structural reform as here suggested, one that would tax gifts and inheritances as income and not as transfers by the donor or decedent, would not only simplify the federal tax structure and reduce the cost of administration and compliance, but would also produce a fairer taxation of gifts and bequests themselves and furthermore a fairer taxation of other items of income, the tax rate applicable to which would be affected by the amount of income received in the form of gifts and bequests during the year or the averageable period.

The structural form proposed here can be viewed as part of a larger package, in which the base of the income tax would be expanded and made more comprehensive, the rates perhaps changed to a different graduation or to a proportional rate system, the payroll tax repealed, or governmental benefits such as Social Security and welfare payments either eliminated or made taxable, and if eliminated then

replaced by a negative income tax or other guaranteed annual income or "demogrant" plan, integration of the personal and the corporate income taxes and other changes. There is some relationship between the proposal made in this statement and other parts of this broader tax reform package. For example, if the income tax were a proportional tax, the taxation of a bunched gift or inheritances in a particular year would not produce a higher tax bill than would have followed if the gifts and inheritances had been received over a period of years or in some other form. In other words, adopting a proportional rate system would remove the inventive on the part of taxpayers to shift income from one year to many years or from a high tax year to a low tax year. Income averaging would become unnecessary. However, the proposal made now, to tax gifts and inheritances as income, can be adopted without adoption of the other dimensions of the structural reform proposal I have alluded to.

I hope that the Treasury Department will see fit to give further attention to this proposal, to provide estimates of revenue loss or gain under various alternative constructions and to work out the legislation necessary to implement the proposal and to safeguard it against abuse or evasion, much as the Federal Estate and Gift Tax laws now deal with transactions not foreseen at the time original and much simpler gift and estate tax laws were enacted.

I should like to thank the Committee for this opportunity to put forward a major, structural proposal. I stand ready to provide any further statement or testimony or assistance that might be thought desirable.

Statement by David Westfall, Professor of Law, Harvard Law School

Biographical Note

David Westfall is a Professor of Law at the Harvard Law School, where he teaches Estate Planning and Property. He received his A.B. degree from the University of Missouri in 1947, his LL.B. degree from Harvard in 1950.

Professor Westfall has published Estate Planning Problems (Foundation Press, 1973) and Readings in Taxation (with Professor Sander, Foundation Press, 1970). He was formerly an associate at Bell, Boyd, Marshall & Lloyd, Chicago, 1950–55. He was Assistant Reporter for the American Law Institute's Estate and Gift Tax Project, 1961–66, and served as Consultant to the Treasury, 1964–68.

Summary of Statement

Estate and gift taxes are an ideal source of federal revenue which is largely unused. Congressional neglect for 35 years has left the rates too low, the exemptions too high for taxpayers without dependents, and a large number of loopholes which permit the taxes to be minimized or avoided altogether by clever planning.

The $60,000 exemption is too low for the young father who leaves a wife and minor children and too high for the bachelor without dependents. It should be reduced to $20,000 and changed to a credit, with more liberal provisions for spouses under the marital deduction and for dependents. Rates should start at 20% to bring the tax on gifts and bequests in line with the income and social security taxes paid by workers. Both taxes should be combined in a single transfer tax.

The charitable deduction should be limited to one-half of the estate.

A parental deduction should be provided to offset the advantage from generation-skipping trusts, which sometimes allow inherited wealth to be enjoyed by children, grandchildren and great-grandchildren without any of them paying an estate or gift tax, and additional taxes should be imposed on trusts which skip two or more generations.

Present loopholes in the taxation of life insurance and employee death benefits should be closed.

The present interest exclusion should be reduced and tightened and the state death tax credit should be repealed.

No special treatment of farms is justified, aside from liberalizing the provisions for deferred payment of the tax.

Unrealized gains when assets are transferred by gift or at death should be subject to income tax.

Address and Telephone Data

Further information regarding the views expressed in this statement can be obtained by writing Professor Westfall at the Harvard Law School, Cambridge, Massachusetts, 02138. Alternatively, he can be reached by telephone during business hours at 617–495–4630.

Introduction

Estate and gift taxes are an ideal source of federal revenues which is largely unused. Before World War II they produced 7 percent of the total but today their share is less than 2 percent—under $5 billion in fiscal 1975. Yet a well-drafted estate and gift tax law could combine two of the best features any tax can have: (1) reliance on ability to pay; and (2) minimal interference with taxpayers' incentives to work and invest.

Our present laws fall far short of this ideal because Congress has neglected estate and gift taxes for 35 years, while the income tax and social security tax have been refined and perfected into efficient means of collecting large amounts from the masses of individual taxpayers. This neglect has left the estate and gift tax rates too low, the exemptions too high for taxpayers without dependents, and a large number of loopholes which permit the taxes to be minimized or avoided altogether by clever planning.

We like to think that our present system is based on ability to pay. Yet the $570 million estate of Ailsa Mellon Bruce, who died in 1969, paid less than 1 percent in federal estate taxes because the bulk of the property went to the Mellon Foundation. The tax would have been no more if she had chosen instead to leave her husband as much as $285 million. Another example is provided by the late Irenee duPont. About two months before he died in 1963, his guardians got court approval to make gifts of $36 million out of his estate of $176 million. By making the gifts just two months before he died, the guardians apparently saved over $16 million for duPont's beneficiaries.

On a more modest scale, an individual who inherits a million dollar estate, no matter how large his income, pays only $270,300 in federal estate tax. At the other end of the scale, the average working man or woman pays a 5.85 percent combined social security and hospital insurance tax on every dollar earned and an income tax which starts at 14 percent.

If the estate and gift taxes are to work fairly and effectively to produce substantially larger amounts of revenue, major changes are needed in their structure as well as in the exemption and rate schedules. Any special problems of farmers should be dealt with separately, rather than by distorting the basic provisions of the taxes.

I. *Exemption and Rates*

Arguments for raising the exemption usually are based on inflation, reducing the tax burden on small estates, and sparing executors inconvenience of filing returns for small estates. None of these stand up.

Inflation would be a reason to raise the $60,000 exemption if it made sense when that figure was first introduced in 1942. But a $60,000 exemption, without regard to whether the estate goes to the decedent's widow or minor children or his wealthy third cousin, didn't make sense in 1942 and doesn't make any better sense today. The income tax tailors the taxpayer's bill to his ability to pay by taking into account how many others are dependent on him, and the estate tax should do likewise. For the young father who leaves a wife with three or four minor children to raise, $60,000 is far too little. For the bacheler who leaves no one who depends on him for support, $60,000 is far too much today, even with inflation. The marital deduction, as liberalized in the bill, takes care of the decedent's spouse, and the Treasury's 1969 proposals included an exemption which would have taken care of orphan children as well, to the extent of $3,000 for each year remaining until the child reached 21. If this were broadened to cover other dependents, it would be appropriate to cut the exemption to $20,000 and change it to a credit equal to the bottom bracket rate on that amount. The present exemption has far greater value in Mrs. Bruce's estate, where it reduces the tax by 77 percent of $60,000 than it does for someone who is at the bottom of the scale.

A $150,000 estate may be small in comparison to the $570 million left by Mrs. Bruce. But from the standpoint of the rest of the population, it is quite large. According to the latest figures, only about 9% of the population manage to leave as much as the $60,000 it takes to require filing a return, and about a third of the returns show no tax due because of deductions and the exemption. This means that the estate tax is limited to about 6% of the population. So there is no reason to keep the present exemption to relieve small estates.

Finally, the inconvenience of filing returns for small estates can be reduced by simplifying the return itself, just as was done with the income tax when it began to apply to larger numbers of people.

Rates have not been increased for 35 years and begin at only 3% for the estate tax and 2¼% for the gift tax. The income tax rate for the average working man or woman is almost five times as high. Combined with 5.85% social security and hospital insurance tax, the rate on earned income dwarfs the lowest rate on gifts. One commentator has suggested that the estate tax should start at 25%, with broader brackets. See Bitter, Federal Estate Tax Reform: Exemptions and Rates, 57 American Bar Association Journal 236, 240 (1971). As a minimum, the initial rate should go up to 20% to put it on a par with the working man or woman's income and social security taxes.

II. *Unification of Estate and Gift Taxes in a Single Transfer Tax*

The Treasury's 1969 proposals set forth completely and persuasively the case for combining estate and gift taxes in a single transfer tax, and there is no need to repeat here what was said there. Of the various arguments which have been made in favor of the present dual system, only one merits serious discussion. It is often said that the reduced rates and separate rate schedule for the gift tax as well as the fact that the tax applies only to net gifts, exclusive of gift tax, provide an incentive for lifetime gifts and encourage the movement of wealth from the older generation into younger hands. Why such an incentive is desirable is usually not spelled out.

Moreover, the effectiveness of the present tax advantages in providing an incentive for the movement of wealth into younger hands is blunted by the fact that such advantages are equally available for gifts in trust, in which control may remain with a trustee who is no younger than the transferor himself.

III. *The Marital Deduction and Gift-Splitting*

There is substantial justification for liberalizing the present percentage limitation and terminable interest rule.

A. *The Percentage Limitation.*—An unlimited marital deduction would be unsound. It would benefit the childless widow who receives a $20 million estate, freeing her from the $6 million tax she now pays. It would cost an estimated 13% of present estate and gift tax revenues. Although part of the loss is merely postponed until the surviving spouse dies, or her interest terminates, part is lost forever if she spends the principal or makes gifts under the annual exclusion. And the part that is postponed will not be collected, on the average, for more than 10 years.

For some widows, however, the increased estate tax rates and reduced exemption that are proposed here would be a hardship without some liberalizing of the percentage limitation. For example, the limit could be 100% of the first $100,000 in the adjusted gross estate and 50% of the excess. This would mean that if the estate were $300,000 the widow could receive tax-free $200,000 plus the amount of the specific exemption.

B. *The Terminable Interest Rule.*—Any income interest bequeathed to a wife should qualify for the marital deduction if she agreed to treat the termination of her interest as a taxable transfer by her. There have been many controversies between taxpayers and the Service over whether the wife had the kind of power of appointment required under the present rule. And in some instances the wife received the kind of power which would cause the property to be taxed on her death but which nevertheless failed to qualify for the marital deduction on her husband's death, thus creating a trap for the unwary draftsman.

IV. *The Charitable Deduction*

One of the most surprising features of the present estate tax is the unlimited charitable deduction. In practical terms, as noted above, this means that Ailsa Mellon Bruce could leave an estate of $570 million and avoid paying as much as 1% in federal estate taxes by giving her wealth to the Mellon Foundation. In 1966, five large estates made a total of $200 million in charitable bequests and paid less than $8 million in federal estate tax. This diversion of potential estate tax revenues would become even more serious if the rate increases proposed above were enacted.

There is no way to determine how much the unlimited charitable deduction actually influences the level of charitable giving. It seems probable, however, that many decedents make charitable bequests not for tax reasons but rather because they are interested in a given charitable organization and believe that any other beneficiaries are adequately provided for. The Treasury concluded in 1969 with respect to the income tax charitable deduction that "noneconomic motivations have considerable influence on the level of giving." (Treasury Dep't, Tax Reform Studies and Proposals, at 198.) If a similar conclusion applies to deathtime transfers to charity, much of the tax revenue lost through the charitable deduction may be wasted as far as inducing gifts to charity that wouldn't be made anyway.

The extensive changes made by the Tax Reform Act of 1969 in the income tax treatment of charitable organizations and their contributors provide guidelines for restricting the estate and gift tax charitable deductions as well. A first step in this direction would be to restrict or deny the deduction for transfers to private charitable foundations. Secondly, some overall limitation should be placed on the charitable deduction to insure that the donor or decedent makes a contribution to public purposes financed by the government as well as to charitable purposes of his individual choosing. For deathtime transfers, an appropriate limitation would be 50% of the adjusted gross estate, reduced by the marital deduction. This would mean that if the adjusted gross estate were $1 million and the marital deduction gifts amounted to $400 thousand, the maximum deduction for charitable transfers would be $300 thousand (50% of the remaining $600 thousand after the marital gifts were deducted). Reducing the adjusted gross estate by the marital deduction gifts is necessary in order to keep the combined charitable deductions on the deaths of husband and wife from exceeding 50% of the husband's adjusted gross estate.

It is more difficult to determine what restrictions should be placed on the present unlimited charitable deduction for gift tax purposes. In view of the Congressional policy to encourage such gifts reflected in the income tax charitable deduction, it does not seem appropriate that gifts which are deductible for income tax purposes should be subject to a gift tax.

V. *Generation-Skipping Transfers and a Parental Deduction*

Present law discriminates against outright gifts and in favor of trusts and other arrangements under which property will not be taxed again when the beneficiary dies. If a father gives his son $1 million outright, the money will be taxed again when the son dies unless he spends it during his lifetime. But if the father gives his son $1 million in trust, the son can have almost the same control over the money without having it taxed when he dies. He can be given income for life; the right to withdraw each year the greater of 5% or $5,000 from principal, in addition to principal required for his support; and the right to make gifts of principal during his life or by his will. Nothing will be taxed when he dies except for the principal he could have withdrawn at that time, in addition to his right to support—a maximum of 5% of the value of the trust. Even that amount need not be included in his estate if the power to withdraw principal is only exercisable if the son is living on the last day of the year and he dies earlier.

After the son's death, the father's will may provide that the same arrangement will continue for his grandchild for life. Depending on the local version of the Rule against Perpetuities and the duration of the lives selected to avoid a violation of the Rule, the same arrangement may be continued, still free of estate tax, for later generations of descendants. Indeed, in Wisconsin there is no restriction on the duration of trusts if the trustee has the power to sell, and the common law Rule Against Perpetuities is not in force. The potential saving in estate taxes from a perpetual trust in that state "to pay the income to my issue from time to time living" is impressive indeed.

This state of affairs should not be allowed to continue. Today it offers impressive advantages for taxpayers willing and able to create trusts (or comparable legal interests) under which beneficiaries do not become owners of the trust property so as to cause it to be taxed in their estates when they die. Those advantages would be even more compelling if the rate increases and reduced exemptions that are proposed here became law. Congress has already acted once, in 1942, when it enacted the predecessor to Code § 2041(a)(3) and § 2514(d), the gift tax counterpart, to deal with a possibility under Delaware law for perpetual tax-free family trusts. It is time that it acted again to close this avenue of avoidance.

The problem is often referred to as "generation-skipping" because tax avoidance occurs when property passes to a later generation (in the example just given, that of the grandson) without being subject to transfer tax on the death of a member of an earlier generation (that of the son). For transfer tax purposes, the son's generation has been skipped. Such skipping may occur whether or not the son actually receives any beneficial interest in the property. For example, if there is a gift from grandparent to grandchild, the intervening generation has been skipped even though no member of that generation receives any beneficial interest.

An easily understood and administered way to deal with the skipping of a single generation is a "parental deduction," similar to the gift tax marital deduction in present law. The deduction would provide a reduced transfer tax rate for

transfers to children of the transferor which do not involve generation-skipping, either because the child receives ownership of the property or because he receives a general power of appointment over it which will cause it to be taxed when he dies, if he doesn't dispose of it during life.

The major purpose of the parental deduction would be to offset the tax advantage from skipping the children's generation. It would seek to make the total transfer tax cost roughly the same, whether property was left in trust for a child for life with remainder to the grandchildren of the transferor or was given outright to the child and then in turn given by him to the grandchildren. With a parental deduction, a father who wanted to give property to his son would no longer be under the heavy pressure from present law to limit the son's rights in the property in order to keep it from being taxed when the son died.

A 40% deduction would be needed to give the transferor the same benefit which he could obtain from a transfer which skipped the son's generation. Over a wide range of rates, a tax on 60% of the transfer from father to son plus a tax on 60% of the transfer from son to grandson would be approximately equal to a single tax on the entire property which would have been payable if the father had given it directly to the grandson or had given it in trust for the son for life with the remainder to the grandson.

Admittedly, a parental deduction would reduce the effective tax rate on transfers to children. Such a reduction, in comparison to rates paid on transfers to collateral relatives, has long been the rule in state inheritance taxes. Any resulting revenue loss should be made up by increasing estate tax rates. A parental deduction has the merit of offering a positive inducement to transferors to forego generation-skipping, rather than imposing a penalty. It would offer a practical alternative for transferors who wished to avoid the complexities involved in the creation of long-term trusts.

If a parental deduction established a difference in tax between arrangements which skipped no generation and those which skipped the single generation of the transferor's children, an additional tax could be imposed on arrangements for skipping of two or more generations of the transferor's descendents.

VI. *The Present Interest Exclusion*

The present interest exclusion of $3,000 (originally $5,000) was included when the current gift tax was enacted in 1932 to eliminate the need to report small gifts and most wedding and Christmas gifts. Today, many donors base substantial annual gift programs on the exclusion, using it to transfer significant amounts of wealth to their descendents tax free. With gift splitting, the exclusion is $6,000 for a married donor. If he has 10 grandchildren, during a 5-year period he can transfer $300,000 to them free of tax. To curb such transfer tax avoidance, the exemption should be reduced to $1,500.

The exemption is abused today by transfers in trust. An interest in trust income has been held to qualify for the exemption, even though the trust consisted of non-dividend paying stock in a corporation controlled by the donor and his brother. See Rosen v. Commissioner, 397 F. 2d 245 (4th Cir. 1968), which, however, the Commissioner has stated will not be followed. See Rev. Rul. 69-344. Gifts of income interests are traditional estate planning devices, not typical Christmas presents. The exclusion should be denied for transfers of limited interests (including interests in trust) unless the transferee receives the equivalent of ownership, as in the case of the present interest trust for minors under § 2503(c).

VII. *Life Insurance and Employee Death Benefits*

Section 2039(c) provides an absolute exemption for employee death benefits which are not payable to the executors and administrators of the deceased employee. No other asset is given comparable treatment, and there is no justification for excluding such death benefits from the gross estate. The exemption, accordingly, should be repealed.

Although life insurance is not treated as liberally as employee death benefits, in that it is includible under section 2042 if it either is payable to the insured's executors and administrators or the insured possessed incidents of ownership over the policy, in practice it is not difficult to keep insurance out of the insured's estate. The common method of achieving this result is for the policy to be taken out by the insured's wife or child, who then pays the premiums, often from funds provided by the insured himself.

Until the enactment of the Internal Revenue Code of 1954, the premium payment test caused policies to be included in the insured's estate to the extent he had paid the premiums, even though he possessed no incidents of ownership when

he died. Removal of the premium payment test has led to the avoidance of large amounts of estate tax on policies financed by the insured.

Restoration of the premium payment test would be one way to curb the avoidance of estate tax by means of policies taken out by the insured's spouse or child but paid for by the insured. The premium payment test does, however, create a problem of tracing of funds to determine to what extent they are attributable to the decedent. An alternative approach would be to require inclusion in the insured's estate of policies with respect to which his spouse or a trust for her benefit had the incidents of ownership, without regard to the source of funds used to pay premiums. This would be analogous to the treatment of insurance trusts for income tax purposes under section 677, under which it is no longer material that trust income is used to pay premiums on policies on the life of the grantor's spouse, rather than the grantor himself. Such inclusion of policies owned by the spouse of the insured would eliminate the problem of tracing funds between spouses. At the same time, hardship could be avoided by the liberalized marital deduction limit proposed above.

In the case of policies held by children of the insured, or trusts for their benefit, tracing problems are likely to be less difficult than between spouses because parents and children are less likely to treat their combined assets as a single fund than are husbands and wives. Accordingly, with respect to policies held by children or trusts for their benefit, restoration of the premium payment test is the more appropriate solution.

VIII. *State Death Tax Credit*

Roughly one-tenth of current federal estate tax revenues is lost to state treasuries through the credit for state death taxes. The credit should be repealed for several reasons. Repeal would raise federal revenues, simplify death taxation, and would be consistent with unification of estate and gift taxes, as discussed above.

Although repeal would result in a decrease in state death tax revenues, the reduction is unlikely to be substantial. In recent years, the credit has accounted for less than half of total state death tax collections. Relatively few states impose a tax which is limited to the amount needed to absorb the credit—only 4 as of January 1, 1969.

When the credit was first introduced in the 1920's, it was thought necessary in order to keep interstate competition for wealthy residents from leading to the repeal of state death taxes. Such competition no longer prevents the imposition in most states of taxes which exceed the federal credit in many estates.

Finally, the state death tax credit is an anachronistic, primitive form of revenue sharing. It is unfair for a state which attracts retired persons in large numbers to collect a portion of what would otherwise be federal estate taxes from their estates. General revenue sharing now provides a more efficient and rational means for the allocation of federal tax revenues to state governments.

IX. *Farms*

It is often suggested that special problems of farmers under the estate tax require an increase in the exemption or a modification of the rules for valuation of farms. I do not believe any such special relief is needed, apart from some liberalization of present provisions for deferred payment of the tax. If the Committee concludes that further relief is needed, it should be provided separately rather than by changing the basic provisions applicable to all estates, such as the exemption.

The Burleson Bill (H.R. 1793) illustrates one approach in reducing estate tax burdens for farmers, by allowing the executor to elect to have "qualified real property" valued at the use in which it qualifies, rather than at fair market value in its most valuable use. A great many reasons have been given for such relief.

It has been said that the present law forces farms to be sold to pay the estate tax, with the result that ownership passes out of local hands into large corporations or developers and may be changed from farming to other uses. It is also said that present market values for farm land are illusory and reflect inflation, rather than real values. None of these reasons provide sufficient support for ignoring the real value of the land in computing the taxable estate. At most they justify some liberalization in provisions for deferring payment of the tax. Some farms doubtless are sold in order to pay the estate tax, but such sales create opportunities for others to enter farming and make available potential building lots near cities. Our need for more housing will not be relieved by encouraging farmers not to sell their farms for home sites.

As to "illusory" market values for farms, the present valuation rule operates to limit the value for estate tax purposes to what a willing buyer would pay. This is the rule for all other assets and it is unfair to make a special exception for farms.

X. *Untaxed Appreciation at Death*

Although the problem of untaxed appreciation at death has great importance, it relates to the income tax, rather than to the estate tax. It therefore is discussed separately in an Appendix.

Appendix

Untaxed Appreciation at Death

Some authorities have described the failure to tax unrealized appreciation of assets transferred at death as the most serious defect in the income tax. As of 1966, the Treasury estimated the amount of gain which thus escapes the income tax at $11.5 billion per year. It is difficult to find any justification for continuance of a loophole of this magnitude. Some, nevertheless, have done so.

One objection made to taxing gains at death is that such gains merely represent the effect of inflation on asset prices. Certainly inflation should be taken into account generally in computing the amount of realized gain when assets are sold or disposed of. The present system, under which the taxable gain on an asset bought for $10,000 and sold in 1976 for $25,000 is the same whether the purchase occurred in 1932 or in 1972, is grossly unfair to sellers who have held assets for extended periods during which the purchasing power of money has declined substantially. But the appropriate solution to this problem is a general provision to recompute gain on all taxable dispositions of assets. See "Price-Level Basis Adjustment—A Modest Proposal," 26 Tax Lawyer 189 (1973). To grant relief only to those who hold assets until death by imposing no tax on asset appreciation is wholly arbitrary. In a given case, the appreciation may be far greater than the rate of inflation during the period the asset was held.

The major alternatives that have been proposed to deal with gains at death are (1) the Treasury's proposal in 1969, under which such gains would be includible in the decedent's final income tax return; (2) the American Bankers Association proposal for an additional estate tax (AET) on net appreciation of estate assets described in Covey, Possible Changes in the Basis Rule for Property Transferred by Gift or at Death, 50 Taxes 831 (December, 1972); and (3) extension of the present carry-over basis rule for gifts to transfers at death as well. The Treasury proposal represents the soundest approach of the three, although it could be improved by some revisions in technical aspects.

A. *The Treasury's 1969 Proposal: Inclusion of Unrealized Gains in the Decedent's Final Return and Recognition of Gain on Lifetime Transfers by Gift*

What the Treasury proposed in 1969 was that "persons holding appreciated capital assets at death would be treated as if they had sold such assets just before death, and such gains would be taxed in the final income tax return of the decedent." The income tax on such appreciation would be deductible in determining the amount of property subject to estate tax. The assets taxed at death would then have a basis equal to the value at death, just as is true today. Items of income in respect of a decedent also would be included in the decedent's final return, eliminating the present complexities of section 691.

Similar treatment would be applied to lifetime transfers by gift, which would also receive a new basis equal to the fair market value at the date of the gift. To fail to do so would be to create an artificial incentive for lifetime gifts. It might also lead to a long-term deferral of tax as property might pass from one donee to another by gift, always with carry-over basis and no recognition of unrealized appreciation.

It is only fair that an individual who has enjoyed the benefit during his lifetime of deferring recognition of gains for tax purposes should be required to account for such gains in his final return when he dies. Any other provision continues the lock-in effect of present law, under which taxpayers are kept from selling appreciated assets by the knowledge that assets retained until death obtain a new basis and the appreciation of such assets is never taxed to anyone.

1. *Criticisms of Treasury Proposal.*—It is appropriate to turn now to some of the criticisms which have been made of the Treasury proposal. First, some have objected that the provision for a deduction for estate tax purposes for the income tax on appreciation at death makes the latter tax regressive. They point out that for an estate in a marginal bracket of 77%, each dollar of income tax on appreciation at death costs the estate only 23 cents because of the offsetting reduction in the estate tax. On the other hand, for an estate in a marginal bracket of 25%, each dollar of income tax on appreciation at death costs the estate 75 cents.

These observations are, of course, factually correct—but equally true of any income tax or other tax paid by the decedent during his life which likewise reduces his taxable estate when he dies. In that sense, every tax is regressive because it reduces the taxpayer's taxable estate, and that reduction means more the higher the marginal estate tax rate is.

Moreover, the capital gains tax is itself progressive at one-half the range of rates for taxes on ordinary income. The bottom capital gains tax is 7 percent (half of the first bracket on ordinary income) and the top rate on capital gains is 35 percent (ignoring the minimum tax). Thus the capital gains tax is highly progressive—the top rate is five times the bottom rate. This difference in rates may more than offset the greater value in a larger estate of deductions which reduce the taxable estate. So the objection that the income tax on appreciation at death is regressive is without substantial foundation.

Others have objected that the tax rate applied to a lifetime of unrealized gains should not be determined by the happenstance factors that may affect the decedent's tax bracket for the year in which he dies. Thus the other income reportable on the decedent's final return will be affected by whether he dies at the beginning or end of his taxable year, whether the final return is a joint return with a surviving spouse, and whether death occurs while he has substantial earned income from current employment (or deferred compensation) or not until after retirement and at a time when deferred compensation is no longer being received. It is true, of course, that these factors may affect substantially the applicable tax bracket on the decedent's final return, and thus the tax on unrealized appreciation. But the availability of liberalized income averaging substantially limits the importance of such effects. Further liberalization, for example, by treating averageable income as if it had been received over 10 years instead of the five years provided in present law (using, however, only the four years preceding the year of death as the bases for computation) should greatly reduce the force of the objection that the tax on a lifetime of unrealized gains is being determined by bunching such gains in income for a single year.

Inclusion of items of income in respect of a decedent has been objected to on the ground that such items are "not marketable and/or difficult to value." (Covey, p. 841) The valuation objection is without substance, as such items must in any case be valued for estate tax purposes. Whether it is a reasonable conclusion that items of income in respect of a decedent are any more difficult to value, on the average, than other estate assets is questionable. The classic examples of such items—unpaid salary, accrued interest and dividends—present no significant valuation problems.

Finally, there is the familiar objection of complexity which assails almost every proposal which seeks to make our tax system work more fairly. In this case, however, the objection is, as usually is not the case, accompanied by a concrete alternative which is said to achieve the desired reform without suffering from similar complexity. Before turning to the alternative proposal for an Additional Estate Tax (AET), it is appropriate to consider the technical aspects of the Treasury proposal.

2. *Technical Aspects of Treasury Proposal.*—The Treasury would have exempted from taxation of unrealized gains at death, transfers to spouses, to charities, and to orphan children (to the extent such transfers were exempt from transfer tax as well). Except for charities, such an exemption is entirely appropriate and would carry out a policy of permitting tax-free provision to be made for spouses and dependents of the decedent. At the same time, ultimate loss of revenue would be avoided by means of a carry-over basis which would cause the unrealized appreciation to be taxed when the property was sold or disposed of by the spouse or orphan child. Such an exemption is inappropriate in the case of transfers to charities, however, as no tax would be imposed on a subsequent disposition by the recipient. The unrealized appreciation at the decedent's death would thus escape taxation altogether. Taxing such appreciation would be in keeping with the proposal in this paper to restrict the estate tax charitable deduction.

A stronger argument can be made for retention of the present treatment of lifetime transfers of appreciated property to charity, even though recognition of gain should be required on such transfers at death. The tax treatment of such transfers was extensively considered by Congress in connection with the Tax Reform Act of 1969 and reflects an evident purpose to retain some incentives for lifetime charitable gifts of appreciated property.

The Treasury took the view that in order to prevent the availability of exemptions from leading to artificially-induced bequests of low-basis assets to spouses, orphans, and charities, it was necessary to reallocate basis between exempt and

non-exempt property. This highly complex aspect of the proposal would mean that if half the decedent's assets passed to his spouse and half to his adult son, only one-half of the total appreciation would be taxed without regard to which transferee received the particular assets which had appreciated. The spouse would receive whatever basis were needed to insure that the remaining gain would be taxed to her when she disposed of the property (if the value of the property were unchanged at that time). Such an allocation is wholly unnecessary and artificial.

It is true, of course, that income tax considerations doubtless would affect the choice of assets to be bequeathed to a spouse and would create an inducement for the transfer of appreciated assets to a spouse. As a theoretical ideal, the income tax should be neutral with respect to the choice of assets to be transferred to a particular transferee. But as long as we have progressive rates, that ideal cannot be attained because the income tax bracket of the transferee inevitably may influence the transferor's choice of high-yielding or low-yielding assets to transfer. Admittedly, the opportunity to postpone taxation of unrealized gains, if such gains represent a major fraction of the value of the property, may create a greater distorting influence in the choice of assets to be transferred than the income tax bracket of the transferee does today. But the price of avoiding such distortion is very high.

The reallocation of basis between the assets transferred to the surviving spouse (and orphan children) and assets transferred to others would greatly complicate the income tax situation of all transferees, because none would know the basis of the assets which they received until the final determination of values for all assets included in the estate. A change in the value of one transferred asset would require a recomputation of basis for all of the others as well. Furthermore, the rule would be confusing for many transferees who could be expected to understand a rule under which the basis for the assets received is either the date of death value or the decedent's cost, but not a reallocated hybrid.

Some commentators appear to assume that the proposed exemption for transfers to spouses and orphan children would be available in the case of assets sold to raise cash to pay bequests to such transferees. It is submitted, however, that the language of the Treasury proposal makes implicit that the exemption would only be available with respect to property delivered in kind in satisfaction of a bequest to a spouse or orphan child. Such a limitation avoids many complexities and is consistent with the goal of the exemption, which merely is to provide tax deferral until assets are sold by the recipient spouse or child. If the sale is made by the executor, the occasion for such exemption never arises.

It is possible, of course, that the executor would be uncertain for some time whether a given asset would be sold or would be delivered in kind to a spouse in satisfaction of a formula or residuary bequest, and thus would be uncertain whether or not the unrealized appreciation of such property would be includible in the decedent's final return. Partial relief from this problem could be provided by delaying the due date for the decedent's final income tax return until the due date for the decedent's estate tax return, if the latter date were later (which it normally would be for a calendar year taxpayer who died after July 15). This would also permit use of the alternate valuation in determining the value of assets subject to tax with respect to unrealized appreciation. Furthermore, it should permit the Internal Revenue Service to develop procedures which would integrate the audit of the estate tax return and the final income tax return so as to avoid the necessity for separate determinations of values for purposes of each tax.

The Treasury also proposed an exemption, in effect, for estates not required to file a federal estate tax return by providing a minimum basis with respect to unrealized appreciation of assets of $60,000. Such an exemption appears to be unjustified and wholly inconsistent with a policy of imposing an income tax on unrealized appreciation at death. The evident purpose of the exemption is to free from that tax any estate for which no estate tax return is required. If the estate tax exemption remains $60,000, the amounts involved are too large to apply the same exemption to unrealized appreciation at death. If, as is proposed here, the exemption is reduced to $20,000, administrative considerations more important in relation to the amounts of tax involved. At that level, an exemption from tax on unrealized appreciation might also be appropriate.

There remains the question of how the Treasury Proposal could properly be applied to unrealized appreciation of assets as of the date of its enactment. The Treasury would have given taxpayers with respect to each owned asset the option of using either adjusted basis or the value as of the date of enactment, with specified adjustments. It is submitted that this option should, like the optional valuation for estate tax purposes, be available only on an aggregate basis. In

other words, the executor should be permitted to make only a single blanket election, applicable to all assets of the decedent, either to use adjusted basis or value as of the date of enactment as the cost in determining taxable gain. Such a single election would simplify the preparation and audit of the decedent's final return. It would also limit the extent to which unrealized gains as of the date of enactment would escape taxation, by requiring that unrealized losses likewise be taken into account if the executor prefers not to use cost basis.

B. The American Bankers Association Proposal: An Additional Estate Tax (AET) on Unrealized Appreciation of Property Transferred at Death

The American Bankers Association Proposal would impose a single flat rate of tax on net appreciation included in (1) an individual's transfers at death; and (2) his transfers made in the two years preceding death unless the transferred property is sold before he dies. The suggested rate is 14%, based on an assumed top estate tax bracket of 60 percent. As the AET would not be deductible in computing the regular estate tax, a 14 percent rate corresponds to a maximum rate of 35 percent on capital gains under the income tax. This follows from the fact that the tax on such gains (whether paid during life or an unpaid claim when the taxpayer dies) reduces the portion of the estate otherwise subject to a 60 percent estate tax, so that of each 35 cents paid in capital gains tax, 21 cents is offset by a reduction in estate tax when the taxpayer dies.

The single rate has been defended on the ground that a decedent who is in the assumed top estate tax bracket of 60 percent "would pay approximately the same total tax as he would pay if a capital gains tax on this appreciation at death were imposed and a deduction for this tax were allowed in computing the estate tax. All other decedents would pay a smaller AET than they would pay under a capital gains tax at death" (Covey at p. 845). The final statement appears to be overly broad. For example, a taxpayer who died January 1 might have no income includible in his final return, under the Treasury proposal, except for unrealized appreciation. Such unrealized appreciation would have to exceed $20,000 for a single taxpayer before any part of it would be subject to a marginal income tax rate on capital gains approaching 14 percent, and would have to be about $50,000 before the average income tax rate on capital gains would be as high as 14 percent. And the comparison just made does not take into account the reduction in the effective tax on gains resulting from the estate tax deduction for the tax itself. Thus it does not seem appropriate to use a single rate for the AET which would apply to all estates, without regard to their size or to the percentage represented by unrealized appreciation.

A second objection to the proposed AET is the failure to provide an exemption for appreciation of assets transferred to a surviving spouse on the ground that "as a matter of theory, imposition of a tax on appreciation should not turn upon the destination or use of the appreciation" (Covey, p. 846). It is submitted that whatever the theoretical justification for a tax on unrealized appreciation, the practical impact of the tax on a surviving spouse should not be ignored. To fail to do so is to force the spouse to pay a tax at the very time that the decedent's earning power ceases to be a source of her support. Yet the absence of the exemption is one of the claimed sources of simplicity of the AET in contrast with the Treasury proposal.

But the most fundamental objection to the AET is that it would continue to provide artificial incentives for some taxpayers to retain appreciated assets until they die, because for them the AET would be lower than the capital gains tax that would be paid during life (after giving effect both to the loss of deferral with respect to tax paid during life and the removal of the amount of the tax from the gross estate for estate tax purposes). For other taxpayers, the AET would provide an equally artificial incentive for lifetime sales of appreciated assets, because for them the relevant comparison would indicate that the AET would be the more budensome levy. Furthermore, any change in the taxation of capital gains realized during life would also distort such comparisons unless it were accompanied by a corresponding change in the flat rate AET. Thus the AET would continue to provide a lock-in effect for some taxpayers and would create for others an artificial incentive for lifetime sales of appreciated assets.

Finally, to call an income tax an additional estate tax is more than illogical. It would be expensive for the Treasury as well. There are outstanding issues of United States bonds which are eligible for redemption at par in payment of the holder's estate tax when he dies. As of early March, 1976, some issues were selling for as little as 81. This gives purchasers an opportunity to settle their estate tax liabilities for just 81 cents on the dollar, if the bonds are bought before they die.

Of course the 19 cent discount would have the effect of increasing the purchaser's taxable estate, as bonds bought at 81 would be valued at 100 for estate tax purposes to the extent redeemable at par to pay the estate tax. But this increased estate tax merely reduces the discount the purchaser enjoys. Thus the tax on unrealized appreciation at death should not be called an additional estate tax if for no other reason to avoid making it subject to payment at a discount by buyers of redeemable bonds.

A further reason which makes inappropriate the designation of an income tax on unrealized appreciation at death as an additional estate tax is the trend for state income tax statutes to follow federal definitions of taxable income. If such appreciation is to be treated in substance as taxable income for federal purposes, the states should not be required to change their income tax statutes to reach a similar result.

C. Carryover-Basis for Deathtime Transfers

No extended consideration of the third alternative, a carryover of the decedent's basis for transfers at death, is appropriate. This approach would perpetuate the lock-in effect of present law, in that taxpayers would know that the tax could be postponed indefinitely if the property were not sold by them or their transferees. It would also perpetuate any uncertainties about basis instead of causing them to be cleared up at the death of the taxpayer if he owns the property at that time.

The Impact of the Estate Tax: Only the Wealthy Feel Its Bite

(By James D. Smith) [1]

The federal estate tax produces relatively little revenue, $3 billion a year, compared to $103 billion from the personal income tax and $36 billion from the corporate income tax. It was never intended to be a leading source of public funds. Its purposes have been and should continue to be to act as (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 to some degree the life chances of children who had the foresight to choose rich parents and those who lacked such 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 provides 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 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 could tax quite heavily wealth flowing to the already affluent.

THE DISTRIBUTION OF WEALTH IN THE UNITED STATES

In most uses of wealth distribution data, we are interested in economic units such as the family, because study of those units gives us a better view of one's economic status than does the study of the wealth an individual 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, because it is the individual's death that triggers the tax.

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[1] James D. Smith is a senior researcher for the Urban Institute, Washington, D.C., and a professor of economics at Pennsylvania State University. He has specialized in studies of the distribution of wealth and its implications for politics and economics. The following article is based on work that Smith and a colleague, Stephen Franklin, did for the Urban Institute under a grant from the National Science Foundation.

In this article, Smith argues that the estate tax is an instrument that makes the economic system fairer by preventing the accumulation of economic power in only a few hands. He also indicates that the estate tax operates to partially equalize the life chances of citizens, some of whom are fortunate to have wealthier parents than others.

The article sets forth statistics showing that the share of U.S. wealth held by the rich has changed very little over the past two decades, and that the concentration of wealth in the U.S. is substantial. Smith also concludes, on the basis of statistical studies, that the so-called liquidity problem, which has caused the Treasury Department to offer substantial tax relief for all estates, is not a general problem at all.

For practical purposes, a quarter of all U.S. citizens owned nothing 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 also about 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.

The assets held by the rich

For some perspective about the types of assets held by the rich (those with a net worth of $60,000 or more), let us examine that group more closely. It is apparent 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 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. Surprisingly, the rich as a group hold a high proportion (13 percent) of their portfolio in cash (demand and time deposits). 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 issued by closely held 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.

Wealth concentration constant over time

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 1 the share of the nation's personally owned wealth held by the richest 1 percent and 0.5 percent of persons is displayed. It can be seen from Table 1 that the share of U.S. wealth held by the richest half of 1 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 further, 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. Wealth in the United States has become less concentrated in the last half century. But the diminution is not great, and it all occurred in periods when the market system was functioning with difficulty or was in administrative abeyance, specifically during the Great Depression and World War II.

Because wealth in the U.S. continues to be so highly concentrated, as shown in Table 1, the burden of the estate tax is similarly concentrated. And because the estate tax burden falls predominantly on the most wealthy, any move to cut estate taxes will necessarily confer its greatest benefits on those whose wealth is susbtantial.

"For practical purposes, a quarter of all U.S. citizens owned nothing in 1972. . . . About 55 percent of all individuals had a net worth of less than $5,000."

THE LIQUIDITY ISSUE

The President and others have stated 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. But from a policy point of view, there are a number of questions that must be answered before one can be comfortable in recommending legislation to alleviate the alleged liquidity problem:

How extensive is the liquidity problem?

In addition to farms and businesses, are there other nonliquid assets, such as personal effects, jewelry, art, household durables and the like, which also pose a liquidity problem?

Is a lack of liquidity in estates an inadvertent 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?

Is the estate the correct unit of analysis for deciding whether a liquidity problem exists? Or is the liquidity of the legatee also a relevant consideration?

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TABLE 1.—SHARES OF RICHEST 0.5 PERCENT AND 1 PERCENT OF PERSONS IN NATIONAL WEALTH, 1953, 1958, 1962, 1965, 1969, AND 1972

Asset	1953					1958					1962				
	Value held by richest (billions)			Share held by richest (percent)		Value held by richest (billions)			Share held by richest (percent)		Value held by richest (billions)			Share held by richest (percent)	
	100 percent	0.5 percent	1 percent	0.5 percent	1 percent	100 percent	0.5 percent	1 percent	0.5 percent	1 percent	100 percent	0.5 percent	1 percent	0.5 percent	1 percent
Real estate	$439.0	$45.0	$68.0	10.3	15.5	$621.5	$62.5	$93.9	10.1	15.1	$770.0	$79.6	$117.8	10.3	15.3
Corporate stock	151.5	116.6	130.8	77.0	86.3	264.1	175.9	199.2	66.6	75.4	426.4	227.3	264.4	53.3	62.0
Bonds	72.8	33.0	38.3	45.3	52.6	87.0	31.3	36.0	36.0	41.4	94.5	33.2	38.4	35.1	40.6
Cash	160.1	20.9	28.8	13.1	18.0	216.0	22.5	32.8	10.4	15.2	278.3	28.9	42.5	10.4	15.3
Debt instruments	34.0	8.2	10.9	24.1	32.1	43.7	12.5	16.3	28.6	37.3	51.5	16.5	21.8	32.0	42.3
Life insurance (cash surrender value)	64.5	6.6	9.1	10.2	14.1	79.9	7.5	11.3	9.4	14.1	93.8	7.1	10.7	7.6	11.4
Trusts	20.5	17.5	18.8	85.4	91.7	30.3	25.8	27.9	85.1	92.1	46.1	NA	NA		
Miscellaneous	222.8	12.5	19.8	5.6	8.9	312.9	19.8	24.9	6.3	7.9	379.4	39.8	52.7	10.5	13.9
Total assets	1,144.7	242.8	305.7	21.2	26.7	1,625.1	332.0	414.4	20.4	25.5	2,093.9	423.4	548.3	20.7	26.2
Liabilities	140.0	21.3	29.0	15.2	20.7	227.4	29.2	38.3	12.9	16.8	314.0	47.8	61.0	15.2	19.4
Net worth	1,004.7	221.5	276.7	22.0	27.5	1,396.7	302.8	376.1	21.7	26.9	1,779.9	384.6	487.3	21.6	27.4
Number of persons (millions)		0.80	1.60				0.87	1.74				.93	1.87		

Asset	1965					1969					1972				
	100 percent	0.5 percent	1 percent	0.5 percent	1 percent	100 percent	0.5 percent	1 percent	0.5 percent	1 percent	100 percent	0.5 percent	1 percent	0.5 percent	1 percent
Real estate	$917.7	$94.4	$135.8	10.3	14.8	$1,188.8	$117.0	$170.7	9.8	14.4	$1,492.6	$150.9	$225.0	10.1	15.1
Corporate stock	596.6	317.2	364.9	53.2	61.2	832.1	346.3	473.3	44.0	50.8	870.9	429.3	491.7	49.3	56.5
Bonds	103.6	57.5	63.2	55.5	61.0	133.9	63.7	71.5	47.6	53.4	158.0	82.5	94.8	52.2	60.0
Cash	366.0	43.7	62.7	11.9	17.1	496.9	48.1	71.2	9.7	14.3	748.8	63.6	101.2	8.5	13.5
Debt instruments	53.3	19.8	25.4	37.1	47.7	72.4	21.9	29.6	30.2	40.9	77.5	30.3	40.8	39.1	52.7
Life insurance (cash surrender value)	107.2	6.5	10.9	6.1	10.2	127.2	8.4	13.8	6.6	10.8	143.0	6.2	10.0	4.3	7.0
Trusts	57.5	49.0	52.7	85.2	91.7	69.9	60.0	64.5	85.8	92.3	99.4	80.3	89.4	80.8	89.9
Miscellaneous	456.6	36.3	49.1	8.0	10.8	632.8	47.0	68.7	7.4	10.9	853.6	[illegible]9.5	83.3	6.8	9.8
Total assets	2,601.0	575.4	712.7	22.1	27.4	3,484.1	672.4	848.8	19.3	24.4	4,344.4	822.4	1,046.9	18.9	24.1
Liabilities	413.3	57.0	73.1	13.8	17.7	557.5	75.8	100.5	13.6	18.0	808.5	100.7	131.0	12.5	16.2
Net worth	2,187.7	518.4	639.6	23.7	29.2	2,926.6	596.7	748.1	20.4	25.6	3,535.9	721.7	915.9	20.4	25.9
Number of persons (millions)		.97	1.94				1.01	2.03				1.04	2.09		

To answer these questions, we computed for each estate a ratio of (a) federal estate taxes plus administration costs, to (b) liquid assets minus debts. We regard this ratio as a conservative index of the estate's ability to pay estate taxes without forced liquidation of less marketable assets.

Liquidity Problem Not Extensive

It is clear from a study of the figures that the liquidity problem is less extensive than one might expect. Nearly three-quarters of the estate tax 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 paid.

The Ford Administration's assertion that estates which include unincorporated businesses or farms are substantially less liquid than others is not entirely without merit, however. About 16 percent of the estates in 1973 that contained business 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 only 4 percent for estates 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 market value. These transfers add to the estate's 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.

"The share of U.S. wealth held by the richest half of 1 percent of the population has been measured repeatedly at between 22 and 24 percent of the total."

Another factor to be kept in mind when evaluating an estate's liquidity is that inter-vivos transfers may well have been made to potential heirs by the decedent. If there is a tendency, for estate planning 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.

Finally, 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, indeed 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 who is rich enough so that access to the capital market is relatively easy.

"It is clear from a study of the figures that the liquidity problem is less extensive than one might expect."

Evaluating the Liquidity of Surviving Spouses

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, spouses, who are identified on the Form 706. Married men, on the average left (or the courts distributed) 65% of their estates to their surviving spouses. Married women left about 50% to their spouses. We can, by making a not-too-heroic assumption that husbands and wives share roughly equally in the ownership of assests, ask the 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 our computer file in the following way:

> The surviving spouse of each decedent was assumed to have assets equal to the decedent's estate. In other words, if the decedent was shown to have an estate with an economic value of $1 million, the surviving spouse was assumed to have assets equal to $1 million. This may understate the survivors' wealth and liquidity, because debt associated with the cost of the last illness (which reduces the value of the decedent's estate) should not be subtracted from the survivor's assets.
>
> The surviving spouse was assigned a tax rate proportionate to the share of the decedent's estate he or she received. Thus, if the surviving spouse got 80% of the decedent's assets, the survivor also was assumed to have borne 80% of the tax.
>
> The ratio of tax burden to liquid assets of the surviving spouse was calculated.

When these things are done, the liquidity problem, at least for transfers at death among spouses, nearly disappears.

Table 2 summarizes a portion of these findings. The table shows the percentage of returns in each asset class on which taxes were equal to or greater than the liquid assets available to the surviving spouse. (The liquid assets included those in the decedent's estate.) These results are shown for estates which consist of some farm and non-corporate business assets, the least liquid type of assets. Results are also shown for all estates. In addition, the table shows the percentages of estates in each asset class that paid no taxes.

Conclusions Regarding Liquidity

Thus, whether one looks at the figures relating to the ratio of taxes and other costs to liquid estate assets, or at figures relating to the liquid wealth of surviving spouses, the point is the same: the liquidity problem is less than one might expect, even when attention is concentrated on estates containing farms or closely held business assets. On average, almost 93 precent of farm and business estates encounter *no* liquidity problem. Even where the liquidity problem is worst—in estates in the $200 thousand to $1 million range—about 90 percent of all estates escape difficulties. Solutions to whatever liquidity problems may exist should take these facts into account.

TABLE 2.—LIQUIDITY BURDEN ON SURVIVING SPOUSES, 1972

Economic value of estate (includes cash value of life insurance, excludes life transfers) (thousands of dollars)	Percentage of returns where taxes were equal to or more than liquid assets		Percentage of returns showing no estate tax liability	
	Some farms and noncorporate business assets	All returns	Some farm and noncorporate business assets	All returns
Negative value	2.4	1.5	97.6	98.5
Less than 60	.7	.2	99.3	99.8
60 to 80	4.0	1.4	76.8	83.5
80 to 100	4.7	1.6	74.5	80.5
100 to 150	6.9	2.6	47.5	51.9
150 to 200	7.9	5.7	1.0	1.4
200 to 300	10.8	4.6	1.4	1.2
300 to 500	10.3	5.4	.5	1.0
500 to 1,000	10.0	4.4	.4	.5
Over 1,000	6.3	3.3	1.0	1.2
Average	7.4	2.9	38.8	48.3

STATEMENT OF ALBERT E. GLISS, PRESIDENT MILK INDUSTRY FOUNDATION AND THE INTERNATIONAL ASSOCIATION OF ICE CREAM MANUFACTURERS

Mr. Chairman, members of the committee, I appreciate this opportunity to comment on the subject of estate and gift taxes which seriously involves my own company and many of the members of the two national industries which I represent.

I am president of Barber Pure Milk Company, Birmingham, Alabama, a family-owned dairy. I am also president of the Milk Industry Foundation, located at 910 Seventeenth Street, N.W., Washington, D.C., and I speak for its members who are located in every state of the union. The companies belonging to this organization are the bottlers of fluid milk and processors of fluid milk products.

Additionally, in an effort to consolidate our testimony, I am speaking for Mr. J. Loyd Langdon, president of the International Association of Ice Cream Manufacturers, located in the Barr Building, Washington, D.C., and the members of that organization. This association also has members in every state of the union, producing ice cream and related frozen products. Together, the associations represent companies which operate approximately 2,000 dairy processing and manufacturing plants.

To emphasize the fact that these industries are characterized by small family-owned enterprises, I would like to point out that according to a recent U.S. Department of agriculture publication, 75% of the plants were operated by local companies which owned only one plant.

The two organizations specifically want to focus attention on badly needed changes in our present estate tax provisions.

We are aware of the many bills that have been introduced and referred to this Committee.

We have read President Ford's recommendation presented March 5th in Springfield, Illinois. We support his ideas.

We know some of the present bills relate only to revising estate taxation of farms, which we support. However, in the President's statement of March 5th, and in his earlier proposal at the beginning of 1976, it seems clear he intended not only to include farms, but also businesses and individuals. He speaks of, and I quote—"To ease the burden of estate taxes on the many Americans with modest estates . . ."

I am sure that agricultural organizations will address the problem of farmers and farm families. However, the burden of this tax is now most onerous, not only for farmers, but for businessmen and all Americans who work and save.

The farmer, with taxed dollars, has had to purchase real and personal property in order to maintain his enterprise. With the value of the dollar constantly eroding, it is surprising that no prior effort has been made to ease the estate tax burden. In fact, several decades have passed with little change.

Senator Gaylord Nelson of Wisconsin has made a further point that since the $60,000 exemption was enacted in 1942, inflation has increased the value of business and farm assets about 224% making this tax burden confiscatory. All of you are aware of the appreciation in the value of individual housing, thus creating an ever-greater hardship for the family survivors.

Senator Nelson also remarked that the income tax exemptions have been increased several times by the Congress to a total of 50 percent. But the estate tax exemption has not been touched! To further drive home the adverse effect of the estate tax, he has been quoted as saying— "While the $60,000 exemption enabled a farmer or business owner in 1942 to pass along to his heirs a home, automobile and a substantial part of his business, the $60,000 can be absorbed today by the family residence alone."

The change that occurred within the last two years has made the burden of these estate tax payments more difficult to bear even with ten years to amortize the obligation to the Treasury. Originally we paid, and I speak from experience in my own company, 4 percent interest. Then, it jumped to 9 percent on July 1, 1975, with the passage of Public Law 93 625, and was reduced to 7 percent February 1st. This is still a considerable increase and further erodes the financial position of those paying estate taxes.

The increase itself is a very substantial burden, but the uncertainty compounds the problem even further. Most family-owned milk and ice cream companies have no way of obtaining needed capital investment except by earnings or by debt financing, and much of it by debt capital. The uncertainty of a changing rate of payment of estate taxes greatly complicates the firm's ability to obtain capital from its normal financial lending institutes.

As with the farmers, the dairy products businesses, and particularly those family-owned enterprises, have purchased with fully taxed dollars, the bricks and mortar for their buildings and equipment needed to process and package their extensive line of products. Additionally, they have purchased large fleets of rolling stock for delivering these perishable commodities to stores, homes, hotels, hospitals and other outlets.

Because the dairy industry is a very low margin industry, the retained earnings are small and even the ten-year amortization period is difficult to meet. The estate tax burden is often equivalent to repurchasing the family farm, home or business. We have some situations where the estate tax constitutes well over 50 percent of the company's net worth.

I know from my own certain knowledge of at least thirteen directors of our associations who are struggling under the effort to continue the family operation and not have the activity liquidated by the tax load placed on the family members attempting to continue the business and pass it on to future generations. I know there are many more dairy companies prospectively facing this problem. I do know of many small companies, family enterprises, which have gone out of business. Some have closed their doors because they could not hope to raise the cash to pay these taxes. There are a host of family dairy plants now for sale because they do not have the resources to face this kind of tax burden to allow their sons and daughters to carry on the business with sufficient capital to make sure it is a viable operation.

The exemption of $60,000 is still creating a hardship for the individual who has worked all of his life and with fully taxed dollars, has purchased a home, personal property and made what investments he could prudently make in order that his survivors would not have to sell their homes and sacrifice other assets to meet their estate tax obligations.

Most of the bills we have examined propose increasing the present $60,000 estate tax exemption in amounts up to $200,000. We think this is very modest in view of what has happened to the economy. Certainly it is obvious that the $60,000 exemption is not realistic in terms of the present values of the farm plants, small businesses and the estates of the average working American who has been frugal in trying to take care of his or her family survivors. We, therefore, hope that you will consider increasing the exemption to at least $200,000 as a minimum.

We support the idea of a tax moratorium for some reasonable period after death in order that the heirs of the farmers, the businessmen or individuals could so arrange finances that they could then pick up the burden of the estate taxes over a period of years.

In this connection we urge that instead of the present ten-year payout period, we follow the initial proposal of the President, that there be a five-year moratorium after death and a period of twenty years with greatly reduced interest rates allowed to amortize the obligation to the United States Treasury. We would hope that the interest rates would be permanently stabilized so we would not have a repetition of the rate changes which occurred in 1975.

It has long been the philosophy of our government to encourage family farms, to help make viable the small and family businesses and to make sure that the hard-working, thrifty people could retain and pass along most of the fruits of their own labor.

One of the most constructive ways that I know to reach these three important objectives would be to make these changes in the estate tax program effective as soon as possible.

STATEMENT OF FRED V. HEINKEL, CHAIRMAN, NATIONAL FARM COALITION

I am Fred Heinkel, Chairman of the National Farm Coalition, which consists of leaders of general, commodity and cooperative farm organizations representing more than one million farmers across the Nation who produce a broad spectrum of agricultural commodities.

The members of the Coalition have a deep commitment to America's traditional family owned and operated farms and businesses. This system, especially in regard to food production, has been a cornerstone of America's unequaled history of prosperity, industrialization and economic growth. To family farmers, the occupation tends to be its own reward. Through a commitment to get the job done—to get the seeds sown, livestock fed, and crops harvested—America's farmers have freed manpower and mines for other pursuits while keeping food costs at the lowest in the world relative to income.

Numerous threats to our family-oriented pattern of agriculture have arisen over the years. But, while the number of family farms has continually decreased, only in recent years has the trend of family farms falling in the hands of corporations and conglomerates become accentuated.

The National Farm Coalition believes our present estate tax laws are in effect prohibiting farmers from passing their land on to their decendants. Forced sales are resulting in fewer and fewer family farmers and an accentuation of the trend toward corporate food production.

To deal with this problem, the Coalition unanimously adopted the following resolution: "The National Farm Coalition urges the Congress to enact, in the current session, legislation to modernize and update the tax provisions relating to estate taxes, including realistic valuation, so as to preserve the family-type of agriculture and small businesses in the United States."

Our interest in this matter is vital, and we are deeply concerned over the present unrealistic estate taxes imposed on farmers and small businesses.

For almost 35 years, the basic exemption in calculating the decedent's estate has been unchanged—in spite of the fact that the value of farm land and homes has increased many fold.

The current provisions of a $60,000 exemption and a 50% spouse exemption are devastating. In all too many cases, the survivors—children or spouse—are forced to sell out to cover the unconscionable tax bite. In most cases, it is impossible to sell off a part or section of the farm because most family farms have evolved into an efficient and logically organized unit of production where any division would leave an unsound economic base.

Farmers and small businessmen must be given some relief from the present burdensome estate taxation.

The Coalition suggests some adjustments in the law that would help relieve the estate tax pressures which threaten our food production system and even the way of life of one of America's most important minority groups.

Farm land values have increased tremendously due to the impact of inflation and speculation since 1942 when the present exemption was established. This exemption from estate taxation should be increased to at least $200,000 or an equivalent deduction in the form of a tax credit.

Statement of Forest Industries Committee on Timber Valuation and Taxation

My name is Bradford S. Wellman of Bangor, Maine. I am the agent and attorney-in-fact for private forest land owners owning collectively nearly one million acres in Maine and New Hampshire. I am also associated with Seven Islands Land Company of Bangor, a professional forest land management company. Neither my clients nor Seven Islands own any mills or other production or operating facilities. Receipts are those solely derived from the sale of standing timber—commonly called stumpage.

I am the chairman of a subcommittee of the Forest Industries Committee on Timber Valuation and Taxation dealing with Federal estate tax matters. Earlier this year our Committee, recognizing both the impact of the Federal estate tax on timberlands and the fact that your Committee intended to commence work on the estate tax, began a nationwide survey in an attempt to develop material for your consideration. Our data is incomplete and we would appreciate the opportunity to appear before you again to submit additional material to your Committee at your next opportunity.

In the nation as a whole, close to 60% of the total forest resource is owned in small acreages by private individuals; approximately 4½ million owners. As land prices and development pressures escalate, the estate tax will fall most heavily on these individuals. Individually, their ownerships are small. In the aggregate, they account for a major portion of the resource.

Family farms by their very nature require the services, labor, management and dedication of both husband and wife. For this reason, we suggest the exemption for the surviving spouse be doubled—to 100 percent.

There is another factor that is even more drastic than the exemption issue—namely, how farm land is valued for estate tax purposes. The present law which uses market value or more precisely speculative value is patently unfair. Farmers gain little from the inflated prices resulting from developer speculation simply because farmers want to grow food—not build houses and shopping centers.

Using development inflated market values for estate taxation makes it almost impossible for survivors to continue farm operations. For this reason, the Coalition urges that assessed valuation be on a basis of farm land value and not on the property's value as a development. In this regard, we feel it is entirely consistent to require the property remain in farming for a specified length of time.

America's family farmers feel the pressure of producing food for an every-growing population. They have responded to pleas for all-out production. Our agricultural system, rooted in the family tradition, will not survive if young farm people are denied the opportunity to own land.

Congress can take a giant step toward preserving a system which has served us well by adopting realistic estate tax provisions such as those suggested by the National Farm Coalition.

In 1972, the American Forest Institute surveyed 33,000 individuals; over 29,000 of whom were tree farmers. The survey showed that the present average period of ownership is between 20 and 30 years—not quite long enough to complete a forest rotation.

Twenty-eight percent of these individuals were over 50 years old; 37 percent were over 60.

Although for all of us death and taxes are sure, the problem is especially acute for this asset since the sample indicates that 65 percent of the owners of 51 percent of the timber production will be in estate tax proceedings within 10 to 15 years.

This is exactly when the country will be needing wood from their forest lands. U.S. Forest Service figures project that within 20 years we will be needing almost double the present production of wood products. Recent trends in reducing harvest from national forests put even more pressure on private lands to meet this country's wood needs. The estate tax will force more and more of these individuals to take land out of resource production to get immediate income for estate tax payments right at a time when we would need their wood.

I would appreciate the opportunity to send more complete data to you at a later date. I know other foresters and organizations are equally concerned about the

effect of the estate tax on forest land, such as: The Society for the Protection of New Hampshire Forests, Maine Forest Products Council, New Hampshire Timberland Owners Association, Vermont Natural Resources Council, Connecticut Forest and Park Association, Society of American Foresters, Forest Farmers Association, and others. Attached is a list of all supporting associations.

I am, however, familiar with the estate tax implications on commercial timberland in Maine and from this perspective would request your indulgence for a few minutes.

Commercial timberland, that is forest acreage capable of and potentially available for growing merchantable trees, in Maine amounts to 16,894,000 acres, approximately 50% of which is owned by the paper and forest industries companies. The other half is owned by some 100,000 private individual owners in large and small amounts. These lands produce a little more than half of the forest products used by the local economy. Of the privately owned half, approximately half (or a quarter of the whole) is owned by people such as the owners I represent and is under professional management by companies and agents such as Seven Islands.

The history of the ownership of Maine's commercial forests goes back to the mid-19th century when the land was purchased from the States of Maine and Massachusetts by individual loggers for the pine and spruce markets. These individuals often pooled their efforts and purchased the lands as tenants-in-common. As paper companies such as International Paper and Great Northern expanded into Maine, about the turn of the century, they commenced and active purchasing program from many of these individuals. This resulted in an exceedingly complex ownership pattern of private owners and corporate interests over substantial acreage. These acquisitions were done for the legitimate corporate purpose of securing the forest base for their business and, as I said earlier, now amount to about half of the total forest acreage in Maine.

In the 1930's the values of timberland dropped to a low of 50 cents per acre and neither the private owner nor companies saw any advantage or threat in the estate tax. However, by the late 1960's and early 1970's, prices paid for timberlands and also fair market value for estate taxation purposes had advanced in some instances to as high as $100 per acre. These levels in fact are such that at the low rate of economic return available in the market place for the sale of standing timber, the private individual commercial timberland buyer has vanished from the scene. The only private buyers we now see are those whose use of the land for commercial commercial timber purposes is incidental to some other use such as recreation or aesthetics.

During this same period Congress reduced the settlement period of the estate from 18 months to 9 months.

What then is the actual result upon the death of one of the owners that I refer to? The usual statement is that there is an estate liquidity problem. Well, that reply is an oversimplification of the problem. Upon the death of the landowner the executor has got to make some hard and quick decisions in the face of a limited market. If the land is owned jointly with either another private owner or a paper company (as is often the case in Maine), and the other owner is reluctant to cut or has differing objectives, lengthy court proceedings are often necessary to arrange partition.

Even in the case of outright fee ownership or when joint owners can agree, drastic harvesting may be required. Harvesting a large timber inventory all at once can be bad forestry in that it disrupts seed sources, wildlife, watersheds, and other benefits of the forest. It also tends to disrupt the local market price situation. Liquidation of a large timber source is also generally physically and economically impossible due to limited markets, limited labor, limited transportation, etc. The executor's option of a sale of standing timber is, therefore, often impractical or causes poor forest practices.

Bankers are generally reluctant to loan money using the land for security because of the risk factor from fire and disease (presently Spruce Budworm) and one has to be pretty large to borrow from an insurance company.

Therefore, the executor is almost forced into a sale of all or part of the land to a large company or to a developer—if such are in fact interested or capable of making the purchase at that time. The market seems to be limited in any one instance to 2 to 5 prospective purchasers. Slowly, therefore, over the years I have witnessed the increase of the corporate ownership and development sales and the decrease of long term private ownership.

Now I suppose you can argue that these are the facts of life but there are three things wrong with this:

(1) The estate and the beneficiaries are being forced into a limited market sale causing them to forfeit the value and effort of the prior sound practices of the decedent such as planting, stand improvement practices, fertilization, etc. The President has pointed out this factor in the case of farms, but the problem is even more severe in the case of forests because forests are not an annual crop but a long term investment. A tree planted in Maine today may not be harvested for anywhere from 40 to 80 years. The current owner may well be inhibited from using present income to improve his forest land and a forest improvement practice passed over is probably lost forever.

(2) The resultant concentration of forest lands into the hands of a few corporations may well reduce both the diversity of small to medium satellite wood using industrial activities and the forest itself. The reason for this is that a paper company will tend to develop that uniform species and growth best suited to its basic milling capacity and interest. The net result will be over a long period of time to restrict the ability of the area to generate a small diversified forest products economy. The private owner tends, on the other hand, to maximize the diversity of his forest growth and, therefore, to support a multiplicity of markets in order to protect himself from the vagaries of the economy and the use of forest products. He tends to place his eggs in as many baskets as possible.

(3) If, of course, there are sufficient alternative assets that readily can be disposed of to pay the taxes, the executor will be faced with the hard choice of selling these more liquid assets and retaining the land. Executors are wary of this because they could be subject to attack for retaining a high risk asset in preference to the higher income producing items which have better marketability. Even in the case where the executor has authority to retain such assets, he is leery because he may, in fact, by so doing be working against the best interest of the beneficiaries. The result in such cases is the sale of a part of the land assets—and interestingly enough a retaining of the portion which the estate beneficiaries have requested on some other basis than commercial timber use either for aesthetic or personal recreation or potential development. Thus the unsold portion is often withdrawn from all but incidental cutting of trees and is held for other purposes. The fragmentation of the asset invariably leads to the reduction or elimination of intensive forest practices. Estate taxation has the effect of concentrating forest lands in the hands of a few where large acreages are involved and there are large industries to buy it. In more urbanized areas where the ownerships are small, the tendency is for the land to be sold for development because this is the only way the heirs can generate funds to pay the estate tax. Development of the forest or farm removes the area, generally irretrievably, from resource production.

Now, unless you think I am making something up let me read to you from a letter handed me by an executor; "Since the tax was there and had to be paid by law we were fortunate in having a buyer at that particular time although from the standpoint of the estate, the situation required liquidation of a considerable portion of the estate and the turning over of the property to a large paper company—I would say the Government's approach in this situation causes property to be sold and the principal customers tend to be paper companies—". Now, I do not fault these companies. They are doing their job well and taking no unfair advantage of anybody. The economics of the situation makes them the best market.

PROPOSALS RECOMMENDED BY THE FOREST INDUSTRIES COMMITTEE ON TIMBER VALUATION AND TAXATION

There are a number of specific proposals which are supported by the Forest Industries Committee on Timber Valuation and Taxation:

A. *Reduction in Estate Tax Rates*

The present estate tax rates (top bracket of 77 percent) are too high. Growing competition for capital requires timber growers be given every incentive to invest in sound forestry practices. High estate taxes have the reverse effect because they discourage such investment.

In particular, we urge that if proposals for changing the treatment of appreciation at death are adopted, a corresponding reduction be made in the estate tax rates. We urge that such reduction exceed any revenues from such proposals in order to compensate for the administrative hardships and liquidity problems that would be created.

B. *Increase the Present Exemption from Estate Taxes*

In addition to reducing the estate tax rates, the $60,000 exemption from the estate tax should be amended. The exemption is clearly out of date and no longer

serves the purpose for which it was enacted. Accordingly, we urge that the exemption be increased to $200,000 to make it conform to the current economy.

C. *Alternative Estate Tax Payment Rules*

We basically endorse the President's proposal to relieve the executor of liability for all postponed taxes on farms and related types of assets. As indicated above, we would urge that timberlands be included as an item subject to this treatment. Going beyond that, however, we should point out that timberland, unlike farms, does not necessarily have an annual income and, therefore, additional special rules are appropriate. We recommend that estate taxes on all land used for the commercial production of trees, which was owned by the decedent at least five years prior to his decease, should, at the option of the executor, be payable at the earlier of either of two occurrences: twenty-five (25) years from the date of death or an economic event, such as the sale and cutting of timber or the sale of the timberland. We think it proper that a lien should attach to the land until the tax is paid and indeed should run with the land as a debt upon the asset in case the surviving heirs should in turn decrease prior to the passage of twenty-five (25) years or the economic event. In other words, the tax obligation would be treated exactly as a mortgage for the purpose of valuation in the hands of the executor of the second estate. The interest rate on these deferred taxes should be below current interest rates to reflect the low earning power of the timber growing stock.

D. *Valuation of Timber Properties in an Estate*

In addition to the liquidity problem, one of the major problems faced by administrators of estates containing small businesses, farms and timberlands is the problem of ascertaining the fair market value. A number of proposals have been introduced over the last few years to provide more specific rules for valuing such assets. Many of these provide that the value of such property in the gross estate shall be the value of such property in its current use.

These proposals providing for current use valuations are supported. These proposals alleviate the problem caused by high valuations placed on timber property because the property has a higher value if used for purposes other than growing timber.

These valuation proposals should not be viewed as substitutes for liberalization of the estate tax payment rules as described above. They are necessary in addition.

CONCLUSION

The above Forest Industries Committee on Timber Valuation and Taxation proposals would achieve greater equity within the estate tax system without changing the existing framework. The United States is at a point in its history where tremendous amounts of capital are necessary in order to expand and compete. No where is this more true than in long term timber operations. Every encouragement should be given to individuals to accumulate capital and put it to work in businesses creating new jobs. We feel that the above proposals will carry out these objectives.

FOREST INDUSTRIES COMMITTEE ON TIMBER VALUATION AND TAXATION

COOPERATING ASSOCIATIONS, 1976

Joe W. Graham
Alabama Forestry Association
Montgomery, Alabama

Donald A. Bell
Alaska Loggers Association, Inc.
Ketchikan, Alaska

J. Mason Meyer
American Hardboard Association
Chicago, Illinois

Paul R. Beattie
American Institute of Timber Construction
Englewood, Colorado

Edwin A. Locke, Jr.
American Paper Institute
New York, New York

Bronson J. Lewis
American Plywood Association
Tacoma, Washington

K. S. Rolston, Jr.
American Pulpwood Association
Washington, D.C.

J. Lundie Smith
American Turpentine Farmers Association Co-Op
Valdosta, Georgia

John D. Ferry
American Wood Preservers Assn.
Washington, D.C.

Theodore J. Duke
American Wood Preservers Inst.
McLean, Virginia

James L. Gundy
Appalachian Hardwood Manufacturers, Inc.
High Point, North Carolina

M. F. Taylor
Arkansas Forestry Association
Little Rock, Arkansas

Bernice Spilker
Associated Cooperate Industries of America, Inc.
St. Louis, Missouri

Ivan Congleton
Associated Oregon Industries
Salem, Oregon

Edward Stuart, Jr.
Association of Consulting Foresters
Wake, Virginia

John Callaghan
California Forest Protective Association
Sacramento, California

Paul Barringer
Eastern North Carolina Lumber Manufacturers Assn., Inc.
Weldon, North Carolina

Nicholas Kirkmire
Federal Timber Purchasers Assn.
Denver, Colorado

Donald H. Gott
Fine Hardwoods-American Walnut Association
Chicago, Illinois

William Carroll Lamb
Florida Forestry Association
Tallahassee, Florida

J. Walter Myers, Jr.
Forest Farmers Association
Atlanta, Georgia

Harold Joiner
Georgia Forestry Assn., Inc.
Atlanta, Georgia

J. Edgar Kennedy
Hardwood Dimension Manufacturers Association
Nashville, Tennessee

Clark E. McDonald
Hardwood Plywood Manufacturers Association
Arlington, Virginia

W. D. Hagenstein
Industrial Forestry Association
Portland, Oregon

James Newman
Kentucky Forest Industrial Assn.
Lexington, Kentucky

William H. Matthews
Louisiana Forestry Association
Alexandria, Louisiana

Frank M. Atchley
Lumber Manufacturers Association of Virginia
Sandston, Virginia

Charles M. Washburn
Maine Forest Products Council
Bangor, Maine

Robley Nash
Maine Hardwood Association
Augusta, Maine

M. R. Allen
Minnesota Timber Products Assn.
Duluth, Minnesota

Glen Jones
Mississippi Forestry Association
Jackson, Mississippi

C. F. Peterson
Mississippi Pine Manufacturers Association
Jackson, Mississippi

Missouri Forest Products Assn.
Jefferson City, Missouri

Donald McNeil
National Christmas Tree Growers' Association
Milwaukee, Wisconsin

Thomas M. Higgins
National Council of Forestry Association Executives
Columbus, Ohio

Ralph D. Hodges, Jr.
National Forest Products Assn.
Washington, D.C.

E. Howard Gatewood
National Hardwood Lumber Assn.
Chicago, Illinois

Henry H. Willins
National Oak Flooring Manufacturers Association
Memphis, Tennessee

Robert E. Dougherty
National Particleboard Assn.
Silver Spring, Maryland

Kendall S. Norcott
New Hampshire Timberland Owners' Association
Gorham, New Hampshire

J. Lewis Dumond
New York Forest Owners Assn.
Syracuse, New York

Ben F. Park
North Carolina Forestry Assn.
Raleigh, North Carolina

William J. Kidd
Northeastern Lumber Manufacturers Association, Inc.
Glens Falls, New York

Thomas P. Brogan
Northern Hardwood and Pine Manufacturers Assn., Inc.
Green Bay, Wisconsin

Thomas M. Higgins
Ohio Forestry Association, Inc.
Columbus, Ohio

William V. Hooker
Oklahoma Forestry Association
Ada, Oklahoma

James B. Corlett
Oregon Forest Protection Assn.
Portland, Oregon

Frank Ter Bush
Oregon Washington Silvicultural Council
Portland, Oregon

Carwin A. Woolley
Pacific Logging Congress
Portland, Oregon

John C. Fralish
Pennsylvania Forestry Assn.
Mechanicsburg, Pennsylvania

Paul Bofinger
Society for the Protection of New Hampshire Forests
Concord, New Hampshire

Robert R. Scott
South Carolina Forestry Assn.
Columbia, South Carolina

John C. Milliner, Jr.
Southeastern Lumber Manufacturers Association
College Park, Georgia

William R. Ganser, Jr.
Southern Forest Products Assn.
New Orleans, Louisiana

George E. Kelly
Southern Forest Products Assn.
Atlanta, Georgia

George Romeiser
Southern Hardwood Lumber Manufacturers Assn.
Memphis, Tennessee

Martin Crane
Southern Oregon Timber Industries Assn.
Medford, Oregon

James J. Cox, Jr.
Southwest Pine Association
Phoenix, Arizona

John Van Mol
Tennessee Forestry Association
Nashville, Tennessee

E. R. Wagoner
Texas Forestry Association
Lufkin, Texas

Carl Theiler
Timber Products Association, Inc. of Michigan and Wisconsin
Crandon, Wisconsin

Larry Frye
United Hardwood Forestry Program of Fine Hardwoods/American Walnut Association
Columbia City, Indiana

William E. Cooper
Virginia Forests, Inc.
Richmond, Virginia

William H. Larson
Washington Forest Protection Association
Seattle, Washington

Joseph W. McCracken
Western Forest Industries Assn.
Portland, Oregon

Steele Barnett
Western Forestry and Conservation Association
Portland, Oregon

George A. Craig
Western Timber Association
San Francisco, California

W. M. Graham
Western Wood Preservers Inst.
Portland, Oregon

H. A. Roberts
Western Wood Products Association
Portland, Oregon

Statement of the Tax Council

CAPITAL CONSCIOUS REFORM OF ESTATE AND GIFT TAXES

The Tax Council is a nonprofit, tax policy organization supported by business. From its inception nearly a decade ago, it has stressed the benefits which would flow to the public from a tax policy less adverse to capital accumulation and preservation.

After intensive study, in 1970 the Council's Tax Policy Committee approved A Program to Reform Estate and Gift Taxes. This statement is an updated version of that program.

Economics of Estate and Gift Taxes

Whether estate and gift taxes are paid from liquid assets or by liquidating property, the result is to convert capital into current government spending. This process violates the economic rule that taxes should be derived from the stream of production, and not be diminishing the capacity to produce.

Little thought seems to have been given to this rule when the extremely high rates of estate and gift taxes were first legislated in the 1930's. At the time, national policymakers were prone to believe that the depression had been caused by oversaving. This belief undoubtedly was a factor among those who voted the high rates, but the stated purpose for the levies was simply to raise revenues. The fact the rates would require effective liquidation of large estates (unless preserved through philanthropic transfers) seems to have caused little concern.

Today, no one would argue that a society could advance by devouring its capital—which is what happens when capital is converted by taxation to government spending. The amount so consumed must be replaced out of current income before there is net addition to the nation's stock of capital.

The yield of estate and gift taxes, estimated at $6 billion in fiscal year 1977, is not of great fiscal importance in a budget in which spending will exceed $400 billion and revenues $350 billion. And it is only six percent of the estimated rate of personal savings. But, for perspective, the figure is best related to the amount of income and numbers of people involved in its replacement.

Specifically, the savings from some $100 billion of personal income are required to replace the capital taken by estate and gift taxes. Or, stated another way, the value to the nation of the savings of 14 millions of its citizens is cancelled out by these taxes.

1970 was a period of intense public discussion of national priorities. We pointed out then that when a claim for priority was examined, it was found that the need was essentially for more capital. Continuing, we said: "The dialogue on priorities has tended to assume that the overall shortage of capital is something which must be accepted and lived with, but the Council view is that the dialogue adds up to a formidable case for priority attention to ways and means for increasing the nation's stock of capital. A good place to start is where taxes now destroy capital."

Since then, a consensus has developed that capital spending as a percentage of gross national product should be increased, and it is widely recognized that reduction in the tax impact on capital is necessary to this end.[1]

Objectives of Estate and Gift Taxation

Although the history of estate and gift taxation shows a legislative aim limited to raising revenue, the academic dialogue tends to assume and support additional aims. The most prominent one is redistribution of wealth, sometimes stated as reducing the concentration of wealth. Another is the taxation of windfalls. And still another is to tax wealth per se on the assumption its existence indicates capacity to pay tax.

Superficially, the redistribution aim might seem consistent with the common law rule against perpetuities which originated in Medieval England. The aim, however, is unrelated to and inconsistent with that ancient rule. The rule was concerned with limiting the power of a living individual to control future inheritance while the redistribution aim is concerned with limiting the amount of property which may be inherited. The aim is inconsistent with the rule because it would accomplish the reduction of wealth in particular hands by destroying it, whereas

[1] A proposed national policy goal for raising the level of gross capital spending from the long time average of 15½ percent to 17 percent of gross national product, through a comprehensive program of capital-releasing tax reforms, is spelled out in the December 1975 revision of the Council's "Program for a Stable, Capital Conscious Federal Tax Policy."

the rule was concerned with freeing the movement of property beyond the living generation and not at all with destroying it.

Unfortunately, the dialogue does not illuminate the problem of concentration of wealth in contemporary America, or tell us why estate and gift taxation would be a good instrument for dealing with such a problem, if it does exist. There are several factors which mitigate against the existence of the problem: first, the amount of wealth passing by testament or gift in any year is only a fraction of our total wealth and is small in relation to the contemporary rate of accumulation; second, just as the accumulation of wealth means the creation of new and better jobs and higher living standards for the public at large, so does the conservation of wealth assure an ever higher base from which to build; third, the American work ethic seems to be more enhanced than dulled by accumulated wealth; and fourth, in the open, viable American society, ostentatious display of wealth is not a social or political problem. The view of the Council therefore is that there is not a major problem of concentration of wealth in contemporary America. If there were such a problem moreover, the tax mechanism would be an inappropriate instrument for dealing with it because taxation destroys instead of redistributing wealth.

There is a view among tax scholars that consideration should be given to transforming the present taxes into an accessions tax to be paid by transferees on a cumulative wealth basis. For example, a legacy of $10 million going to a person without prior wealth would be taxed from the bottom of the rate scale up, but such a legacy going to a person who already was worth $10 million would be taxed off the top of the scale. The Council believes it much better to concentrate on lightening the destruction of capital under the present system than to become involved in developing what inevitably would be a much more complicated but also a more destructive system of taxation.

With respect to the aim of taxing windfalls, this seems a poor way to describe the great bulk of transfers which inevitably go to relatives or others who have reason to expect remembrance. This aim may be dismissed with the observation that it seems as oblivious to bonds between human beings as it is to the importance of conserving capital to serve the public interest.

The assumption that wealth indicates capacity to pay tax overlooks the far greater revenue potential of taxing income generated by wealth than by taxing the wealth itself. It is one thing to use wealth as the measure of tax we expect to be paid out of income, as with local property taxes, but is quite another to look on the wealth itself as a major tax object. The present rates of estate and gift tax may be tolerable because such a small part of the nation's wealth is subjected to this taxation in any one year. This does not change the fact that the rates are uneconomic, destructive and quite inimicable to the public interest in maintaining and expanding the nation's stock of capital.

General Summary of Program

These estate and gift taxes deprive the private economy of the growth, new jobs and other values which would come from a six percent increase in personal savings, and deprive the government of the increase in the income tax base which would come therefrom. The broad objective of the Council program is a restructuring of the estate and gift tax system to reduce the amount of capital converted to government spending, and thus to enlarge the bases for economic growth and for income taxation. The key proposals would:

1. Progressively lighten the burden of these taxes over a period of years without reduction in the dollar amount of revenue from this source, and
2. Provide a practical means by which taxes due with respect to income-producing property would be derived from the income and not from the property itself.

A number of other proposals are designed to improve the structure of the estate and gift tax system while avoiding revisions which would subject affected property to greater taxation.

Summary of Specific Policy Proposals

In brief, the Council program would accomplish the following results.

1. *Allocation of Revenue Growth.*—Revenue growth from the estate and gift taxes would be allocated for a decade ahead to rate reduction and other capital-saving reforms.

2. *Ten-Year Plan of Rate Moderation.*—The rates of estate and gift taxes would be reduced fifty percent over ten years through a series of annual cuts in a uniform pattern.

3. *Tax Payment Trusts.*—All testators or donors would be permitted to place income producing properties in "tax payment trusts", thus providing for payment of tax from income while conserving property intact. The maximum time for payment of taxes through a trust would be twelve years.

4. *Credit for Capital Gains Taxes.*—A credit would be provided for lifetime taxes on capital gains against deathtime taxes on estates.

5. *Five-Year Averaging of Gift Taxes.*—To permit greater flexibility as regards both the timing and amount of gifts, gift taxes would be averaged over a period of five years in place of the cumulation during life under present law.

6. *Carryover of Capital Gains in Case of Gifts.*—Because the carryover of capital gains basis does not seem to discourage giving during life, there would be no change in law in this respect.

7. *Marital Deduction.*—The marital deduction, now 50 percent for both estate and gift taxes, would be increased to 100 percent.

8. *Gift-Splitting with Respect to Deathtime Transfers.*—The splitting of gifts between spouses as permitted in lifetime transfers would be extended to deathtime transfers.

9. *Low Priority for Other Tax-Saving Proposals.*—Proposals to increase exemptions and exclusions and for extra reduction in lower rates are accorded low priority in the Council program.

10. *Separate Taxation of Estates and Gifts.*—Contemporary proposals for unifying and cumulating these taxes under one rate scale would discourage lifetime giving, and thus under the Council program would not be enacted.

11. *Avoiding New or Additional Taxation.*—Proposals for increasing the burden of estate and gift taxes through various means—including additional taxation for so-called generation skipping, comparable taxation of property transferred to nonrelatives, and inclusion of employee death benefits in gross estates—run counter to the public interest in conserving capital or are otherwise objectionable, and thus are opposed in the Council program.

There follows a discussion of the Council proposals in some depth.

1. Allocation of revenue growth

Estate and gift taxes are now yielding annual revenue of about $6.0 billion, and experience would indicate an average annual growth in tax base of at least ten percent. The Council proposal is that the federal government forego for a decade the revenue increase which would come from this growth in base. This would allocate $600 million a year for rate reductions and other tax-saving reforms of the estate and gift taxes. Although this is a small or even insignificant sum in relation to current budget levels—about one-seventh of one percent—over a decade the contribution to capital formation would be substantial.

If present rates were continued, a ten-percent annual growth in base of the estate and gift taxes would push revenue from this source up to $16 billion a decade hence. It would take the savings from nearly $270 billion of personal income to replace the $16 billion before there was net addition to the nation's stock of capital.

By allocating the revenue growth to tax reduction, these taxes a decade hence would still be yielding only $6 billion annually. A quick reaction might be that the government therefore would be losing $10 billion a year in revenue as the result of enactment of the program. But this would not be so. While the government would be getting $10 billion less a year from the estate and gift levies, it would be reaping through the income and excise taxes the benefit of $10 bilion in capital formation. Estimating the revenue take through these taxes at 30 percent of the gross national product generated by the capital formation, the total would be nearly $8 billion in the tenth year. The revenue yield would increase to over $10 billion in the twelfth year, and the increments thereafter would be all plus values.

2. A 10-year plan of rate moderation

Estate tax rates begin at 3 percent on the first $5,000 of taxable estate, reach 30 percent at $100,000, move from 49 to 53 percent at $2,500,000 and reach a top rate of 77 percent at $10,000,000. Gift rates are a uniform three-quarters of the estate rates. The rates and amounts of tax at the turn of each bracket are given in Tables I and II.

The ten-year plan contemplates a cross-the-board reduction of 50 percent in the rates of estate and gift taxes at the end of the period. One means of doing this would be to reduce rates a uniform five percent of present rates in each of the ten years. However, because the base for these taxes grows yearly (10 percent), a

uniform rate cut would not coordinate with maintaining revenues from this source at a level $6 billion over a decade, releasing $600 million a year for rate reduction and other reforms. A five-percent cut in rates would reduce revenues only $300 million in the first year but $800 million in the tenth year.

The other means for reducing the rates on a uniform pattern would be to apply the same percentage cut each year to the declining rate scales. Roughly, seven percent would accomplish the objective. This would encumber about $420 million out of the $600 million available annually for reducing the burden of these taxes, leaving $180 million a year on the average for other reforms.

The 77-percent top rate of estate tax would be reduced to 38.5 percent in the following progression:

Year:	*Tax rate percent*
1	71.8
2	66.9
3	62.3
4	58.0
5	54.3
6	51.0
7	47.3
8	44.2
9	41.4
10	38.5

The rates for all brackets of the estate tax after each annual reduction are shown in Table III.

3. Tax payment trusts

With a sharply restricted exception, there is no substantial escape as regards large estates from the design for payment of estate tax liability by liquidating property. The marital deduction will generally delay but not prevent full payment of the death levies. The tax may be avoided by philanthropic transfers of property, but this cuts out the natural heirs or others to whom the testator might have liked to transfer property intact. Without liquidating part of the property, he is unable to transfer ownership to sons, daughters or others. If he wishes his property preserved intact, he is estopped from transferring it to those he would like to assume the responsibilities of ownership and management.

The exception to the design of liquidation is in the case of closely held businesses. The law provides that the estate tax attributable to a closely held business may, under tightly defined conditions and at the election of the executor (not the testator), be made in not more than ten yearly installments. The conditions are that the value of the estate's interest in the business exceed 35 percent of the value of the gross estate or 50 percent of the taxable estate; that the ownership interest be not less than 20 percent of the stock of the corporation; and, in the latter case, that there be not more than ten shareholders.

Although this provision seems to have received less use than contemplated when enacted, its purpose—an unqualified departure from the design for tax payment from liquidations or property—is sound. Other than the restrictions, major reasons why greater use has not been made of the provision is that it keeps the estate open for the duration of the payment schedule, thereby increasing cost of administration and prolonging the executor's exposure to liability for tax payment.

Nevertheless, the provision for installment payment of estate taxes constitutes a precedent or principle as broad as the public interest in preserving capital. The reason for the provision is not special virtue of the testator or legatees directly affected, but the public interest in preserving intact the capital in a business. While the provision was enacted because business groups had pointed to the hardship of the estate tax on small, closely held businesses, from the public standpoint a given amount of capital invested in a small business is of no greater importance than a similar amount invested in a larger business. In fact, the provision as enacted is in no sense restricted to small businesses. If the conditions are met, there is no limit to the size of a business which may qualify as a closely held business under the provision.

There is in fact no line of demarcation based on size or breadth of ownership between capital which does or does not serve the public. The public benefits from the existence of capital employed in an enterprise regardless of its size or whether it is closely or widely owned. There is no way to draw a line of public interest in use of capital short of the nation's total stock of capital.

To conserve capital which otherwise would be converted by estate or gift taxes into government spending, therefore, the Council's proposal is that provision be made for payment of estate and gift taxes generally out of income from the affected property instead of by liquidating part or all of the property. This would mean that any ownership interest in any income-producing property could be transferred intact to managers, employees or others regardless of family ties or whether a business is small or closely held.

The property involved would be placed in "tax payment trusts," the sole purpose of which would be to collect the income from the property and pay the tax attributable thereto. When the taxes were fully paid, the trust would be terminated and the transfer of the property completed.

Details of the proposal, and some comments in regard to revenue effect, as developed six years ago, are available on request.

4. Credit for capital gains taxes against estate taxes at death

A problem generally associated with estate taxation is the appreciated value of property held at death. This value, generally referred to as "unrealized gains," is not subject to the capital gains tax. A common proposal has been that, through one means or another, such gains be brought into a tax base. One proposal would tax the gains by requiring inclusion in the decedent's final income tax return. Other proposals would tax the unrealized gains under the estate tax system. Whichever way it might be done, the taxation of unrealized gains at death would mean a double simultaneous impost on a transfer of capital.

The Council's approach to the problem is quite different. Instead of imposing a double tax at death, it would provide a credit against estate taxes of capital gains taxes paid during life. This would eliminate the double tax which now results from paying estate tax on property which in one form or another has been subjected to capital gains taxation one or more times during the decedent's life. The credit is a key proposal of the Council program for reform of capital gains taxation which would take the pure capital gains of individuals out of the federal income tax base. Under the program, such gains would be taxed under a separate system of transfer taxation associated with the other federal capital transfer taxes, that is, those on estates and gifts. The credit at death would reflect the fact that the tax object is capital and not income. Of course, the credit should be provided for gains taxed under the income tax law if the transfer system is not adopted.

5. A 5-year averaging of gift taxes

Because a person's capital is diminished by the amount of his gifts (and the tax thereon under present law) and gifts in different periods of his life may have no relation whatsoever to each other, it could be argued that these transfers should be taxed annually without cumulation. There is continuity in plans for giving, however, which extends over years even though each gift separately breaks continuity of ownership. As a middle proposition, it is suggested that gift taxes be averaged over five years. This would encourage giving earlier, more often and in greater total amount during life. In some cases, there undoubtedly would be a spreading out of gifts beyond five years to benefit from lower tax rates, but this would serve the public interest in lightening the burden of taxes on capital.

6. Continued carryover of capital gains basis in case of gifts

Under present law, unrealized gains on gifts during life do not become tax free as happens with respect to deathtime transfers. The donee takes the tax basis of the donor and, if he subsequently sells the property, pays tax on the appreciation in value from the time the property was acquired by the donor. Proposals for unifying estate and gift taxes[1] and for paying tax on appreciated value at death generally contemplate that donors would pay tax on appreciated value at the time of giving. The result inevitably would be to discourage giving.

The approach of the Council's program is that more giving during life is generally desirable but not if the tax consequences would convert more capital to government spending at the expense of the needs of the private economy. The carryover of capital gains basis in the case of gifts does not discourage giving as regards time or amount, and therefore should be continued.

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[1] See Section 10.

7. *Increase in marital deduction*

Under present law, the marital deduction is 50 percent of each lifetime gift between spouses, and 50 percent of the adjusted gross estate of a deceased spouse. There is a view with considerable support among tax authorities that this or any limit on free transfers of property between spouses violates the mutuality of the marriage bond or, stated differently, any tax on transfers between spouses is an inappropriate exercise of the taxing power.

Because the 50 percent deduction is so generally availed of under present law, there is some concern that change in the law to permit unlimited tax-free transfers between spouses would create a strong incentive to disregard the facts and circumstances which would indicate only partial transfer in individual situations. In joining in the proposal to raise the marital deduction to 100 percent on all interspousal transfers, the Council hopes that the incentive created will be for more objective evaluation of all the factors before the deductions to be taken are decided.

8. *Gift-splitting with respect to deathtime transfers.*

Under present law, a gift by a married person to someone other than his or her spouse may be treated taxwise as if half had been given by the other spouse. This splitting of gifts, however, is not permitted as regards testamentary bequests. In other words, the surviving spouse cannot take one-half of the gift's value out of the estate and treat it as a gift by him or her. The Council joins in the proposal initiated by others that the privilege of gift-splitting be extended to deathtime transfers.

9. *Low priority for proposals to increase exemptions and exclusions, and for extra reduction in lower rates*

The Council program accords top priority to reforms in estate and gift taxes which would be most significant for conserving and enlarging the nation's stock of capital.

When the estate and gift taxes are reviewed from the standpoint of direct impact on people, however, instead of impairment of the nation's stock of capital, there is a tendency to dwell on marital arrangements, exemptions and exclusions and the level of rates on taxable amounts up through a few hundred thousand dollars. The adequacy of marital arrangements is the only one of these areas to which the Council program accords priority. Even with a 100 percent marital deduction, it is believed the revenue effects of the complete program would not average more than the $600 million annual revenue growth in the estate and gift area which it is recommended the government forego for a decade to accomplish reform. If official estimators should conclude that the program would fall significantly short of encumbering all of the revenue growth, acceleration in rate reduction would be the most desirable additional option. In other words, until the values in the public interest emphasized in its proposals have been largely achieved, the Council believes that low priority should be accorded proposals for increasing exemptions and exclusions and for extra reduction in the lower rates of tax.

Three factors are especially significant to these conclusions. First, the proposed rate reductions would substantially ease the burden of tax in the lower ranges of estates and gifts with the major part of the reductions coming in the early years of the program. With the recommended seven percent annual reduction applied to the declining scale of rates, nearly two-thirds of the overall fifty percent reduction would take place in the first five years of the program. For example, as shown in Table III, the 30 percent rate which now applies to $100,000–$250,000 of taxable estate would be reduced to 20.8 percent in five years and to 15 percent in ten years.

The second factor of significance is the extent to which exemptions and exclusions plus the marital deduction now provide protection from tax as regards the smaller amounts of transfers. As computed from Table IV, which abstracts data from taxable estate returns for 1972, exemptions and marital deductions removed 56 percent of the total estates from the tax base in estates up to $500,000. But for estates over $5 million, the same provisions removed only 14 percent of the total estates from the tax base.

The third factor is that personal hardship under the existing arrangements would in general be limited to situations in which transferred property is intended to provide for the old age of the surviving spouse, and the 100 marital deduction would resolve this situation.

10. Continued separate taxation of estates and gifts

Proposals for a unified estate and gift tax rate scale tend to assume an inherent inter-connection between all life-time (inter vivos) giving and deathtime transfers. Yet, there is a vast difference between the act of a person who in the prime of life permanently foregoes further use of property by giving it away, and the act of a person in providing by will for the disposition of property come the time when he can make no further use of it.

When a person makes a gift of property, the continuity of ownership is broken and his capital worth is diminished accordingly. By contrast, when property is sold, the seller's capital worth is diminished only by the amount of the capital gains tax. Unless subsequently given away, the property remains in one form or another for inclusion in his estate when finally disposed of by will. Thus, there is no break in the continuity of ownership before death except for the part of ownership taken away by capital gains taxation.

The Council's position, set forth in section four, is that continuity in ownership of capital in whatever form through life and until disposed of at death provides a connection between tax on lifetime transfers and on the final transfer at death which should be reflected in a credit for the former against the latter. By the same reasoning, there is nothing to connect up between lifetime gifts and the transfer of property still owned at death, and thus there is no rationale for connecting up or unifying the taxes paid on the two.[2]

A proposal of the Johnson administration as it went out of office in 1968 was that the top rate of estate tax be reduced from 77 to 65 percent over a ten year period, at the same time moving up the top rate of gift tax from 57¾ to 65 percent. Under this proposal, it would become more expensive to give during lifetime and, after lifetime giving, in many if not most cases death duties would be higher on the remaining estates than under present law.

Unifying unconnected tax events, discouraging lifetime giving and assuring higher transfer taxes in many cases add up to a move in the wrong direction. The public interest in lightening the tax burden on capital would be best served by continuing the separate taxation of estates and gifts, but with progressively lower rates and with provision for payment out of income, as proposed in the Council's program.

11. Avoiding new or additional taxation

The estate and gift area has not escaped attention in the continuing dialogue on enlarging tax bases. The most prominent proposal identified with this area has been to tax capital gains unrealized at death. Regardless of how such a tax would be imposed, it would be another—in effect a double—tax on the capital which a person leaves at death. As stated earlier, the Council's view is that the carryover tax problem with respect to property at death is not that unrealized gains have not been taxed, but is that the property already has been diminished by a tax on capital to the extent of realized gains. Considering the public interest in conserving and enlarging the capital supply, as well as the fact that capital held during life and until death is one and the same thing, a credit against estate taxes of capital gains taxes paid during life is advocated by the Council. The imposition of a new tax at death on unrealized gains is strongly opposed.

Two related proposals for increasing estate and gift taxes are those to impose additional taxation for so-called generation-skipping and with respect to other property which had not been reached by transfer taxes over a period of years. For example, the Johnson Administration recommended that: first, to assure tax with respect to each generation, a substitute tax should be imposed to be paid either by the original transferor or, on election, by the first transferee; and, second, as an equalizer in the case of non-relatives, such a substitute tax should be applied when the transferee is more than 25 years younger than the transferor.

Such proposals are based on assumptions with respect to the aim of estate and gift taxation which, as discussed under "Objectives of Estate and Gift Taxation," are not reflected in the legislative history of the taxes. The case against the proposals is that transfers by which income from property becomes available for use in one generation while the capital is conserved for passing to the next or a later generation serve both the public interest as regards the nation's stock of capital and the government interest as regards revenue. Such a transfer assures that the capital will remain intact for at least one generation, and over the average time

[2] Unless a gift is made in contemplation of death, in which event it is now included in the decedent's gross estate with an offsetting credit for gift tax if paid.

span involved the government undoubtedly would derive much more revenue than it would have by consuming the capital in the first instance. From the economic standpoint, it would be a step backwards to impose an additional tax under these circumstances.

The Johnson Administration also recommended that employee death benefits under qualified pension plans be included in gross estates. While the marital deduction, if raised to 100 percent, would render such an inclusion meaningless insofar as the surviving spouse is concerned, the fact is that such benefits often are intended to provide support for children and others as well as the spouse dependent on the transferor. Looking on these transactions as extensions of lifetime compensation, there seems no appropriate reason why they should be subjected to estate taxation.

Conclusion

Looking back, we may wish that the legislators of a preceding era had displayed greater economic sophistication than is reflected in the rates of estate and gift taxes which have held for forty years. Certainly, more moderate rates would have meant more capital formation, more good jobs, higher standards of living, less inflation and more government revenue over the intervening years. But there is one compliment we can pay to the work of those legislators—they did not embellish their aims. They gave their objective as simply that of raising revenue.

We commend the same objective to this Committee, but to be accomplished differently. We ask that you recognize the public interest in conserving more capital so that it may generate more income which, among other [illegible] goods purposes, would raise more revenue than would come from taxing the capital directly.

Respectfully submitted.

John C. Davidson, *President.*

TABLE 1.—FEDERAL ESTATE TAX TABLE FOR COMPUTATION OF GROSS ESTATE TAX

Taxable estate equal to or more than—	Taxable estate less than—	Tax on amount in column (A)	Rate of tax on excess over amount in column (A) (percent)
(A)	(B)	(C)	(D)
0	$5,000	0	3
$5,000	10,000	$150	7
10,000	20,000	500	11
20,000	30,000	1,600	14
30,000	40,000	3,000	18
40,000	50,000	4,800	22
50,000	60,000	7,000	25
60,000	100,000	9,500	28
100,000	250,000	20,700	30
250,000	500,000	65,700	32
500,000	750,000	145,700	35
750,000	1,000,000	233,200	37
1,000,000	1,250,000	325,700	39
1,250,000	1,500,000	423,200	42
1,500,000	2,000,000	528,200	45
2,000,000	2,500,000	753,200	49
2,500,000	3,000,000	998,200	53
3,000,000	3,500,000	1,263,200	56
3,500,000	4,000,000	1,543,200	59
4,000,000	5,000,000	1,838,200	63
5,000,000	6,000,000	2,468,200	67
6,000,000	7,000,000	3,138,200	70
7,000,000	8,000,000	3,838,200	73
8,000,000	10,000,000	4,568,200	76
10,000,000	....	6,088,200	77

TABLE II.—FEDERAL GIFT TAX

Amount of taxable gifts equal to or more than— (A)	Amount of taxable gifts less than— (B)	Tax on amount in column (A) (C)	Rate of tax on excess over amount in column (A) (percent) (D)
0	$5,000	0	2¼
$5,000	10,000	$112.50	5¼
10,000	20,000	375.00	8¼
20,000	30,000	1,200.00	10½
30,000	40,000	2,250.00	13½
40,000	50,000	3,600.00	16½
50,000	60,000	5,250.00	18¾
60,000	100,000	7,125.00	21
100,000	250,000	15,525.00	22½
250,000	500,000	49,275.00	24
500,000	750,000	109,275.00	26¼
750,000	1,000,000	174,900.00	27¾
1,000,000	1,250,000	244,275.00	29¼
1,250,000	1,500,000	317,400.00	31½
1,500,000	2,000,000	396,150.00	33¾
2,000,000	2,500,000	564,900.00	36¾
2,500,000	3,000,000	748,650.00	39¾
3,000,000	3,500,000	947,400.00	42
3,500,000	4,000,000	1,157,400.00	44¼
4,000,000	5,000,000	1,378,650.00	47¼
5,000,000	6,000,000	1,851,150.00	50¼
6,000,000	7,000,000	2,353,650.00	52½
7,000,000	8,000,000	2,878,650.00	54¾
8,000,000	10,000,000	3,426,150.00	57
10,000,000	....	4,566,150.00	57¾

TABLE III.—PROPOSED SCHEDULE OF REDUCTIONS IN FEDERAL ESTATE TAX RATES

Taxable estate brackets	Present rates	Rates after annual reductions (year)									
		1	2	3	4	5	6	7	8	9	10
0 to $5,000	3	2.8	2.6	2.4	2.2	2.0	1.9	1.8	1.7	1.6	1.5
$5,000 to $10,000	7	6.5	6.0	5.6	5.2	4.8	4.5	4.3	4.0	3.7	3.5
$10,000 to $20,000	11	10.2	9.5	8.9	8.3	7.7	7.2	6.7	6.2	5.8	5.5
$20,000 to $30,000	14	13.0	12.0	11.2	10.4	9.6	9.0	8.5	8.0	7.4	7.0
$30,000 to $40,000	18	16.7	15.5	14.4	13.4	12.5	11.4	10.8	10.2	9.5	9.0
$40,000 to $50,000	22	20.4	19.0	17.8	16.6	15.4	14.4	13.4	12.4	11.6	11.0
$50,000 to $60,000	25	23.2	21.6	20.2	18.7	17.5	16.4	15.3	14.3	13.4	12.5
$60,000 to $100,000	28	26.0	24.0	22.4	20.8	19.2	18.0	17.2	16.0	14.8	14.0
$100,000 to $250,000	30	27.9	25.9	24.1	22.4	20.8	19.5	18.3	17.2	16.1	15.0
$250,000 to $500,000	32	29.8	27.7	25.8	24.0	22.4	20.7	19.4	18.2	17.0	16.0
$500,000 to $750,000	35	32.5	30.0	28.0	26.0	24.0	22.5	21.5	20.8	18.5	17.5
$750,000 to $1,000,000	37	34.4	31.9	29.7	27.6	25.6	24.0	22.6	21.2	19.8	18.5
$1,000,000 to $1,250,000	39	36.2	33.5	31.3	29.1	26.9	25.2	23.9	22.2	20.6	19.5
$1,250,000 to $1,500,000	42	39.0	36.1	33.7	31.3	28.9	27.1	25.7	23.9	22.2	21.0
$1,500,000 to $2,000,000	45	41.8	38.7	36.1	33.5	30.9	29.0	27.5	25.6	23.8	22.5
$2,000,000 to $2,500,000	49	45.5	42.1	39.3	36.5	33.7	31.6	30.0	27.9	25.9	24.5
$2,500,000 to $3,000,000	53	49.2	45.6	42.6	39.6	35.6	34.3	32.4	30.1	28.0	26.5
$3,000,000 to $3,500,000	56	52.0	48.1	44.9	41.7	38.7	36.1	34.3	31.9	29.6	28.0
$3,500,000 to $4,000,000	59	54.8	50.7	46.3	43.9	40.7	38.0	36.1	33.6	31.2	29.5
$4,000,000 to $5,000,000	63	58.5	54.0	50.5	46.9	43.5	40.6	38.6	35.9	33.3	31.5
$5,000,000 to $6,000,000	67	62.2	57.6	53.8	50.0	46.4	43.3	41.0	38.1	35.4	33.5
$6,000,000 to $7,000,000	70	65.0	60.2	56.2	52.2	48.4	45.2	42.8	39.8	37.0	35.0
$7,000,000 to $8,000,000	73	67.8	62.8	58.6	54.4	50.4	47.1	44.6	41.5	38.6	36.5
$8,000,000 to $10,000,000	76	70.8	66.0	61.4	57.2	53.5	50.3	46.6	43.6	40.8	38.0
$10,000,000 and over	77	71.8	66.9	62.3	58.0	54.3	51.0	47.3	44.2	41.4	38.5

TABLE IV.—TAXABLE RETURNS, 1972—FEDERAL ESTATE TAX

[Money amounts in thousands]

Size of total estate	Number of returns	Total estate	Deductions: Total	Deductions: Charitable	Deductions: Marital	Deductions: Exemption	Taxable estate	Estate tax: Before credits	Estate tax: After credits
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1. Under $60,000	4,468	113.013	419,575	31,351	69,571	268,080	483,709	130,317	115,951
2. $60,000 under $100,000	30,496	2,471,516	2.123,016	12,748	73,058	1,829,760	621,175	90,110	83,438
3. $100,000 under $500,000	75,880	15,218,373	9,279,450	223,965	3,075,000	4,552,800	6,811,595	1,531,672	1,416,856
4. $500,000 under $1,000,000	6,468	4,396,361	1,889,628	126,995	914,298	388,080	2,718,698	808,647	717,963
5. $1,000,000 under $2,000,000	2,277	3,096,677	1,290,212	202,803	636,516	136,620	2,058,204	700,470	604,722
6. $2,000,000 under $3,000,000	574	1,375,283	528,791	75,227	258,231	34,440	891,868	331,333	282,068
7. $3,000,000 under $5,000,000	341	1,286,268	543,188	116,731	255,671	20,460	813,252	339,409	284,147
8. $5,000,000 under $10,000,000	183	1,257,632	555,026	159,634	216,995	10,980	715,184	348,685	290,496
9. $10,000,000 or more	74	1,549,137	898,892	492,693	226,824	4,440	701,092	439,734	357,608
10. Total	120,761	30,764,260	17,527,776	1,442,146	5,726,163	7,245,660	15,814,777	4,720,378	4,153,250

Source: Table 2, Statistics of Income 1972—Estate Tax Returns, U.S. Department of Treasury, Internal Revenue Service.

Statement of the National Retail Merchants Association

The National Retail Merchants Association ("NRMA"), a non-profit corporation, represents approximately 30,000 department, chain and specialty stores in the United States. The aggregate annual sales volume of our members exceeds $80 billion. The retailing industry is probably our nation's largest employer outside of the governmental and health care agencies.

Many of the stores we represent are operated by small retailers. Due to their lack of liquid assets with which to pay estate taxes, these retailers are exposed to the hardships that may be caused to small businesses by the estate tax burden. Therefore, the NRMA is submitting these comments and suggestions with respect to estate and gift tax reform.

As a general matter, the NRMA strongly urges the Committee to conduct a thorough review and revision of the estate and gift tax laws rather than focusing on just the few aspects of these laws that have been widely discussed and publicized in the past few months. This area of the tax law, which has not undergone such a review and revision since 1942, in large part remained substantially unchanged when the 1954 Internal Revenue Code was enacted. Furthermore, the estate and gift tax provisions have escaped careful scrutiny in the past several years notwithstanding the publication of comprehensive proposals for reform by such distinguished groups as the Treasury Department, the American Law Institute, the American Bankers Association, and the American Institute of Certified Public Accountants. Public sentiment and the economic situation in the United States have changed radically since 1942. Certainly estate and gift tax reform is an idea whose time has come.

In addition, the NRMA urges the Committee to approach estate and gift tax reform with a primary concern for the effect of the estate and gift tax laws on the people of the United States. The estate and gift tax laws are responsible for approximately 2 percent of the annual revenues raised by the United States, yet they can cause the sale of family businesses and farms and the disposition of property in a manner other than that which personal considerations alone would dictate. The Committee should seek to the greatest extent possible to remove the influence of estate and gift taxes on highly personal decisions regarding the transfer of assets accumulated through a lifetime of work.

In particular, we would like to express our support for an increase in the estate tax exemption, a reduction in estate tax rates, the enactment of more favorable rules for the deferred payment of estate tax where the estate consists in large part of a small business, and an increase in the marital deduction.

I—Estate Tax Exemption

The estate tax exemption of $60,000, which went into effect in October, 1942 actually was enacted as part of the Revenue Act of 1938. Since that time, inflation has reduced the value of the dollar by more than half, and property worth $60,000 in 1942 would be worth substantially more than $120,000 today. Indeed, as prestigious a publication as the Wall Street Journal has suggested that an adjustment in the exemption solely to account for inflation would increase it to $210,000. Wall Street Journal, March 10, 1976, p. 14, col. 1 (editorial).

The effect of this exemption when first enacted was to relieve from estate taxation all estates except those that were quite large by contemporary standards; its effect now is to relieve from taxation only estates that are quite small by today's standards. Many homes alone currently are worth $60,000. Small businessmen, many of whom would have been free from estate taxation in 1942, today are bearing estate tax burdens that are significant in relation to the size of their estates.

In light of the above, the NRMA supports an increase in the estate tax exemption to at least $150,000.

II—Estate Tax Rates

The estate tax is imposed primarily on capital, and therefore may have an adverse impact on the supply and formation of capital necessary to economic growth. This impact would be felt keenly in the retailing industry, which even now is faced with a limited availability of capital for both the normal conduct of business and possible expansion. Furthermore, the estate tax rates are more sharply progressive with respect to estates of $100,000 and less than with respect to larger estates, so that these smaller estates bear a disproportionate share of the estate tax burden. The NRMA favors reduced estate tax rates to encourage the flow of capital, and a restructuring of such rates to make them uniformly progressive.

III—DEFERRED PAYMENT OF ESTATE TAX

Many of the small retailers represented by the NRMA are facing the prospect that their families will be required to sell or liquidate their businesses in order to pay estate taxes. A retailing business, like many other businesses, is not of the sort that a portion of it can be sold to meet estate tax obligations. As a result, if the retailer's estate does not possess sufficient liquid assets to pay estate taxes, the consequences—sale or liquidation of the family business—are drastic. Furthermore, because of its very competitive nature, retailing historically is an industry of small profit margins. Additional costs cannot be readily passed on to the consumer, and minor changes in costs thus become magnified, usually resulting in reductions in the labor force of many of our stores. In an industry such as retailing, the payment of estate taxes even over a ten-year period can reduce an already small profit margin to such an extent that retention of the business is no longer economically feasible.

Therefore, the NRMA supports in principle proposals to revise Internal Revenue Code Section 6166 by liberalizing the eligibility requirements, extending further the period for payment of estate tax, delaying the beginning of estate tax payments until several years after the decedent's death, and reducing the rate of interest owing on the deferred payments. However, these provisions should not be limited to businesses worth less than a fixed dollar amount (which is an element of the President's proposal), because it is the value of the business in relation to the entire taxable estate, not its value in absolute terms, that causes the difficulty in meeting estate tax obligations. Furthermore, the NRMA supports in principle proposals (such as S. 3139 and S. 3140, introduced by Senators Packwood and Nelson, respectively) to reduce the amount of the estate tax obligations of estates consisting primarily of small businesses.

IV—MARITAL DEDUCTION

The present marital deduction provisions serve as a useful illustration of the fact that the estate and gift tax laws often interfere with highly personal family matters. An estate tax is imposed with respect to property that will be transferred to a surviving spouse notwithstanding the fact that family property is commonly considered by both spouses as "ours." Furthermore, limiting the marital deduction to a percentage of the decedent's estate has an adverse effect on the person with a small estate, who may be required to leave more than half the estate to the surviving spouse for the latter's support, in comparison to the person whose estate is sufficiently large that leaving half or less to the surviving spouse is adequate to provide for such spouse's needs.

Therefore, the NRMA favors an unlimited marital deduction for qualifying transfers to surviving spouses or, as a suitable alternative, a marital deduction of 50% of the decedent's estate plus property worth a flat dollar amount such as $100,000. This alternative at least would enable the decedent to provide for the support of the surviving spouse in a tax-free manner.

Re Revision of Federal Estate and Gift Tax Laws.

AMHERST, N.Y., *May 15, 1976.*

Mr. MICHAEL STERN,
Staff Director, Senate Finance Committee, Dirksen Senate Office Building, Washington, D.C.

DEAR MR. STERN: Real reform of the Federal estate and gift tax laws is to abolish them completely.

The conventional wisdom is to make piecemeal adjustments from time to time Current discussion centers around increasing the specific estate tax exemption of $60,000. Some have suggested combining estate and gift taxes into a single transfer tax. I say, Why bother? Repeal them entirely.

As a revenue device, estate and gift taxes are trivial: one percent of the federal budget.

As a social tool, they are repugnant. The notion that a family should not retain its wealth is contrary to anything I ever learned.

If you want to close the loophole through which capital gains escape income taxes upon death, then do so directly—amend the income tax provisions of the Code so as to (1) make death a taxable event and (2) assess a capital gain tax on the gain.

Hence, the value of property on the date of death will continue to be the new "basis," as before. At the same time, an income tax on the gain will solve the problem of "generation skipping" which is afforded by the estate tax law.

Estate and gift taxes have become a serious impediment to the nation's economic well-being. They should be repealed immediately in their entirety.

Yours respectfully,

BEDROS ODIAN.

NATIONAL SMALL BUSINESS ASSOCIATION,
Washington, D.C., May 18, 1976.

Hon. WALTER MONDALE,
Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR MONDALE: We are pleased to forward to you a communication from an organization of family businessmen called the "Sons of Bosses International". You will note that they have members in 27 States. These businesses are typical of several million small firms to whose principals estate tax reform is of the greatest importance. Whether they can continue to be family-owned concerns will often depend on their ability to meet estate taxes.

The general principles of the tax treatment are suggested by the bill which you and Senator Humphrey have sponsored (S. 2394). We consider that these are minimal measures, and that there might well be more effective taxing of larger estates to reduce the burdens on smaller ones still more.

We should appreciate it if you would make this communication part of the record of your proceedings.

Sincerely,

MILTON D. STEWART, *President,*

P.S. You may find this excerpt from the 1956 Democratic Platform of interest: "An option should be provided to spread Federal estate taxes over a period of years when an estate consists principally of the equity capital of a closely held small business."

SONS OF BOSSES INTERNATIONAL,
Westville, N.J., May 14, 1976.

Mr. MILTON STEWART,
National Small Business Association,
Washington, D.C.

DEAR MILTON: At our Board of Directors meeting in St. Louis this past week-end, we held an 'at length' discussion concerning the estate tax bill now before congress. There were fourteen chapters represented at this meeting from Boston, Detroit, Philadelphia, North Jersey, Green Bay, Chicago, Milwaukee, St. Louis, Cleveland, Omaha, Miami County Ohio, and the National Beer Wholesalers Association and the National Candy Wholesalers Association. Since our paid membership is currently from twenty-seven states, we urge you to carry our message to Chairman Long, Senator Mondale, and the other members of the finance committee.

Massachusetts	North Carolina	Iowa
Connecticut	Georgia	Michigan
New York	Florida	Wisconsin
Pennsylvania	Louisiana	Minnesota
New Jersey	Ohio	Texas
Delaware	Illinois	North Dakota
Maryland	Missouri	Washington
Washington, D.C.	Nebraska	Oregon
Virginia	Kansas	California

Our message is that we, the Sons of Bosses, feel there must be some major relief from the current estate tax laws. With the strong backing of our fathers and fathers-in-law, we urge congress to act now to bring us this relief. A positive step in this direction would help us insure our children of their opportunity to become a Son of the Boss.

I am confident that you will stress the importance of this issue and will bring us positive results. On behalf of our entire membership, thank you for your tireless efforts toward the perpetuation of free enterprise and small business.

Respectfully yours,

STEVAN A. WOLF, *President.*

Statement of the Interreligious Taskforce on U.S. Food Policy

The Taskforce welcomes this opportunity to submit a statement for the consideration of the Committee.

The Taskforce is a team of Washington-based staff of over twenty Protestant denominations and national Roman Catholic, Jewish, and ecumenical agencies. In each of our organizations, as well as in many other national religious bodies not related to our Taskforce, hunger at home and abroad has become a major concern and programmatic priority. New programs to deal with this problem have been developed and new funds contributed. There is widespread recognition in the religious community that public policy has played a key role in aggravating the problem of hunger and that it can play a key role in solving the problem. Thus it is commonly held that one of the primary religious duties of members of the community of faith is to address public policy issues.

The particular function of the Taskforce is to facilitate the witness of the American religious community for a responsible U.S. food policy. We are seeking to do this by clarifying moral issues in U.S. food policy, by providing reliable information about policy and policy options, by identifying policies and policy objectives which in our judgment serve the cause of justice, and by recommending ways in which concerned members of the religious community can most effectively make their witness in the political arena.

The Taskforce speaks for itself only, and not for the almost two dozen national religious bodies cooperating in its work. The Taskforce speaks to those bodies, to the larger religious community, to the general public, and, on occasion, to units of the U.S. government such as this Committee.

The Grounds for Our Advocacy of the Revisions in the Law

The Taskforce, whose primary concern is for justice in the production and distribution of food, is advocating revisions in the current law regarding estate and gift taxes for four reasons.

First, we are committed to the survival of the family farm. We believe that family farming as a means of producing food for the hungry at home and abroad is a precious way of life which should be continued. Some people boast of the way in which America's energy-intensive agriculture, expecially in its technological forms introduced by agribusiness corporations, is making it possible for fewer and fewer people to grow more and more food. We believe that the transition of recent decades toward fewer family farms and more agribusiness operations is a mixed blessing which should not go unchallenged. Family farming is not only a rich part of our national heritage; it is also inherently more respectful of our fragile and precious farming land than is the care given by many of the large corporations.

Second, we believe that justice demands that our nation give the family-owned and -operated farm a fair chance to survive as a viable social and economic unit of our society. The current structure of our estate and gift taxes, when combined with other economic factors such as the escalating cost of land and other farm inputs, unfairly stacks the deck against the individual farmer who wishes to keep his or her farm in the family.

Third, the current situation is contrary to the intent that Congress demonstrated in its most recent revision of the estate tax structure thirty-four years ago in 1942. Two goals of the 1942 revision were to protect the family farmer and to break up excessive concentrations of wealth in agriculture by taxing those farmers with large land holdings. In 1942, $60,000 represented a fairly large farm estate. Hence, estates under that amount were exempt from estate taxes; only those at or over that amount were taxed. However, even though the asset value of the average American farm was only $50,000 as late as 1960, in recent years the cost of land and farm inputs has skyrocketed to the point that by 1974 the value of the average American farm was $170,000.

This combination of "old law" and "new prices" has worked considerable hardship on family farmers. An increasing number of family farmers, for example, have been required to file estate tax returns. In 1942, only 17,000 estate tax returns (farm and non-farm) were filed, approximately one for every 60 deaths. In 1972, 175,000 such returns were required, one for every 10 deaths. Many farmers have been forced either to sell a portion of their land in order to raise enough funds to pay the estate tax or, if they could get credit, to go further into debt by borrowing at the current high rates of interest. For a significant number of these, selling off a segment of their land has meant being left with an uneconomically small amount of land with which to earn a living.

Finally, the consequences of the current situation have been harmful for practically every sector of our society. For the structure of American agriculture itself, the current situation has meant that land sold of necessity by family farmers has been bought either by large agribusiness corporations or, in the case marginally suburban land, by developers who convert it to shopping centers or housing developments. Between 1950 and 1974, one half—2.8 million—of the farms in the United States disappeared. Farm land lost to commercial development can never be regained.

By encouraging absentee ownership, the present tax law has contributed to dissolving the fabric of our rural communities. As family farmers move out and corporations move in, communities have less need for local businesses and services. For example, a recent study by a Wisconsin economist of the effect on small communities of the sale of small businesses in them to absentee, out-of-town owners found that employment dropped and the use of local lawyers, banking services, and other community services which kept the local economy healthy was reduced.

And then, for our national economy, present estate tax laws have meant greater concentration of agricultural land and wealth in the hands of fewer and fewer people, with the consequent loss of competition, accompanied by declining food quality and rising consumer prices.

For all these reasons—our commitment to the survival of the family farm; our conviction that justice demands that family farms be given a fair chance to survive; our sense that the current law violates the original intention of Congress; and our judgment that the consequences of the current law are harmful to practically every segment of society—the Taskforce recommends that certain changes be made in the present tax law.

Recommendations

One, we recommend that families today be provided the equivalent benefit of the 1942 exemption levels of $60,000 per estate and $30,000 per person via gifts during a lifetime. This benefit could be provided in several ways. The exemption levels could be increased. The $60,000 estate tax exemption could be updated for inflation to at least $200,000 and the gift tax exemption to $100,000.

A second option, which we would prefer, would be to substitute a reasonable tax credit for the present exemptions. This credit should be at least $50,000, which could perhaps be instituted on a gradual basis. The credit would have the positive effect of taxing the total asset value of the estate, thereby placing the greatest tax burden upon the wealthiest landholders while reducing the amounts contributed by smaller farmers and businessmen. It would also mean that approximately $1 billion less would be lost to the federal treasury than with a straight increase in exemption levels.

Another way of reducing the tax burden on the small farmer would be to adjust the current tax rate schedule by making it more progressive. A gross estate of $200,000, for example, is under current law taxed $20,700 plus 30 percent of the excess over $100,000.

It would be possible to adjust the current tax rates by adopting a revision such as the following one:

Taxable estate	*Tax rate (percent)*
$0 to $50,000	5
$50,000 to $100,000	10
$100,000 to $150,000	15
$150,000 to $200,000	20
$200,000 to $400,000	25
$400,000 to $600,000	30
$600,000 to $1,000,000	35

Any one or a combination of the preceding alternatives would seem to us a substantial improvement over the present situation. Each should include an inflation escalator clause to prevent exemptions, credits, or tax rates from being outdated in the future.

Two, we recommend that some recognition be given to the unique partnership between husband and wife in operating a family farm. In the case of many families farming is a joint venture and involves a real partnership between the husband and wife. It is unfair to tax a surviving spouse on an estate that he or she has been heavily involved in building. We would favor the elimination or substantial reduction of estate taxes when an estate is being passed on to a surviving spouse who has been involved in building that estate. The estate will in any case be

taxed when passing from the surviving spouse to his or her children. It seems unfair also to tax that estate when it initially passes to that surviving spouse.

Three, we recommend that the executor of a farm estate be given the option of valuing land used in farming at its value for agricultural purposes rather than at its "fair market value." Under current federal law all land, including farm land, is valued for estate tax purposes at its "fair market value." Thus, land used in food production is taxed not on the basis of its agricultural use, but on its commercial potential. This inequity, combined with the antiquated $60,000 deduction for estate taxation, has contributed to the conversion of many family farms to non-agricultural uses.

In one sense the valuation is real, in that the land could be sold for that price to non-agricultural interests. But it is a false valuation from the viewpoint of the farmer paying the tax, because that value does not provide a commensurate profit to him or her. The farmer can only realize a profit by selling his or her land, and going out of business.

This creates a peculiar and unfair burden upon the farmer. While the government is encouraging full production of agricultural commodities which will help feed the world's hungry, the farmer is actually being penalized for producing food on the land rather than converting it to commercial use.

An attendant threat to future agricultural use of land exists if the farmer is forced to sell the farm. In a large majority of cases, it is a nearby well-established farmer with large land holdings or a non-agricultural commercial developer who can afford to purchase the land. The latter lends itself not only to non-agricultural use of the land, but to holding actions on land that is used for speculative purposes or tax shelters when it could and should be used in the production of food.

This revision providing for an optional method of valuing land would encourage continuity in the family operation of a farm and, according to the economic division of Congressional Research Service, would have a negligible effect on the total tax revenues received by the federal government. A safeguard is of course needed to insure that a farmer's heirs could not unfairly take advantage of a reduced land valuation for tax purposes and then at some future date sell that land to commercial interests at its higher market value.

Finally, we recommend that the current system of allowing estate tax payments to be spread out in installments over ten years be continued but that the interest rate on the deferred balance be reduced to 4 percent from the current 9 percent. This revision in interest rate would be in line with the original intent of the law, which was "to prevent undue hardship" in paying estate taxes. This provision is not currently being used very widely. The interest rate should be reduced in order to encourage its use in hardship cases.

The Taskforce realizes, Mr. Chairman, that one result of the foregoing suggestions would be a reduction in the total amount of federal tax revenue. It seems to us, however, that it is not worth the consequences of imposing such inordinate burdens upon our family farms for the small fraction of total federal tax receipts currently represented by estate tax payments. It would also seem possible to increase taxes on larger estates and incomes in order to make up the amount lost through a reduction in taxes for small or moderate estates and incomes. This would place the heaviest burden of taxation where it legitimately belongs: upon the wealthiest segments of our economy.

The Taskforce believes that the recommendations offered in this testimony are reasonable and fair, and that they would contribute to the preservation of the family-owned and -operated farm and to the common good. We commend them for your serious consideration.

GEORGE A. CHAUNCEY, *Chairman.*

NATIONAL ASSOCIATION OF HOME BUILDERS,
Washington, D.C., May 28, 1976.

Mr. MICHAEL STERN,
Staff Director, Senate Finance Committee,
Dirksen Senate Office Building, Washington, D.C.

DEAR MICHAEL: I should like to request that this letter and the attached statement be included in the record of the hearings of the Finance Committee on revision of the Federal Estate Tax laws, pursuant to the Committee's press release of May 12, 1976.

Attached is a copy of a letter statement submitted to the Committee on Ways and Means of the House of Representatives on March 26, 1976 on the same subject. In this letter to the Ways and Means Committee we pointed out the serious problems faced by the heirs of home builders upon their death as a result of the present Federal Estate Tax laws. The vast majority of home building firms are small and closely held. They are not readily saleable if that course of action is necessary in order to pay an estate tax. Some significant adjustment in the present law is necessary in order to correct this hardship.

I hope that the Committee will take into consideration these views in the course of its deliberations on changes in the Federal Estate Tax laws. Thank you for the opportunity to present our views.

Sincerely yours,

CARL A. S. COAN, Jr.,
Staff Vice President and Legislative Counsel.

NATIONAL ASSOCIATION OF HOME BUILDERS,
Washington, D.C., March 26, 1976.

Hon. AL ULLMAN,
Chairman, Ways and Means Committee U.S. House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: I should like to request that this statement be included in the record of the hearings that the Ways and Means Committee has been holding on Federal estate and gift taxes on behalf of the National Association of Home Builders. The National Association of Home Builders is the trade association for the homebuilding industry. Its membership totals over 74,000 firms in 614 associations.

The predominant number of the members of NAHB operate through small businesses. Our members are thus interested in a number of areas under consideration for changes in the Federal estate and gift tax laws.

The major areas of interest are as follows:

(1) *Increase in Estate Tax Exemption.*—NAHB strongly supports the proposal by the President to increase the estate tax exemption from $60,000 to $150,000 over a five year phase-in period. We believe that such change is necessary in order to take into account the substantial increase in the value of assets, principally real estate, resulting from the rapid inflation in our economy over the last several years. The existing exemption, established more than 30 years ago, is unrealistic in light of present values and would, if retained, continue to work a severe hardship on the survivors of a large number of persons engaged in the homebuilding business.

(2) *Liberalization of Estate Tax Payment Provisions.*—NAHB supports the proposal by the President to liberalize the provisions for the payment of estate tax with respect to businesses. Such liberalization is particularly important to many of our members whose homebuilding business operations are conducted in proprietorships, partnerships or closely-held corporations. The interests in such entities generally constitute a significant part of their gross and taxable estates and thereby create a severe liquidity problem for their executors or other legal representatives.

By reason of the fact that such interests are not readily liquid assets, the requirement for payment of the estate tax under existing rules often results in "forced sales" of the interests in such businesses in order to raise the funds to pay the estate tax. The economic detriment resulting from the receipt of an artificially depressed amount of proceeds upon such forced sales is particularly acute to the widow who assisted the decedent in developing his building business over a period of many years.

In order to alleviate this problem, we support the proposal to provide a five year moratorium on the payment of that portion of the estate tax liability attributable to the ownership interest in a closely-held business qualifying for installment payments under section 6166 of the Code. This would be in conjunction with the proposal to provide an election by the estate to pay the deferred tax after the end of the five year moratorium in equal annual installments over the next 20 years. We believe that such provisions would, if enacted, alleviate the existing hardship and give specific recognition to the unique problem facing members of the homebuilding industry and other owners of closely-held businesses as a result of the non-liquid nature of the interests therein.

(3) *Imposition of Capital Gains Tax Upon Unrealized Appreciation.*—NAHB strongly opposes the proposal to impose a capital gains tax on the unrealized appreciation in the value of the property transferred at death. As pointed out by Secretary of the Treasury Simon in his statement of March 22 before this Committee in opposition to such proposal, the concept of a capital gains tax has been to tax realized gains and the event of death hardly qualifies as a tax realization transaction. Moreover, the asserted "gain" which occurs with respect to real estate held for a long period of time is to a large extent illusory since it represents mere changes in price levels resulting from inflation rather than a real economic gain. Imposition of such a capital gains tax would, in addition to the high estate tax rates under existing law, result in an unreasonable high effective tax burden to the estate and the survivors.

Enactment of such proposal would have a substantial adverse effect upon the homebuilding industry by reason of the severe liquidity problem which would result from the requirement of payment of such capital gains tax. As described above, most of our members conduct their homebuilding operations in a proprietorship, a parternership or closely-held corporation, the interests in which generally are not readily marketable. Typically, such persons often also own unimproved land which was purchased many years ago and held for investment or possible development. In many situations, such land is not marketable because of its non-income producing nature. In addition, they may hold for investment interests in partnerships or joint ventures which own and operate rental real estate, which interests are effectively non-marketable.

In view of this, a requirement of payment of a capital gains tax on the unrealized appreciation at death with respect to either real estate owned directly by the decedent or interests in entities owning real estate would in all likelihood result in forced dispositions of such property or interests under extremely unfavorable circumstances solely for the purpose of providing funds to pay the tax. We believe that this would effect a severe hardship on the survivors of a large number of the members of the homebuilding industry.

For the foregoing reasons, we believe that this Committee should reject any proposal to impose a capital gains tax on the unrealized appreciation in property transferred at death.

(4) *Carryover Basis at Death.*—NAHB also opposes adoption of the proposal to have the basis of the decedent in property transferred at death carried over to the successors. Such proposal, which has been offered at an alternative to the proposal for capital gains upon the unrealized appreciation at death discussed in (3), above, would result in a tax upon the unrealized appreciation upon subsequent disposition of the property by the successors.

We believe that there are several problems with this proposal. The major problem is that the requirement of a carryover of basis will produce significant administrative difficulties in determining the appropriate basis for each asset held by the decedent at death. The basis of an asset in the hands of a decedent will be either (a) his cost; (b) the donor's basis if the decedent received the asset by gift; or (c) the fair market value at the transferor's death if the decedent inherited the asset, subject to certain adjustments required by the Code. It will be extremely difficult and often impossible to determine the appropriate basis where the asset has been held for many years. This will occur, or example, where the decedent received a gift of a parcel of land many years ago—the records reflecting the donor's original basis often will no longer be in existence. Such requirement of determination of the carryover basis will likely result in non-compliance in many situations.

A second problem is that a carryover basis result will not eliminate the "lock-in" of investment which may occur under existing law to the extent that a taxpayer retains appreciated property until death in order to avoid the substantial capital gains tax which would result upon a lifetime disposition. The carryover of basis will result in the inherent gain with respect to an asset being transferred to the successor who in turn would likely hold onto the asset for a substantial period to recognition of such gain. The result would be to exacerbate the "lock-in" effect.

We therefore oppose adoption of a carryover basis proposal and support the Treasury in opposing any changes in the present tax treatment of unrealized appreciation in property transferred at death.

Sincerely yours,

CARL A. S. COAN, Jr.
Staff Vice President and Legislative Counsel.

Statement of the American Council on Education

The following associations join in this statement: American Association of Community and Junior Colleges; American Association of State Colleges and Universitites; Association of American Universities; Association of Jesuit Colleges and Universities; Council For American Private Education; Council For The Advancement and Support of Education; National Association of State Universities and Land-Grant Colleges; National Catholic Educational Association, College and University Department; and National Council of Independent Colleges and Universities.

On behalf of the American Council on Education, an association of 1,330 colleges and universities and 175 national and regional education associations, we are grateful for this opportunity to present this testimony to you on behalf of America's colleges and universities and its privately supported elementary and secondary schools. We are authorized to speak for the associations, noted on the cover sheet of this testimony, whose memberships include virtually all of the accredited, public and private, nonprofit colleges and universities, as well as nonprofit elementary and secondary schools which enroll approximately ninety percent of the nation's private school children. While we are speaking for colleges and universities, public and private, for private schools and for associations of such institutions, what we are really talking about are some thirteen million students served by those institutions.

Over the course of the past several years, schools, colleges and universities have faced a critical financial plight that has resulted in a substantial curtailment of programs and limitation of activities. State institutions face increasing competion for funds. Private institutions, large and small, incur substantial operating deficits. One single factor—the increase in energy costs—shattered the expectations of many to balance their budgets. The anticipated increase in philanthropic support has not been realized. In fact, in the year 1973-74, for the first time in many years, there was no overall increase in contributions and bequests to institutions of higher education. In the same period, the expenses of providing education have substantially increased. Moreover, schools, colleges and universities, public and private, fortunate enough to realize income from endowment sources, have seen that income sharply reduced in many instances. As an inevitable result, the crucial share of support which educational institutions receive from private gifts and bequests (and the income from those contributions which are funneled into endowment) has been reduced?

Other than the fact that overall contributions to educational institutions did not increase in the 1973-74 year, there are few material changes in the patterns of giving to schools, colleges and universities.

The Amercian Council on Education has just completed a third in-depth analysis of voluntary support of American colleges and universities showing the patterns of giving to those institutions in the 1973-74 fiscal year. The study is attached. In summary, the report indicates that:

(*a*) Total documented voluntary support was found by the Council for Financial Aid to Education to be $1.746 billion, with an estimate of a probable $2.240 billion.

(*b*) Twenty-two percent of voluntary support was received by public colleges and universities.

(*c*) The 988 colleges and universities participating in the 1973-74 Survey reported $1.746 billion voluntary support. Of these institutions 961 reported $15.626 billion in expenditures for general education and student aid, and 863 of these institutions reported endowments with a market value of $10.827 billion. In 1973-74 estimated endowment yield was 4.93 percent. Thus, voluntary support reported by the institutions participating in the 1973-74 Survey was 11 percent of educational expenditures reported. Such voluntary support, if derived from endowment income, would have required an additional endowment of more than $35 billion in contrast to reported endowment of $19.827 billion.

(*d*) Some 47.5 percent of all voluntary support in 1973-74 consisted of gifts from individuals—alumni and nonalumni. Aggregate support from this category of donor was approximately $796 million, of which $564 million came in transactions of more than $5,000.

(*e*) Higher education is dependent upon the large gift. Of all gift transactions by individuals (alumni and nonalumni) to higher education in 1973-74, 93.56 percent were for less than $5,000 and in the aggregate produce 29.16

percent of all voluntary support. The remaining 0.44 percent of all transactions (those over $5,000) produce 70.84 percent of all voluntary support by individuals.

(*f*) Approximately 52 percent of gifts over $5,000 from individuals were received in the form of securities, real estate, or other property.

(*g*) In 1973-74 voluntary support by bequest reached $267 million. Bequests of $5,000 or more amounted to approximately 98 percent of all bequest receipts, while bequests of securities, real estate, and other property represented 41 percent of all bequest receipts.

(*h*) The total amount of annuities, life contracts, insurance policies, and other forms of deferred giving amounted to $56.9 million in 1973-74, a decrease of 29 percent from the amount reported in 1972-73. Deferred giving transactions of more than $5,000 represented 98.5 percent of all deferred giving receipts.

Thus, higher education in 1973-74, as in prior years, was dependent upon large gifts, approximately half of which come from individuals; and approximately 40 percent of these gifts from individuals, both over and under $5,000, were in the form of securities, real estate, or other property.

Private sources of support are essential to the continued existence of private institutions of elementary, secondary and higher education and crucial to the quality of education provided by many public institutions. For that reason, we urge this Committee, in considering modification of the tax laws at this critical time, to carefully weigh the potential effect of any modification on charitable and educational institutions, particularly those which like private schools, colleges and universities perform functions that would otherwise have to be financed for the most part by direct public budget outlays. In fact, we would hope that the Committee could find ways to encourage charitable contributions and bequests which are so essential to the continuation of the system of education. We feel certain that each member of this Committee is sensitive to the critical condition of schools, colleges and universities and supportive of the crucial role which they play in the life of this nation. On the other hand, we are genuinely fearful that, in making changes, which for other reasons may seem justified, Congress may, inadvertently, significantly damage the incentives to giving which are so important to the continued private support of all charities.

As a result of reforms enacted in 1969, a donor cannot incur financial benefit for himself or his family by means of a gift or bequest. The personal satisfaction that may accrue to a donor as a result of his directing a contribution to a recognized charity is small in comparison to the benefits which the charity and, directly and indirectly, the public receive. With this in mind, we trust the Committee will give serious consideration to the potential detriment to private support that could result from particular changes, especially where the increases in tax revenues to the Federal government are minimal in comparison with the losses to educational institutions.

In this connection, we would like to call the Committee's attention to the Commission on Private Philanthropy and Public Needs' study of all aspects of philanthropy and philanthropic organizations in the United States. One of the Commission's most important acts was to sponsor the first comprehensive examination, based on econometric analyses, of the role which the Federal tax laws play in encouraging contributions and bequests. Studies conducted by Professor Martin Feldstein at Harvard and others confirm for the first time the significant role that the charitable contribution deduction plays in encouraging donations and, in the process, refute prior suggestions to the contrary. Studies conducted by Professor Michael J. Boskin of Stanford and the National Bureau of Economic Research, Professor Feldstein and others for the first time establish the even greater incentives to giving provided by the Federal estate tax deduction.

References are made to studies which will be included in a compendium to be published in the near future. Martin Feldstein and Charles Clotfelter, "Tax Incentives and Charitable Contributions in the United States: A Microeconometric Analysis"; Michael J. Boskin, "Estate Taxation and Charitable Bequests"; Martin Feldstein, "Charitable Bequests, Estate Taxation and Intergenerational Wealth Transfers."

These studies show that the income and estate tax deductions for charitable gifts are indeed "efficient" in that for every dollar of tax revenue foregone by the Treasury, substantially more than a dollar is gained by the beneficiary charitable institutions. In the case of gifts of property and bequests, the benefits to charity resulting from the deduction are even more important.

Foundations are funding sources of great significance to colleges and universities, providing 23 percent to 26 percent of their gift income in recent years. For 1973-74 foundation contributions to higher education amounted to some $535 million. But it is not only the volume of dollars that is important. Functioning as independent funding sources, foundations materially add to the flexibility and capacity of colleges and universities in meeting such needs as broadened educational opportunities among women and minority groups, the development of new curricula and lines of inquiry, and qualitative improvement within both public and private higher education.

We would now like to make specific comments on those subjects that have a major impact on educational institutions.

TAXATION OF GIFTS OF APPRECIATED PROPERTY

The proposal which could have the most far-reaching effect on the private support of education is that of changing the present rules with respect to gifts of appreciated property. The rules were modified in 1969 with respect to gifts of appreciated property to private foundations. Donors to private foundations of long-term appreciated property must reduce the fair market value by one-half of the unrealized appreciation

There are those who believe that it has virtually eliminated the support of private foundations through current gifts. We believe that the extension to public charities of a provision which would tax gifts of long-term appreciated property could result in eliminating the property gift which accounts for almost half of all individual donations and for more than one-quarter of the overall private support of higher education. The proposal that unrealized appreciation (and it *is* unrealized since the property, including the appreciation, passes to charity) be taxed at the time of gift to a public charity might well eliminate this form of giving, since it imposes a penalty on the donor who makes a contribution. This is a penalty that the donor can avoid by reducing the amount of his charitable contribution so that the real burden of the increased tax will be borne by the charitable institutions that are the donees.

We believe that the imposition of a tax at the time of gift would cause the donor to reduce or eliminate gifts of appreciated property. The Felkstein-Clotfelter studies indicate that for every dollar of revenue gained by taxation of the unrealized appreciation in property given to public charities, there will be a reduction in contributions to such public charities of nearly $1.60 and suggest that the burden of that reduction will be borne disproportionately by colleges and similar charities which perform a clearly public function which would otherwise have to be supported by Federal or state funds. The Filer Commission, after a careful examination into and spirited debate with respect to this issue, recommended that the "appreciated property allowance within the charitable deduction be basically retained but amended to eliminate any possibility of personal financial gain through tax-deductible charitable giving." ("Giving in America—Toward a Stronger Voluntary Sector," Report of the Commission on Private Philanthropy and Public Needs, page 147, see discussion pages 143-147).

In this regard, it is important to note that the charitable contribution, unlike any other deduction, is a voluntary act. The donor's choice is to give or not to give, and many factors play a role in the decision. The present tax laws are relatively benign towards the donor who wishes to give appreciated property for charitable purposes, and it encourages such gifts or bequests by allowing tax deductions. A change that would place on the donor a burden, which in some cases he might be in no position to assume, would, in our opinion, cause him to choose not to give. In such a case, we do not see how there could be resulting benefit or revenue to the Government. In short, we believe that the effect of the proposed changes with respect to gifts and bequests of property will not benefit the Treasury, but it will cause a substantial diminution of the support of public charities and in particular schools, colleges and in universities at a time of dire financial stress.

TAXATION OF APPRECIATED PROPERTY AT DEATH

There are a number of proposals with respect to the treatment of unrealized appreciation at death. The suggestion that basis be carried through at death would not affect public charities. Other proposals, however, could substantially inhibit gifts of property. The imposition of a tax on unrealized appreciation at death without an exception for property passing to charitable purposes would clearly impose a burden which the taxpayer would have to take into account in planning for charitable bequests.

The extent of that burden may be suggested by the fact that over 40 percent of the value of estates bequeathed to colleges and universities is in the form of property. Since few people can anticipate the time of death, the problems associated with making judgments with respect to charitable gifts and bequests, if such a proposal were adopted, could be overwhelming. We believe that the effect would be distressing even if a simplified version of this tax were adopted, such as an additional estate tax. (See Feldstein, "Charitable Bequests, Estate Taxation and Intergenerational Wealth Transfers" for an indication of the magnitude of the penalty which may be imposed.) We strongly urge that, if a tax on unrealized appreciation at death is imposed, there be an exception (as supported by President Kennedy in his initial tax message to Congress) for property passing to charity.

LIMITATION ON CHARITABLE DEDUCTIONS FOR ESTATE TAX PURPOSES

We find it difficult to understand the rationale of the proposal that there be a limitation on the estate tax deduction. In the case of a bequest, no individual benefits by reason of that deduction. All of the assets flow to a public or quasi-public entity. As indicated above, the Congress in 1969 ensured that those entities would either be public in nature, like schools, colleges and universities, or would operate strictly for the public benefit. Thus, it is incorrect to speak of the estate bearing its share of the tax burden. The burden will be borne by the charitable beneficiary or legatee. As indicated above, the Council for Financial Aid to Education survey indicates that private support of public and private charities for the sample of reporting institutions reached the total of over $1.7 billion the 1973-74 fiscal year. Over 15 percent, or $267 million, was in the form of bequests. If nearly 40 percent of the dollar value of these bequests were part of or constituted the residue, as the 1973-74 survey indicates, then the effect of a limitation on this form of support could be serious indeed.

Special examinations suggest that many of the residue bequests consist of virtually the whole estate. Clearly, the large bequest provides virtually all of this form of support. If even 50 percent of the bequests represent substantially more than half the testator's estate, then the taxes which would have to be borne by the recipient educational institutions would certainly be many millions of dollars. Equally important, we feel that testators, when faced by the imposition of a tax on half of their estate passing to charity would react to this disincentive by limiting their charitable bequests to 50 percent. In such case, the loss to the colleges and universities alone could well exceed $100 million annually in vital support. The Boskin studies prepared for the Filer Commission indicate that the imposition of a 50 percent ceiling on charitable bequests would result in a maximum increase in revenue of $43 million in return for a loss in bequests to charitable institutions, particularly educational, scientific, health and social welfare organizations of between $189 and $338 million or that for a maximum gain in revenue of one dollar, charities can be expected to lose $4.40. This indicates that the charitable bequest is a significant incentive indeed. The same studies further indicate that, if the deduction were replaced with a 30 percent credit, for every dollar gained in revenue, there would be a loss of $1.60 in bequests to charities, virtually all of which will be borne by the educational, scientific, health and social welfare organizations. (Boskin, *supra*, Table 13.)

As in the case of the charitable gift, the fact that Congress has established a procedure for recognizing and supervising worthy charities and permits unlimited deductions for charitable bequests to them is itself an incentive regardless of the actual effect on the taxpayer's estate. In this regard, we note that after due deliberation the American Law Institute concluded that:

"The 100 percent charitable deduction in the field of transfer taxation should be retained, under either a dual tax system or a unified tax." (Federal Estate and Gift Taxation Recommendations adopted by the American Law Institute at Washington, D.C., May 23-24, 1968, page 23).

We would also note that the Filer Commission, after due deliberation, recommended that "the charitable deduction be retained in its present form." "Giving in America", *supra*, page 151, see discussion pages 147-151.

INTEGRATION OF ESTATE AND GIFT TAXES

The joinder of the proposal to limit the charitable deduction with the suggestion that the gift and estate tax be unified could be most unfortunate. We do not understand exactly how the limitation might be reflected insofar as the gift taxes are concerned. However, if any limitation is imposed on the gift tax deduction, then support of education at all levels, and we suspect of many other public

charities, could well be destroyed. As indicated, 70 percent of the money raised comes in gifts of $5,000 or more. If one-half these gifts are subject to a gift tax, then we suspect we simply would not receive them except in the most unusual circumstances. To impose a gift tax on a transfer to charity would be to discourage giving to charity, which seems directly contrary to the long-standing policy of Congress to encourage contributions through the income and estate tax deduction. Even if the change merely proposed that charitable contributions during lifetime be considered in determining the amount of charitable contributions deducted within the limitation discussed above, the effect would be most detrimental. Donors would be hard put at any time to know exactly what their charitable bequest deduction might be, and they would be even more likely to apply formula limitations on the charitable bequest.

Moreover, particularly in the case of a gift tax proposal, we cannot believe that any substantial revenue would be involved, simply because donors would be unlikely to continue their pattern of giving in the face of substantial gift taxes. Since no individual benefits are involved, we seriously question whether the revenue resulting from all of these proposals would be substantial. Because, singly or together, they might destroy an important source of support for public charities, particularly colleges, universities, and schools, we would urge that any changes proposed provide suitable exceptions and reservations to preserve the present tax incentives to charitable bequests and not impose a burden, such as a gift tax, on donations.

Mr. Chairman, I respectfully suggest that any combination of the proposals we have discussed today, for the reasons inherent in the patterns of giving to educational institutions, may virtually destroy important sources of private support for public and pivate educational institutions, all performing functions for which the state or federal government would otherwise have to assume financial responsibility. We believe that there is little evidence that the changes would be accompanied by any significant increase of revenue to the federal government. We further believe that the changes proposed would not produce a more equitable tax system, for there are no cases where an individual, alive or dead, benefits financially by reason of his gift or bequest. Thus, it is difficult for us to believe that the public purposes would be served by curtailing the present tax incentives to charitable contributions and bequests. Certainly there is no warrant for imposing burdens and disincentives. If there is no indication of increased revenue and no proof of financial advantage, the only real effect would be to reduce substantially private support of public and private educational institutions with no corresponding benefit.

SHELDON ELLIOT STEINBACH,
Staff Counsel, American Council on Education.

An Analysis of Voluntary Support of American Colleges and Universities, 1973 - 74

Julian H. Levi
Sheldon Elliot Steinbach

American Council on Education

SUMMARY

Since 1954 the Council for Financial Aid to Education has published surveys of *Voluntary Support of Education*. The present special study under the auspices of the American Council on Education supplements the CFAE material for fiscal 1973-74.

a. Total documented voluntary support was found by the Council for Financial Aid to Education to be $1.746 billion, with an estimate of a probable $2.240 billion.

b. Twenty-two percent of voluntary support was received by public colleges and universities.

c. The 988 colleges and universities participating in the 1973-74 Survey reported $1.746 billion voluntary support. Of these institutions 961 reported $15.626 billion in expenditures for general education and student aid, and 863 of these institutions reported endowments with a market value of $10.827 billion. In 1973-74 estimated endowment yield was 4.93 percent. Thus, voluntary support reported by the institutions participating in the 1973-74 Survey was 11 percent of educational expenditures reported. Such voluntary support, if derived from endowment income, would have required an additional endowment of more than $35 billion in contrast to reported endowment of $10.827 billion.

d. Some 47.5 percent of all voluntary support in 1973-74 consisted of gifts from individuals—alumni and nonalumni. Aggregate support from this category of donors was approximately $796 million, of which $564 million came in transactions of more than $5,000.

e. Higher education is dependent upon the large gift. Of all gift transactions by individuals (alumni and nonalumni) to higher education in 1973-74 99.56 percent were for less than $5,000 and in the aggregate produced 29.16 percent of all voluntary support by individuals. The remaining 0.44 percent of all transactions (those over $5,000) produced 70.84 percent of all voluntary support.

f. Approximately 52 percent of gifts of over $5,000 from individuals were received in the form of securities, real estate, or other property.

g. In 1973-74 voluntary support by bequest reached $267 million. Bequests of $5,000 or more amounted to approximately 98 percent of all bequest receipts, while bequests of securities, real estate, and other property represented 41 percent of all bequest receipts.

h. The total amount of annuities, life contracts, insurance policies, and other forms of deferred giving amounted to $56.9 million in 1973-74, a decrease of 29 percent from the amount reported in 1972-73. Deferred giving transactions of more than $5,000 represented 98.5 percent of all deferred giving receipts.

Thus, higher education in 1973-74, as in prior years, is dependent upon large gifts, approximately half of which came from individuals, and approximately 40 percent of these gifts from individuals, both over and under $5,000, were in the form of securities, real estate, or other property.

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FOREWORD

In [illegible] and [illegible], the American Council on Education published analyses showing patterns of voluntary support to higher education. A third study, presented here, shows the patterns of giving in [illegible] but with the focus on contributions from alumni and non-alumni (individual donors) and only summary figures supplied for contributions from businesses, religious denominations, foundations, and other sources. Although total giving in [illegible] is estimated at the same amount as in [illegible], contributions from the latter sector increased, whereas voluntary support from individual donors declined by 6 percent.

In 1969 and 1974 the Congress debated issues of tax reform, with much attention devoted to tax treatment of individual donors. Inasmuch as the tax structure can encourage or can cause a severe decline in individual giving to colleges and universities, information and data about the individual donor and donor gifts should enter into policy determinations. Given the significance of private gift support, it is incumbent on all those concerned with the financing of higher education—in government, in the higher education enterprise, and elsewhere—to understand the amount, characteristics, and patterns of private philanthropy.

In [illegible] alumni and non-alumni made [illegible] gifts to the [illegible] colleges and universities reporting in the aggregate amount of [illegible]. In human terms these statistics mean that on more than three million occasions in this one year, men and women made decisions that collectively provided more than [illegible] million to colleges and universities to help those institutions carry forward the services for which they have the primary responsibility. To the institutions, individual donor gifts may well mean the difference between high-quality education, research, and services or mediocrity (in some cases even survival).

Higher education in this nation owes its beginnings to the generosity of private benefactors. Even though the succeeding decades have seen increasing governmental support and funding, the contributions of private donors remain essential to the financial health of all colleges and universities, both public and private.

This report has been prepared by the Office of Governmental Relations and its Committee on Taxation.

Roger W. Heyns, *President*
American Council on Education

PATTERNS OF GIVING TO HIGHER EDUCATION III

In 1968 and 1973 the American Council on Education published an analysis of voluntary support to higher education under the titles "Patterns of Giving to Higher Education."

As the case with the prior publications, this study builds upon the reports of *Voluntary Support of Education* published by the Council for Financial Aid to Education. Nine hundred eighty-eight institutions of higher education participated in the fifteenth survey for the fiscal year 1973-74, and a total voluntary support of $1.746 billion was reported.

Congressional attention has recently focused on the tax treatment of individual donors. This study therefore is limited to patterns of giving by individuals. "Individual donors" are classified between alumni and non-alumni donors, which is consistent with the practices of the Council on Financial Aid.

As in the previous studies, the Council for Financial Aid to Education and its staff, together with officers and staffs at hundreds of colleges and universities throughout the United States, made additional data and information available. For this support and cooperation, the deepest gratitude and appreciation must be expressed.

I. The Survey of Voluntary Support of Education, 1973-74

The Survey Report *Voluntary Support of Education 1973-74* stated certain highlights.

No Change in Total Support. The total voluntary support received by the institutions of higher education is estimated at $2.240 billion, the same as in 1972-73.

Public Institutions Gain. The public colleges and universities reported nearly 5% more support in 1973-74 than in 1972-73. Although the private women's colleges and professional and specialized schools reported similar increases, the private institutions as a group received 1.5% less support. The two-year institutions reported a large decline in voluntary support.

Table 1 Total Support by Source, All Colleges and Universities Reporting (000 omitted)

	1972-73 (1,020 inst.)		1973-74 (988 inst.)		% Change
Foundations	$ 409,926	(23.4)	$ 416,924	+ (23.9)	+ 1.7
Non-Alumni Individuals	469,087	(26.8)	433,409	(24.8)	7.6
Alumni	418,016	(23.9)	396,866	(22.7)	- 5.1
Business Corporations	249,764	(14.3)	276,192	(15.8)	+ 10.6
Religious Denominations	78,131	(4.4)	90,611	(5.2)	+ 15.8
Other	126,085	(7.2)	132,870	(7.6)	+ 5.4
Total	$1,750,989	(100.0)	$1,746,851	(100.0)	0.2
Memo					
All Individuals	$ 887,103	(50.7) (100.0)	$ 830,255	(47.5) (100.0)	- 6.4
Bequests	255,908	(28.8)	267,123	(32.2)	+ 4.4
Deferred Gifts	80,211	(9.0)	56,904	(6.9)	- 29.1
Other Gifts	550,984	(62.1)	506,228	(60.9)	8.1

Voluntary Support of Education (New York: Council for Financial Aid to Education, 1975), p. 8

Major Shift Among Donor Groups. There was a decrease of 6% in voluntary support from individual donors, alumni and non-alumni alike. This was offset by a large increase in support from business corporations, foundations, religious denominations, and other sources. Alumni support of Annual Funds continued to gain.

Current Giving Up; Capital Support Down. Private gifts and grants for current operations gained about 4.3%, with support for faculty compensation up sharply. Voluntary support for capital purposes, including endowment, decreased 5.4%, with gifts for physical plant and for student aid down moderately.

Table 1 (a) Voluntary Support of Education
All Institutions Participating 1973-74

GROUP AND NUMBER OF INSTITUTIONS	VOLUME OF SUPPORT			SOURCES OF SUPPORT						FORMS OF GIVING	
	1	2	3	4	5	6	7	8	9	10	11
	Grand Total of Support	Current Operations	Capital Purposes	Business Corporations	Religious Denominations	Alumni	Non-Alumni Individuals	General Welfare Foundations	Other Groups & Sources	Bequests (% of Total Gifts)	Annuities Life Contracts Insurance (% of Total Gifts)
Major Private Universities (88)	$ 701 160 291 (100%)	$364 137 722 (51.9%)	$337 022 575 (48.1%)	$ 91 362 708 (13.0%)	$12 842 089 (1.8%)	$185 856 097 (26.5%)	$167 749 861 (2[illegible]%)	$205 786 486 (29.4%)	$ 37 771 128 (5.4%)	$141 877 284 (20.2%)	$22 254 348 (3.2%)
Private Men's Colleges (14)	26 670 537 (100%)	9 337 767 (35.0%)	17 332 770 (65.0%)	1 384 334 (5.2%)	1 523 240 (5.7%)	6 384 116 (23.9%)	11 767 079 (44.1%)	4 931 880 (18.5%)	[illegible] (2.0%)	2 826 221 (10.6%)	1 081 483 (4.1%)
Private Women's Colleges (78)	68 291 281 (100%)	28 824 477 (42.2%)	39 466 804 (57.8%)	5 794 598 (8.5%)	3 051 970 (4.5%)	30 433 864 (44.7%)	13 875 323 (20.3%)	13 289 448 (19.6%)	1 761 874 (2.6%)	13 957 479 (20.4%)	2 356 822 (3.5%)
Private Coeducational Colleges (463)	461 116 970 (100%)	228 844 865 (49.6%)	232 471 905 (50.4%)	70 593 128 (15.3%)	59 437 194 (12.9%)	90 231 889 (19.6%)	140 931 465 (30.5%)	77 942 519 (16.9%)	22 700 495 (4.9%)	61 219 471 (13.3%)	20 500 701 (4.4%)
Professional & Specialized Schools (51)	84 365 300 (100%)	41 738 543 (49.5%)	42 626 757 (50.5%)	10 588 874 (12.6%)	10 156 650 (12.0%)	10 320 304 (12.2%)	22 838 169 (27.1%)	27 926 767 (33.1%)	2 534 836 (3.0%)	13 084 271 (15.5%)	4 178 431 (4.9%)
Public Institutions (206)	386 160 502 (100%)	283 646 841 (73.5%)	102 513 661 (26.5%)	94 888 771 (24.7%)	293 184 (0.1%)	70 676 340 (18.3%)	70 197 313 (18.2%)	84 857 671 (22.0%)	66 148 275 (17.1%)	33 826 856 (8.8%)	6 280 756 (1.6%)
Junior Colleges (108)	19 084 221 (100%)	12 700 948 (66.5%)	6 385 273 (33.5%)	2 458 280 (12.9%)	3 407 159 (17.9%)	2 771 451 (14.5%)	6 139 957 (32.1%)	2 614 671 (13.7%)	1 094 703 ([illegible]%)	1 353 138 (7.1%)	185 532 (0.9%)
Total (988)	$1 746 850 708 (100%)	$969 030 963 (55.5%)	$777 819 745 (44.5%)	$276 191 893 (15.8%)	$90 511 217 (5.2%)	$388 085 209 (22.2%)	$433 689 127 (24.8%)	$416 924 370 (23.9%)	$132 089 027 (7.6%)	$267 123 916 (15.3%)	$58 906 870 (3.3%)

Voluntary Support of Education (New York Council for Financial Aid to Education, 1975), p. 62

Bequests Up; Deferred Gifts Down. There was an increase of 4.4% in individual support in the form of bequests. However, deferred gifts, which had risen sharply in the two previous years, showed a 29% drop. College and university endowment funds were down in market value despite a gain in book value.

The number of colleges and universities participating in the Survey was 988, down 3% from 1972-73. The year-to-year trends and other comparative findings are derived primarily from an analysis of data supplied by 827 institutions that took part in both the 1972-73 and 1973-74 Surveys.

Voluntary Support of Education 1973-74 (New York: Council for Financial Aid to Education, 1975), p. 3.

Table 1. (a) – Continued

SUPPORT THROUGH THE ANNUAL FUND						TOTAL NON ALUMNI PARENT SUPPORT		CORPORATION MATCHING GIFTS		VITAL STATISTICS	
12 Total No of Alumni of Record	13 No of Alumni Solicited Through Annual Fund	14 No of Alumni Donors to the Annual Fund	15 Dollar Value Alumni Gifts to the A F	16 Dollar Value Non Alumni Parents Gifts to the A F	17 Dollar Value Total Gifts to the A F	18 No of Non Alumni Parent Donors for All Purposes	19 Amt of Contributions by Non Alumni Parents for All Purposes	20 Amt of Corporate Support from Corporation Matching Gift Programs	21 Total Number of Gifts Matched	22 Expenditures Education & General & Student Aid	23 Endowment Market Value
3 431 496	3 059 819	665 427	$ 63 020 741	$ 2 184 369	$ 90 043 758	31 459	$ 3 908 234	$ 3 905 712	30 572	$ 3 905 108 980 (64 inst)	$ 6 121 663 611 (64 inst)
104 909	95 031	32 541	2 854 721	225 276	2 413 550	2 569	349 456	794 203	1 638	64 817 883 (16 inst)	197 881 033 (13 inst)
595 140	534 407	164 849	13 943 719	1 114 616	12 931 451	14 524	2 150 630	678 752	6 130	248 079 836 (76 inst)	556 993 058 (75 inst)
3 598 283	3 138 313	612 963	37 450 105	4 982 581	49 043 713	71 984	8 633 749	3 400 [illegible]	25 508	1 844 880 807 (455 inst)	2 200 585 385 (411 inst)
367 243	294 148	48 167	3 240 020	128 050	6 825 448	1 622	253 674	362 381	2 271	345 785 979 (50 inst)	492 946 918 (48 inst)
7 102 025	5 732 077	722 550	35 416 906	373 872	57 600 969	15 224	381 127	1 308 091	17 891	8 828 238 730 (198 inst)	1 128 104 360 (189 inst)
411 342	250 957	31 023	1 288 589	860 742	4 540 949	6 201	1 271 299	104 590	741	389 382 231 (102 inst)	29 290 828 (85 inst)
15 608 438	13 104 747	2 277 520	$157 214 301	$9 849 506	$294 219 840	143 583	$17 948 471	$10 054 528	84 751	$15 628 224 246 (961 inst)	$10 827 285 173 (863 inst)

II. Gifts of Individual Donors, Alumni and Non-Alumni

The issues of tax reform debated by the Congress in 1969 and again in 1974 centered on tax treatment of individual donors. Public Law 93-344 requires an analysis of tax expenditures defined as

> those revenue losses attributable to provisions of the federal tax laws which allow special, exclusion, exemption, or deduction from gross income or which provide a special credit, or a preferential rate of tax, or a deferral of tax liability.

Accordingly, the fiscal 1976 budget of the United States includes special Analysis F-1, "Tax Expenditure Estimates by Function"

	(in millions of dollars)					
	Corporations			Individuals		
Description	**1974**	**1975**	**1976**	**1974**	**1975**	**1976**
Deductibility of contributions to educational institutions	155	160	155	355	405	435
Deductibility of charitable contributions (other than education)	290	295	285	3,820	4,485	4,840

Special Analyses Budget of the U.S. Government 1976 (Washington: Government Printing Office), p. 109

III. Methodology of This Study

Patterns of Giving to Higher Education I, II drew upon samples selected from institutions participating in the Council for Financial Aid (CFAE) *Survey of Voluntary Support of Education*. Generally, both American Council studies included all institutions reporting more than $1,000,000 in gifts, 50 percent of all institutions in the $500,000 to $1,000,000 brackets, 10 percent of all institutions in the $250,000 to $500,000 brackets, and 5 percent of all institutions reporting less than $250,000 in gifts.

This study, based on the *Voluntary Support of Education 1973-74*, uses the same classification system. A questionnaire was then prepared and circulated to the sample institutions. Thus, the sample for this study consisted of 463 institutions of the original 988 participating in the CFAE report for 1973-74. Usable responses for this study were received from 306 institutions. The participating institutions are listed in Appendix A. The form of questionnaire is shown in Appendix B.

This study sought greater detail concerning the support reported in the *Survey of Voluntary Support to Education 1973-74*, but limited, as noted, to gifts made by individual donors. Respondents were requested to classify each gift received as support for current operations only or for capital purposes only, to classify gift transactions as more or less than $5,000, to classify gift transactions as to whether received in cash, securities, real estate, or other property, and to classify bequests and deferred gift transactions with regard to size and form of gift received. Support reported from individual donors by the institutions responding totals $513,868,094.

The total reported in the *Voluntary Support of Education 1973-74* from individual donors was $830,355,000, as indicated by Table 1. Thus, the study response is equal to approximately 62 percent in this universe.

Table 2 tabulates the unweighted data provided by all institutions participating in this study related to individual donors, the number of transactions more or less than $5,000, whether received in cash, securities, or other property, and whether donated in support of current operations or capital purposes.

Table 2: Voluntary Support: Individual Donors; All Colleges & Universities Reporting: ACE Study 1973-74 (Unweighted Data)

Under 5,000	Transactions	Cash	Securities	Real Estate	Other	Total
Current	1 587 051	94 774 037	5 686 632	22 197	1 517 735	102 000 601
Operations		(92.92%)	(5.58%)	(0.02%)	(1.49%)	
Capital	222 284	29 325 031	2 961 9[illegible]3	54 318	1 097 702	33 438 994
Purposes		(87.70%)	(8.86%)	(0.16%)	(3.28%)	
Total	1 809 335	124 099 068	8 648 575	76 515	2 615 437	135 439 595
	*99.48%	(91.63%)	(6.39%)	(0.06%)	(1.93%)	*26.36%
Over 5,000						
Current	4 044	55 054 837	27 674 644	4 045 838	4 611 473	92 291 082
Operations		(60.30%)	(30.31%)	(4.39%)	(5.00%)	
Capital	5 453	123 168 057	130 370 280	16 700 323	15 838 247	286 137 407
Purposes		(43.05%)	(45.50%)	(5.86%)	(5.54%)	
Total	9 497	178 822 894	158 345 224	20 818 861	20 449 720	378 428 489
	*0.52%	(47.25%)	(41.84%)	(5.50%)	(5.40%)	*73.64%
Grand Total	1 818 832	302 921 962	166 993 799	20 887 176	23 065 157	513 868 084
		(58.95%)	(32.49%)	(4.06%)	(4.48%)	

*Indicates % of Total to Grand Total

Table 3 further tabulates this unweighted data as between alumni and non-alumni donors, as more or less than $5,000 and whether donated in support of current operations or capital purposes.

The procedures followed in preparation of *Patterns of Giving I* and *II* were applied to this study as well. Appendix C, *Patterns of Giving II*, describes the preparation and weighting of the data. Except where specifically noted, all data hereafter provided have had appropriate weighting procedures applied.

Table 3: Voluntary Support Received in 1973-74 by All Institutions Participating, Distinguishing Individual Donors between Alumni/Non-Alumni: ACE Study

Above & Under $5,000						(unweighted data)
Under $5,000	**Current Operations**					
	Transactions	**Cash**	**Securities**	**Real Estate**	**Other**	**Total**
Alumni	1 245 776	$63 576 222	$4 115 673	$12 425	$445 333	$68 099 653
		(93 28%)	(6 04%)	$0 02%)	(0 65%)	
Other	341 275	31 247 815	1 570 959	9 772	1 072 402	33 900 948
		(92 17%)	(4 63%)	(0 03%)	(3 16%)	
Total	1 587 051	$94 774 037	$5 686 632	22 197	1 517 735	102 009 601
		(92 92%)	(5 58%)	(0 02%)	(1 49%)	
Capital Purposes						
Alumni	156 772	17 220 348	2 035 824	29 979	251 556	19 537 707
		(88 14%)	(10 42%)	(0 15%)	(1 29%)	
Other	65 512	12 104 683	926 119	24 339	846 146	13 901 287
		(87 08%)	(6 66%)	(0 18%)	(6 09%)	
Total	222 284	29 325 031	2 961 943	54 318	1 097 702	33 438 994
		(87 70%)	(8 83%)	(0 16%)	(3 28%)	
Grand Total	1 809 335	124 099 068	8 648 515	76 515	2 615 437	135 438 595
		(91 63%)	(6 39%)	(0 06%)	(1 93%)	
Over $5,000	**Current Operations**					
	Transactions	**Cash**	**Securities**	**Real Estate**	**Other**	**Total**
Alumni	1 863	$ 26 008 031	$ 12 568 883	$ 480 790	$ 1 372 613	$ 40 428 317
		(64 33%)	(31 09%)	(1 19%)	(3 40%)	
Other	2 181	29 646 806	15 406 061	3 569 048	3 238 860	51 862 775
		(57 17%)	(29 71%)	(6 88%)	(6 25%)	
Total	4 044	55 654 837	27 974 944	4 049 838	4 611 473	92 291 092
		(60 30%)	(30 31%)	(4 39%)	(5 00%)	
Capital Purposes						
Alumni	2 657	63 177 988	63 931 146	4 785 683	3 374 144	135 268 961
		(46 71%)	(47 26%)	(3 54%)	(2 49%)	
Other	2 796	59 990 069	66 439 134	11 975 140	12 464 103	150 868 446
		(39 76%)	(44 04%)	(7 94%)	(8 26%)	
Total	5 453	123 168 057	130 370 280	16 760 823	15 838 247	286 137 407
		(43 05%)	(45 56%)	(5 86%)	(5 54%)	
Grand Total	9 497	187 822 894	158 345 224	20 810 661	20 449 720	378 428 499
		(47 25%)	(41 84%)	(5 50%)	(5 40%)	

IV. Qualifications Governing This Study

1. The Council for Financial Aid to Education (CFAE) requires self-classification by participating institutions within the seven categories of institutions shown by Table 4.
2. CFAE surveys of individual support fall within two categories: alumni and non-alumni individuals. Determination of classification is made by reporting institutions. These procedures and classifications were accepted for the purposes of this study.
3. This study deals with consummated donor transactions rather than donors. Successive gifts by any one donor will appear as independent donor transactions rather than as an aggregate total from the single donor.
4. The data were sought with regard to consummated donor transactions in the 1973-74 study year. At many institutions recording of gifts may be handled by development officers and personnel, whereas the actual receipt of the gift will be dealt with by the treasurer. Accordingly, single payments by a donor may cover, on occasion, more than one donor transaction or may include payment on pledges from prior years.
5. Distinctions between current and capital support are made by the institutions concerned upon their application of the guideline that current operations include gifts earmarked for that purpose or placed there at the institution's discretion; support for capital purposes include gifts for endowment whether earmarked for that purpose or placed there at the institution's discretion.
6. Distinctions between bequests as specific or residuary were accepted as reported by the institutions. Responses about the character and the nature of the bequest were not complete throughout, and the two totals are not reconciled. Distinctions of nature of bequests as between cash, securities, real estate, or other property were accepted as reported by the participating institutions. It is assumed payment of bequests ordinarily will occur at the time of final distribution and accounting. The data as collected make no allowance for sale and conversion of estate assets to cash by an executor or administrator during the course of administration.

V. The Importance of Voluntary Support

Of the [illegible] institutions reporting to CFAE, [illegible] reported the volume of expenditures for education and general student aid purposes, and [illegible] institutions reported the market value of their endowment. This material shown in Table 1 may be extrapolated with reference to voluntary support received by each class of institution and in the aggregate.

While, as noted, there is a discrepancy between the number of institutions reporting voluntary support and those reporting expenditures and endowment market value, the data available demonstrate:

1. The grand total of reported voluntary support ($1,746,850,708) is equal to 11 percent of the reported expenditures ($15,626,224,246).
2. The average yield on investment of colleges and universities during 1973-74 on endowment funds is taken to have been 4.93 percent.* The $1,746,850,708 is thus the rough equivalent of an added endowment to American higher education of $35 billion in contrast to the actual admitted endowment of $10.827 billion shown on Table 4.

* *Results of the 1974 NACUBO Comparative Performance Study* (Washington, 1975) p. 8.

Table 4 Voluntary Support Received, 1973-74 and Endowment Market Value All Institutions Participating CFAE Report 1973-74

GROUP AND NUMBER OF INSTITUTIONS	Grand Total of Support	Endowment Market Value	GROUP AND NUMBER OF INSTITUTIONS
Major Private Universities (68)	$ 701 100 297	$ 6 121 063 613	Major Private Universities (68)
	(100%)	(84 inst.)	
Private Men's Colleges (14)	26 670 537	197 081 033	Private Men's Colleges (14)
	(100%)	(13 inst.)	
Private Women's Colleges (78)	68 291 281	556 993 056	Private Women's Colleges (78)
	(100%)	(75 inst.)	
Private Coeducational Colleges (463)	461 116 570	2 200 585 385	Private Coeducational Colleges (463)
	(100%)	(411 inst.)	
Professional & Specialized Schools (51)	94 385 300	552 946 918	Professional & Specialized Schools (51)
	(100%)	(46 inst.)	
Public Institutions (206)	386 160 502	1 128 104 280	Public Institutions (206)
	(100%)	(169 inst.)	
Junior Colleges (108)	19 086 271	29 290 826	Junior Colleges (108)
	(100%)	(85 inst.)	
TOTAL (988)	$1 746 850 708	$10 827 265 173	TOTAL (988)
	(100%)	(863 inst.)	
Private Secondary & Elementary Schools (313)	$100 956 406	$529 471 123	
	(100%)	(260 inst.)	
Institutions Outside U.S. (2)	$ 787 014	$ 10 072 890	Institutions Outside U.S. (2)
	(100%)	(1 inst.)	
GRAND TOTAL (1 303)	$1 848 594 188	$11 367 809 186	GRAND TOTAL (1 303)
	(100%)	(1 124 inst.)	

Voluntary Support of Education (New York: Council for Financial Aid to Education, 1975), pp. 62-63

3 In the ten years 1964-65 to 1973-74, voluntary support of public institutions increased from $195,266,000 (16 percent of all voluntary support to higher education) to $386,161,000 (22 percent of all voluntary support to higher education). See Table 5.

Table 5. Voluntary Support of Higher Education, By Type of Institution
(including percentage of Grand Total, and average per institution)
(dollar totals and averages in thousands)

Group	1964 1965	1965 1966	1966 1967	1967 1968	1968 1969
Major Private Universities	$ 477 743 (38.4%) (53) Av $9 014	$ 444 701 (36.1%) (55) Av $8 076	$ 481 365 (37.9%) (55) Av $8 752	$ 605 364 (44.1%) (61) Av $9 924	$ 619 209 (42.1%) (61) Av $10 000
Private Coed Colleges	304 220 (24.4%) (365) Av $ 833	276 770 (22.5%) (369) Av $ 750	289 427 (22.0%) (375) Av $ 772	277 439 (20.2%) (372) Av $ 746	343 409 (23.3%) (354) Av $ 970
Public Institutions	195 208 (15.7%) (191) Av $1 022	242 892 (19.8%) (191) Av $1 271	243 705 (19.2%) (193) Av $1 263	241 500 (17.6%) (203) Av $1 190	269 555 (18.5%) (185) Av $1 457
Professional & Specialized Schools	99 265 (8.0%) (83) Av $1 196	119 330 (9.7%) (79) Av $1 511	114 200 (9.0%) (75) Av $1 524	98 888 (7.2%) (77) Av $1 287	78 179 (5.4%) (71) Av $1 101
Private Women's Colleges	75 046 (6.0%) (140) Av $ 536	66 594 (5.4%) (142) Av $ 469	65 233 (5.1%) (143) Av $ 456	69 906 (5.1%) (136) Av $ 515	76 196 (5.2%) (132) Av $ 577
Private Men's Colleges	75 456 (6.1%) (67) Av $1 126	59 521 (4.8%) (63) Av $ 945	57 154 (4.5%) (64) Av $ 893	58 692 (4.3%) (57) Av $1 030	57 329 (3.9%) (53) Av $1 081
Junior Colleges	17 801 (1.4%) (165) Av $ 108	20 486 (1.7%) (136) Av $ 137	18 765 (1.5%) (137) Av $ 137	19 423 (1.5%) (137) Av $ 142	20 963 (1.4%) (157) Av $ 133
Grand Total	$1 244 815 (100%) (1 064) Av $1 170	$1 229 794 (100%) (1 033) Av $1 191	$1 269 906 (100%) (1 042) Av $1 219	$1 371 557 (100%) (1 043) Av $1 315	$1 468 870 (100%) (1 013) Av $1 442

Group	1969 1970	1970 1971	1971 1972	1972 1973	1973 1974
Major Private Universities	$ 638 927 (43.4%) (61) Av $10 474	$ 604 405 (40.2%) (58) Av $10 421	$ 685 887 (41.7%) (62) Av $11 081	$ 709 409 (40.5%) (65) Av $10 913	$ 701 100 (40.2%) (68) Av $10 311
Private Coed Colleges	331 034 (22.5%) (422) Av $ 784	345 004 (22.9%) (438) Av $ 787	409 309 (24.9%) (469) Av $ 872	442 598 (25.3%) (433) Av $1 022	461 117 (26.4%) (463) Av $ 995
Public Institutions	291 701 (19.8%) (197) Av $1 480	325 000 (21.6%) (231) Av $1 409	354 753 (21.6%) (222) Av $1 404	383 276 (21.9%) (217) Av $1 766	388 161 (22.1%) (208) Av $1 874
Professional & Specialized Schools	89 084 (6.0%) (75) Av $1 186	118 267 (7.9%) (80) Av $1 478	82 643 (5.0%) (73) Av $1 132	108 413 (6.1%) (71) Av $1 490	84 305 (4.8%) (51) Av $1 654
Private Women's Colleges	58 481 (4.0%) (106) Av $ 551	58 772 (3.8%) (96) Av $ 602	60 964 (3.7%) (89) Av $ 684	61 567 (3.5%) (85) Av $ 724	68 291 (3.9%) (78) Av $ 875
Private Men's Colleges	37 209 (2.5%) (35) Av $1 065	31 382 (2.1%) (28) Av $1 121	28 570 (1.7%) (20) Av $1 428	22 437 (1.3%) (14) Av $1 602	26 671 (1.5%) (14) Av $1 905
Junior Colleges	25 073 (1.8%) (169) Av $ 173	22 220 (1.5%) (151) Av $ 173	23 017 (1.4%) (150) Av $ 165	25 700 (1.4%) (135) Av $ 167	19 086 (1.1%) (108) Av $ 176
Grand Total	$1 472 309 (100%) (1 009) Av $1 466	$1 503 837 (100%) (1 080) Av $1 392	$1 646 007 (100%) (1 093) Av $1 506	$1 750 984 (100%) (1 020) Av $1 716	$1 746 851 (100%) (906) Av $1 766

Voluntary Support of Education (New York: Council for Financial Aid to Education, 1975), p. 95

[1] In every Survey, each institution is classified in the category appropriate to its status in that year. Since the status of many institutions has changed over the years, the data by category is not strictly comparable from one Survey to another.

4. CFAE also summarizes the purposes of voluntary support of the past ten years, shown in Table 6.

The ten year CFAE study, as well as the two prior *Patterns of Giving*, demonstrates: (1) Voluntary support, as related to expenditure and endowment values, is indeed essential to the future survival and excellence of higher education. (2) Public institutions are increasingly benefited by private voluntary support. Such support, although a significantly smaller percentage of reported expenditures as contrasted to that of private institutions, is twice as beneficial in relation to endowment market value. This voluntary support is the one counterbalance to total dependence upon the state legislature and the federal government. (3) The designated purposes of voluntary support are at the core of the educational enterprise. More than one third of all giving is unrestricted and thus may be spent for those objectives seen as most urgent by higher education itself; in 1973-74, 13 percent for basic research, 13 percent for student financial aid, and 6.2 percent for faculty compensation.

Table 6. Voluntary Support Received in 1973-74, Distinguished by Purpose, by All Participating Institutions

Purpose	1964-1965 (1,084 inst.)	1965-1966 (1,033 inst.)	1966-1967 (1,042 inst.)	1967-1968 (1,041 inst.)	1968-1969 (1,013 inst.)	1969-1970 (1,045 inst.)	1970-1971 (1,080 inst.)	1971-1972 (1,093 inst.)	1972-1973 (1,020 inst.)	1973-1974 (990 inst.)
Unrestricted	$ 401,970 (32.0%)	$ 378,969 (30.8%)	$ 380,110 (30.0%)	$ 460,078 (33.5%)	$ 424,570 (29.1%)	$ 461,021 (31.3%)	$ 481,096 (32.0%)	$ 552,052 (33.0%)	$ 594,542 (34.0%)	$ 579,995 (33.2%)
Physical Plant	333,962 (26.8%)	311,900 (25.4%)	312,537 (24.6%)	319,250 (23.3%)	360,230 (25.2%)	323,534 (22.0%)	317,054 (21.0%)	322,570 (19.6%)	322,030 (18.4%)	302,330 (17.3%)
Basic Research	139,581 (11.2%)	136,710 (16.0%)	156,133 (12.6%)	171,730 (12.5%)	182,578 (12.5%)	177,490 (12.1%)	200,873 (13.3%)	210,505 (12.6%)	228,447 (13.0%)	227,951 (13.0%)
Student Financial Aid	143,912 (11.6%)	149,544 (12.2%)	174,025 (13.7%)	176,020 (12.9%)	171,707 (11.6%)	202,001 (13.7%)	205,156 (13.5%)	214,741 (13.0%)	251,400 (14.4%)	227,032 (13.0%)
Faculty Compensation	63,423 (5.1%)	75,709 (6.1%)	84,400 (6.6%)	75,241 (5.5%)	76,763 (5.3%)	78,191 (5.3%)	80,590 (4.8%)	80,993 (4.9%)	88,901 (5.1%)	107,400 (6.2%)
Other Purposes	155,987 (12.5%)	128,950 (11.1%)	161,400 (12.7%)	168,374 (12.3%)	235,441 (16.1%)	229,900 (15.6%)	238,150 (15.0%)	205,870 (10.9%)	264,002 (15.1%)	301,251 (17.2%)
Grand Total	$1,244,815 (100%)	$1,229,794 (100%)	$1,269,968 (100%)	$1,371,557 (100%)	$1,400,670 (100%)	$1,472,300 (100%)	$1,502,837 (100%)	$1,646,007 (100%)	$1,750,900 (100%)	$1,746,851 (100%)

Voluntary Support of Education (New York: Council for Financial Aid to Education, 1975), p. 60.

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VI. The Dependence of Higher Education on the Large Gift

Table 7 tabulates the weighted data as between individual alumni and non alumni donors, as more or less than $5,000 and whether donated in support of current operations or capital purposes.

Table 7: Voluntary Support: 1973-74; Alumni, Non-Alumni Individuals, All Colleges and Universities Reporting ACE Study (Weighted)

	Transactions	Cash	Securities	Real Estate	Other	Total
Under 5,000						
Current Operations	2 919 918	165 351 690 (93.68%)	8 674 391 (4.91%)	61 359 (0.03%)	2 400 668 (1.36%)	176 498 339
Capital Purposes	388 730	49 161 899 (88.22%)	4 635 558 (8.31%)	76 391 (0.13%)	1 851 055 (3.32%)	55 725 402
Total	3 308 648 (99.56%)	214 513 589 (92.37%)	13 309 949 (5.73%)	137 750 (0.05%)	4 260 323 (1.83%)	232 221 801 (29.16%)
Over 5,000						
Current Operations	6 260	87 794 027 (61.80%)	40 726 300 (28.66%)	6 359 055 (4.48%)	7 172 795 (5.05%)	142 052 253
Capital Purposes	8 230	184 312 926 (43.66%)	188 569 972 (44.67%)	25 831 404 (6.12%)	23 394 083 (5.54%)	422 108 491
Total	14 490 (0.44%)	272 106 953 (48.23%)	229 296 272 (40.64%)	32 190 459 (5.71%)	30 566 867 (5.42%)	564 160 744 (70.84%)
Grand Total	3 323 138	486 620 352 (61.10%)	242 606 221 (30.46%)	32 328 209 (4.06%)	34 827 185 (4.37%)	796 382 545

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Table 8 applies the data obtained from the participating institutions to classification of voluntary support of individuals by class of individual donor, size of gift (as more or less than $5,000), and designation.

Thus, 3,308,648 transactions each less than $5,000 produce an aggregate of $232,221,801, while 14,490 transactions each over $5,000 produce an aggregate of $564,160,744 in voluntary support. Accordingly, 0.44 percent of all transactions (more than $5,000) produce 70.84 percent of individual support.

Table 8. Voluntary Support Received in 1973-74 All Institutions Participating. Distinguishing Individual Donors between Alumni - Non-Alumni ACE Study (Weighted)

Part A		Under $ 000			Current Operations	
	Transactions	Cash	Securities	Real Estate	Other	Total
Alumni	2 321 059	108 246 929	6 120 353	17 776	711 987	115 097 145
Individuals		(92.94%)	(5.41%)	(0.02%)	(0.63%)	
Non Alumni	598 859	59 104 761	2 554 030	43 583	1 696 686	63 399 190
Individuals		(93.23%)	(4.03%)	(0.07%)	(2.68%)	
Total	2 919 918	165 351 690	8 674 391	61 359	2 408 668	176 496 339
		(93.69%)	(4.91%)	(0.03%)	(1.38%)	
					Capital Purposes	
Alumni	274 772	28 819 803	3 039 123	42 484	363 634	32 265 125
Individuals		(89.32%)	(9.42%)	(0.13%)	(1.13%)	
Non Alumni	113 958	20 341 896	1 596 435	33 907	1 488 021	23 460 337
Individuals		(86.71%)	(6.80%)	(0.14%)	(6.34%)	
Total	388 730	49 161 699	4 635 558	76 391	1 851 655	55 725 462
		(88.22%)	(8.32%)	(0.14%)	(3.32%)	
Grand Total	3 308 648	214 513 389	13 309 949	137 750	4 260 323	232 221 801
		(92.37%)	(5.73%)	(0.16%)	(1.83%)	

Part B		Over $ 000			Current Operations	
	Transactions	Cash	Securities	Real Estate	Other	Total
Alumni	2 686	38 736 689	18 099 965	776 977	2 200 155	59 813 813
Individuals		(64.76%)	(30.26%)	(1.30%)	(3.68%)	
Non Alumni	3 574	49 057 348	22 626 335	5 582 078	4 972 644	82 238 440
Individuals		(59.65%)	(27.51%)	(6.79%)	(6.05%)	
Total	6 260	87 794 037	40 726 300	6 359 055	7 172 799	142 052 253
		(61.80%)	(28.66%)	(4.48%)	(5.05%)	
					Capital Purposes	
Alumni	3 941	93 347 595	91 236 460	7 874 581	5 032 737	197 491 426
Individuals		(47.27%)	(46.20%)	(3.99%)	(2.55%)	
Non Alumni	4 289	90 965 331	97 333 512	17 956 823	18 361 331	224 617 005
Individuals		(40.50%)	(43.33%)	(7.99%)	(8.17%)	
Total	8 230	184 312 926	188 569 972	25 831 404	23 394 063	422 108 491
		(43.66%)	(44.67%)	(6.12%)	(5.54%)	
Grand Total	14 490	272 106 963	229 296 272	32 190 459	30 566 862	564 160 744
		(48.23%)	(40.64%)	(5.71%)	(5.42%)	

VII. The Importance of Gifts of Property

Gifts of securities, real estate, and other property may be distinguished from gifts of cash and also between more or less than $5,000, all as shown by Table 8. Gifts of securities, real estate, and other property account for less than 8 percent of all gift transactions under $5,000. Gifts of securities, real estate, and other property account for more than 51 percent of all gift transactions over $5,000.

It may be concluded that dependence on the large gift and the importance of gifts of securities, real estate, and other property are applicable to all classes of higher education.

Table 9 details and distributes the data shown in Table 8 among the institutional classifications of higher education. Table 10 analyzes the dollar statistics in percentages of applicable totals.

Table 9: Voluntary Support: Alumni/Non-Alumni, Under and Above $5,000

Number of Transactions, Subject Matter of Gift and Type of Institution, in actual dollars: 1973-74 ACE Study

Source			Cash		Securities		Real Estate		Other		Total Dollar Value
			Transactions	Dollar Value	Transactions	Dollar Value	Transactions	Dollar Value	Transactions	Dollar Value	
Private Universities	Alumni	Under 5 000	661 053	$ 46 400 282	4 371	$ 4 351 334	15	$ 28 150	986	$ 287 488	$ 51 183 854
		Above 5 000	1 003	77 708 021	1 131	68 701 111	22	2 288 175	34	1 421 530	150 299 485
	Non-Alumni	Under 5 000	131 426	15 400 812	825	1 215 088	3	1 521	1 670	453 830	17 111 972
		Above 5 000	1 878	61 947 288	519	57 958 856	23	2 925 754	88	8 250 105	131 083 004
	Total		801 810	201 628 934	6 786	132 228 181	73	5 243 558	2 714	18 481 850	368 882 475
Private Men's Colleges	Alumni	Under 5 000	42 678	2 018 483	141	119 888	0	0	25	66 000	2 171 007
		Above 5 000	27	308 001	11	628 367	0	0	0	0	915 288
	Non-Alumni	Under 5 000	5 341	625 137	38	48 237	1	4 795	6	903	671 027
		Above 5 000	42	771 848	19	379 110	11	867 888	1	30 148	2 287 987
	Total		48 088	3 805 518	189	1 521 818	12	872 485	32	75 738	5 905 308
Private Women's Colleges	Alumni	Under 5 000	138 883	9 525 507	938	7 818 528	0	0	3	803	18 538 918
		Above 5 000	387	7 088 215	148	7 170 110	2	132 938	0	0	14 398 215
	Non-Alumni	Under 5 000	24 182	3 022 476	287	331 796	6	18 100	130	97 488	3 468 858
		Above 5 000	370	3 973 348	88	2 278 458	1	498 788	2	156 788	6 987 385
	Total		163 808	23 608 544	1 413	18 798 843	10	858 878	136	254 178	38 312 377
Private Co-educational Colleges	Alumni	Under 5 000	882 716	43 747 447	2 428	2 715 088	16	78 888	1 564	298 101	46 788 744
		Above 5 000	1 133	26 757 234	648	18 504 281	57	3 022 432	37	865 541	98 278 318
	Non-Alumni	Under 5 000	238 871	34 584 778	1 051	1 577 082	28	46 578	1 897	514 801	36 738 958
		Above 5 000	2 288	41 988 788	858	35 535 571	68	10 048 689	184	5 848 884	93 421 383
	Total		1 146 285	147 085 018	4 785	58 488 867	163	13 158 625	3 862	7 588 987	221 158 884
Professional and Specialized Schools	Alumni	Under 5 000	38 836	2 384 854	88	185 784	0	0	7	17 758	2 587 677
		Above 5 000	58	3 238 924	43	2 438 811	3	47 228	13	1 278 751	6 983 212
	Non-Alumni	Under 5 000	15 771	3 885 988	131	343 788	0	0	137	81 858	4 297 788
		Above 5 000	524	11 989 857	183	8 432 888	5	1 248 214	10	488 887	22 154 881
	Total		55 388	21 585 243	388	11 213 172	8	1 298 588	167	1 842 447	35 987 383
Public Institutions	Alumni	Under 5 000	434 831	28 122 488	588	751 184	2	11 183	736	448 188	29 323 861
		Above 5 000	585	14 986 888	211	10 378 848	22	3 881 895	113	3 888 847	31 889 888
	Non-Alumni	Under 5 000	168 882	18 574 283	225	414 588	6	4 438	2 019	2 848 288	21 333 488
		Above 5 000	887	18 415 884	182	14 438 888	44	7 985 889	279	8 438 889	49 289 888
	Total		1 004 295	88 886 473	1 178	25 983 278	78	11 882 994	3 887	14 617 143	131 146 638
Junior Colleges	Alumni	Under 5 000	58 284	2 815 573	181	188 158	0	0	0	0	2 928 873
		Above 5 000	88	2 381 561	31	476 389	0	0	0	0	2 787 958
	Non-Alumni	Under 5 000	17 858	2 883 741	281	331 751	0	0	7	15 258	3 138 858
		Above 5 000	84	928 873	31	588 887	2	141 185	6	115 881	1 775 148
	Total		77 148	8 918 838	516	1 852 287	2	141 185	13	131 338	18 634 788
	Grand Total		3 288 876	488 828 362	15 251	242 888 221	382	32 318 788	10 848	36 287 185	788 371 561

The generosity of donors is by no means limited to the so-called major institutions. In the case of the public institutions for example, 19.87 percent of all non-alumni gift transactions over $5,000 accounted for 52.14 percent of all receipts.

Table 10. Voluntary Support, Alumni/Non-Alumni, Under and Above $5,000, Percentages of Transactions to Subject Matter of Gifts, in the Eight Institutional Types 1973-74

Source			Transactions	Cash	Transactions	Securities	Transactions	Real Estate	Transactions	Other	Total	
Private Universities	Alumni %	Under 5,000	83.10%	23.08%	63.58%	3.29%	70.54%	[illegible]	34.60%	2.57%	[illegible]	[illegible]
		Above 5,000	.73%	38.17%	16.66%	51.99%	61.56%	68.84%	1.25%	13.66%	[illegible]	[illegible]
	Non-Alumni %	Under 5,000	16.37%	7.65%	12.18%	.92%	4.10%	.87%	59.56%	6.98%	[illegible]	[illegible]
		Above 5,000	.73%	30.72%	7.66%	43.83%	41.50%	56.15%	3.61%	19.60%	[illegible]	[illegible]
	Total		802,818	$201,626,934	6,798	$132,229,101	77	$5,343,554	2,118	$10,681,990		
Private Men's Colleges	Alumni %	Under 5,000	88.75%	56.10%	70.85%	7.62%	70.0%	0.0%	78.12%	98.01%	59.41%	40.50%
		Above 5,000	.38%	7.02%	5.12%	47.16%	20%	0.0%	0.0%	0.0%	1.45%	12.28%
	Non-Alumni %	Under 5,000	11.10%	16.17%	18.07%	2.66%	8.13%	.7%	18.75%	1.19%	13.00%	5.36%
		Above 5,000	.08%	20.18%	5.55%	48.57%	11.66%	99.28%	3.12%	10.10%	26.10%	52.12%
	Total		48,088	$3,495,710	199	$1,521,810	12	$477,485	32	$75,738		
Private Women's Colleges	Alumni %	Under 5,000	84.00%	60.18%	66.14%	9.38%	0.0%	0.0%	1.50%	.7%	[illegible]	[illegible]
		Above 5,000	.24%	30.17%	9.90%	66.41%	30.00%	20.41%	0.0%	0.0%	[illegible]	[illegible]
	Non-Alumni %	Under 5,000	14.76%	12.10%	18.18%	[illegible]	60.00%	2.19%	97.00%	18.35%	61.49%	18.25%
		Above 5,000	.18%	16.12%	5.96%	21.10%	10.0%	5.18%	1.50%	81.30%	6.12%	66.30%
	Total		163,808	$23,909,044	1,411	$10,198,663	10	$450,870	134	$754,120		
Private Coed Colleges	Alumni %	Under 5,000	70.03%	29.18%	50.16%	6.51%	8.16%	.72%	42.09%	3.96%	67.90%	3.60%
		Above 5,000	.10%	18.19%	13.50%	32.90%	31.16%	22.99%	1.00%	11.20%	.66%	21.35%
	Non-Alumni %	Under 5,000	29.67%	21.12%	21.98%	2.64%	18.60%	.17%	54.00%	6.88%	10.52%	9.35%
		Above 5,000	.20%	28.55%	13.11%	59.80%	43.12%	76.12%	2.87%	77.93%	[illegible]	60.60%
	Total		1,165,380	$147,095,310	4,785	$59,488,863	181	$13,152,625	3,852	$1,508,507		
Professional & Specialized Schools	Alumni %	Under 5,000	70.47%	11.14%	24.32%	.96%	0.0%	0.0%	6.20%	.96%	24.95%	3.23%
		Above 5,000	.11%	15.10%	11.75%	21.60%	37.50%	3.64%	2.78%	69.20%	6.28%	2.87%
	Non-Alumni %	Under 5,000	28.48%	18.65%	35.00%	2.18%	0.0%	2.0%	87.04%	3.38%	36.50%	6.00%
		Above 5,000	.94%	55.10%	28.14%	75.20%	62.50%	96.36%	5.98%	26.43%	24.39%	61.11%
	Total		55,380	$21,595,743	366	$11,213,772	8	$1,296,580	167	$1,842,447		
Public Institutions	Alumni %	Under 5,000	83.06%	35.12%	41.53%	2.98%	2.64%	.19%	18.88%	3.07%	38.07%	16.30%
		Above 5,000	.06%	18.19%	11.81%	39.94%	28.98%	21.58%	2.90%	25.26%	12.27%	21.14%
	Non-Alumni %	Under 5,000	16.80%	23.13%	19.10%	1.60%	7.99%	.04%	17.34%	13.98%	29.06%	9.80%
		Above 5,000	0.07%	21.10%	19.45%	55.56%	57.90%	72.27%	5.80%	57.11%	19.87%	52.14%
	Total		1,004,290	$80,005,473	1,178	$25,903,226	76	$11,062,994	3,897	$14,612,143		
Junior Colleges	Alumni %	Under 5,000	76.90%	31.10%	31.32%	1.26%	0.0%	0.0%	0.0%	0.0%	27.05%	9.11%
		Above 5,000	.08%	26.10%	6.03%	29.30%	0.0%	0.0%	0.0%	0.0%	.57%	13.98%
	Non-Alumni %	Under 5,000	22.90%	31.48%	56.61%	22.08%	0.0%	0.0%	53.85%	11.70%	33.38%	16.50%
		Above 5,000	.11%	10.42%	6.03%	40.55%	100.00	100.00	46.15%	88.30%	38.07%	59.82%
	Total		77,104	$8,910,130	514	$1,452,707	2	$141,185	13	$111,339		

1 Transactions and gifts %'s are determined by their relationship to the total shown in the fifth row of the individual columns, i.e. 83.10 percent shown in column one demonstrates that of the cash transactions 83.10 percent were given in gifts under $5,000 by alumni; that 83.10 percent of transactions yielded 23.08 percent of the total cash received.

VIII. Bequests

The Council for Financial Aid to Education reported in 1973-74 that bequests rose to $267,121,916, 32.2 percent of all voluntary support obtained from individual donors. The ACE study sought to differentiate between specific bequests and residuary bequests, as well as between cash, securities, real estate, and other property. The totals for the category and designation of the bequests are not reconciled, nor does the study take into account sale and conversion of estate assets to cash during the course of administration.

Character of bequest responses total $176,200,000; nature of bequest responses total $193,900,000. The bequest responses of the CFAE 1973-74 *Response Survey Report* are $267,121,916. Thus, the ACE study responses on character of bequests is 65.9 percent and on the nature of the bequest are 72.6 percent. Under these circumstances, preparation of a weighted table would add little to the results, so this study proceeds from the sample data.

Table 11: Character and Nature of Bequests Received 1973-74 by All Institutions Participating in ACE Study. (Unweighted Data)

Character of Bequest	Size	# of Bequests	Dollar Total	% of Beq	% of Dollars
Specific Bequests	Less than 5,000	1,256	1,476,920	8.34	0.84
	5,000 or more	1,068	88,468,608	7.09	50.19
Residuary Bequests	Less than 5,000	363	559,323	2.41	0.32
	5,000 or more	568	71,229,818	3.77	40.41
Unclassified	Less than 5,000	11,618	975,234	77.14	0.56
	5,000 or more	187	13,540,171	1.24	7.68
Total		15,058	176,254,072	100.00	100.00

Nature of Bequests	Size	# of Bequests	Dollar Total	% of Beq	% of Dollars
Cash	Less than 5,000	14,327	3,208,866	87.37	1.65
	5,000 or more	1,510	110,315,530	9.21	56.88
Securities	Less than 5,000	86	153,323	0.52	0.08
	5,000 or more	360	74,310,845	2.20	38.31
Real Estate	Less than 5,000	6	7,585	0.04	0.02
	5,000 or more	49	5,142,413	0.30	2.65
Other Property	Less than 5,000	40	45,966	0.24	0.02
	5,000 or more	20	762,761	0.12	0.39
Total		16,398	193,947,089	100.00	100.00

Certain conclusions are evident.

1. Voluntary support by bequest was found by the Council for Financial Aid in 1973-74 to represent 15.3 percent of all gifts, varying from 7.1 percent of all gifts to junior colleges to 20.4 percent of all giving to private women's colleges. (See table 1a.)

2. Bequests of $5,000 or more represent 98.28 percent of all bequest receipts (Table 12). Again, higher education is dependent upon the large donor.
3. Bequests of stock, real estate, or other property represent 41.47 percent of all bequest receipts (Table 11). Again, gifts of property are most significant to higher education.

Table 12 Character & Nature of Bequests Unweighted (1973-74 ACE Study)

Character*		Total Dollars	%	Transactions	%
1 Specific 2 Residuary 3 Unclassified	Under $5,000	$ 3,015,477	1.72%	13,235	87.90%
1 Specific 2 Residuary 3 Unclassified	Above $5,000	$173,238,595	98.28%	1,823	12.10%
		$176,254,072	100%	15,058	100%
Nature*		**Total Dollars**	**%**	**Transactions**	**%**
1 Cash 2 Securities 3 Real Estate 4 Other Property	Under $5,000	$ 3,415,740	1.76%	14,459	88.20%
1 Cash 2 Securities 3 Real Estate 4 Other Property	Above $5,000	$190,531,349	98.24%	1,939	11.80%
		$193,947,089	100%	15,058	100%

*Character (1) Total dollars given by conditions, number of transactions lesser than, greater than $5,000
(2) Determines percentages of dollars, transactions
*Nature (1) Totals dollars given less than, greater than $5,000 transactions
(2) Determines percentages of dollars to transactions

Table 13 Forms of Individual Giving as a Percentage of Voluntary Support by Individuals

Year	Bequests	Deferred Giving	Year	Bequests	Deferred Giving
1964-65	31.4%	6.7%	1969-70	27.3%	5.0%
1965-66	30.1%	6.8%	1970-71	24.9%	3.9%
1966-67	25.5%	6.1%	1971-72	37.0%	6.4%
1967-68	25.1%	7.1%	1972-73	28.8%	9.0%
1968-69	26.6%	5.4%	1973-74	32.2%	6.9%

Voluntary Support of Education 1973-74 (New York: Council for Financial Aid to Education, 1975), p. 60, table 8

IX. Deferred Giving

CFAE reported that in fiscal 1973-74 deferred giving amounted to $56,904,000.

The ACE study sought to differentiate between forms of deferred giving in more precise legal classifications and also to learn of the distribution of such support between gifts of more or less than $5,000.

The gross sample response is $40,559,150, in contrast to the CFAE total of $56,904,000. Study response represents 71.2 percent of the CFAE total giving.

Under the circumstances, preparation of a weighted table would add little to the results and the study proceeds from sample data. As shown by Table 15, deferred giving transactions of more than $5,000 represent 98.55 percent of all deferred giving receipts.

Table 14. Types and Size of Deferred Giving Received 1973-74 by All Institutions Participating ACE Study (Unweighted Data)

Deferred Gifts	Size	# of Gifts	Dollar Total	% of Gifts	% of Dollars
Charitable Remainder	Less than 5 000	42	78 523	3.73	0.19
Annuity Trusts	5 000 or more	138	6 909 797	12.28	17.04
Charitable Remainder	Less than 5 000	25	55 092	2.22	0.14
Unitrust	5 000 or more	194	17 062 370	17.23	42.07
Pooled Income Fund	Less than 5 000	147	180 012	13.06	0.69
Contracts	5 000 or more	274	6 589 531	24.33	16.20
Other	Less than 5 000	127	173 435	11.28	0.43
	5 000 or more	179	9 429 790	15.90	23.25
Total		1 126	40 559 150	100.00	100.00

Table 15. Deferred Gifts: Unweighted All Colleges & Universities Participating in ACE Study 1973-1974

Type	Size	Total Dollars	%	Transactions	%
Charitable Remainder Annuity Trusts Charitable Remainder Unitrust Pooled Income Fund Other	Under $5 000	$ 587 662	1.45%	341	30.28%
Charitable Remainder Annuity Trusts Charitable Remainder Unitrust Pooled Income Fund Other	Above $5 000	$39 971 488	98.55%	785	69.72%
		$40 559 150	100.00%	1 126	100 %

X. Life Time Gifts vs. Bequests

[illegible] Council for Financial Aid Reports do not, however, analyze support between cash, securities, and real estate. The [illegible] study makes this analysis (Table [illegible]).

Table 16 Life Time Gifts vs Bequests (Unweighted Gifts over $5,000 Dollars/Percent)

	Cash	%	Securities	%	Real Estate	%	Other	%
Bequests	[illegible]	[illegible]	[illegible]	46.[illegible]	[illegible]	24.[illegible]	162,761	3.[illegible]
Interviews Gifts	68,50[illegible],364	38.3	84,034,57[illegible]	[illegible]	15,664,248	[illegible]	19,686,959	96.3
Total Giving	[illegible]8,822,894	100.0	158,345,224	100.0	20,810,66[illegible]	100.0	20,849,[illegible]20	100.0

[illegible] high bequest support (see Table [illegible]).

[illegible] Bequests [illegible]

[illegible] cash by the executor during the period of administration.

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APPENDIX A - RESPONDING INSTITUTIONS

ALABAMA

Birmingham-Southern College
Tuskegee Institute

ARIZONA

University of Arizona

ARKANSAS

Arkansas College
John Brown University
University of Arkansas, Little Rock

CALIFORNIA

Art Center College of Design
Biola College
California Institute of Technology
California Institute of the Arts
Chapman College
Claremont Graduate School
Claremont Men's College
Claremont University Center
Harvey Mudd College
Immaculate Heart College
Loma Linda University
Mills College
Occidental College
Pitzer College
Pomona College
Scripps College
Stanford University
University of California – Summary
University of Redlands
University of San Francisco
University of Santa Clara
University of Southern California
University of the Pacific

COLORADO

Colorado College
Colorado State University
University of Denver

CONNECTICUT

Albertus Magnus College
Connecticut College
Fairfield University
Trinity College
University of Bridgeport
University of Connecticut
University of Hartford
Wesleyan University
Yale University

DELAWARE

University of Delaware
Wesley College

DISTRICT OF COLUMBIA

Catholic University of America
Georgetown University
Trinity College

FLORIDA

Bethune Cookman College
Eckerd College
Florida Southern College
Rollins College
St. Petersburg Junior College
University of Florida
University of Miami
University of South Florida
University of Tampa

GEORGIA

Agnes Scott College
Berry College
Columbus College
Emory University
Mercer University
Morris Brown College
Shorter College
University of Georgia

HAWAII

University of Hawaii

ILLINOIS

Augustana College
Central YMCA Community College
Concordia Teachers College
DePaul University
Elmhurst College
George Williams College
Illinois Institute of Technology
Illinois Wesleyan University
Knox College
Lake Forest College
Loyola University of Chicago
Millikin University
North Park College & Theological Seminary
Northwestern University
Rockford College
Roosevelt University
University of Illinois
University of Chicago

INDIANA

Anderson College
Ball State University
DePauw University
Hanover College
Indiana State University
Indiana University
St. Mary's College
Tri-State College
University of Evansville
Valparaiso University

IOWA

Briarcliff College
Coe College
Cornell College
Drake University
Grinnell College
Iowa State University of Science & Technology
University of Dubuque
University of Iowa

KANSAS

Friends University
Kansas State University
Ottawa University
University of Kansas
Wichita State University

KENTUCKY

Alice Lloyd College
Asbury College
Centre College of Kentucky
Union College
University of Kentucky

LOUISIANA

Dillard College
Tulane University
Xavier University of Louisiana

MAINE

Bowdoin College

MARYLAND

Goucher College
Johns Hopkins University & Hospital
University of Maryland
Western Maryland College

MASSACHUSETTS

Amherst College
Boston College
Clark University
College of the Holy Cross
Dakota Wesleyan University
Gordon College
Harvard University
Massachusetts Institute of Technology
Mount Holyoke College
Northeastern University
Pine Manor Junior College
Radcliffe College
Smith College
Wheaton College
Williams College
Worcester Polytechnic Institute

MICHIGAN

Albion College
Alma College
Calvin College
Hope College
Kalamazoo College
Michigan Technical University
Oakland University
University of Detroit
University of Michigan
Western Michigan University

MINNESOTA

Augsburg College
Carleton College
College of St. Thomas
Concordia College
St. John's University
St. Olaf College

MISSISSIPPI

Mississippi College
University of Southern Mississippi

MISSOURI

St. Louis University
Stephens College
University of Missouri
Washington University

NEBRASKA

Concordia Teachers College
Nebraska Wesleyan University

NEVADA

University of Nevada, Reno

NEW HAMPSHIRE

Dartmouth College
Keene State College
St. Anselm's College

NEW JERSEY

Drew University
Fairleigh Dickinson University
Monmouth College
Princeton Theological Seminary
Princeton University
Stevens Institute of Technology

NEW MEXICO

College of Santa Fe

NEW YORK

Alfred University
Bank Street College of Education
Barnard College
Bennett College
Canisius College
Clarkson College of Technology
Colgate University
Columbia University
Cooper Union
Cornell University
Fordham University
Hartwick College
Hobart & William Smith Colleges
Hofstra University
Houghton College
Kirkland College
Le Moyne College
New York University
Pace University
Rensselaer Polytechnic Institute
Rochester Institute of Technology
Rockefeller University
Rosary Hill College
Sarah Lawrence College
Skidmore College
St. John's University
St. Lawrence University
Suny Buffalo State University
Suny-Albany
Suny-Upstate Medical Center
Syracuse University
Teachers College, Columbia University
Union College
Vassar College
Wagner College
Wells College

NORTH CAROLINA

Bennett College
Campbell College
Davidson College
Duke University
Guilford College
Lenoir Rhyne College
North Carolina State University, Raleigh
St. Andrews Presbyterian College
University of North Carolina, Chapel Hill
Warren Wilson College

NORTH DAKOTA

University of North Dakota

OHIO

Baldwin Wallace College
Bowling Green State University
Capital University
Case Western Reserve University
College of Wooster
Denison University
Heidelberg College
John Carroll University
Kent State University
Kenyon College
Marietta College
Miami University
Oberlin College
Ohio Northern University
Ohio State University
Ohio Wesleyan University
University of Akron
University of Cincinnati
University of Dayton
University of Toledo
Wilberforce University
Wittenberg University
Xavier University

OKLAHOMA

University of Tulsa

OREGON

Lewis & Clark College
Oregon State University
Reed Institute

PENNSYLVANIA

Albright College
Allegheny College
Carnegie Mellon University
Chatham College
Dickinson College
Franklin & Marshall College
Geneva College
Gettysburg College
Juniata College
Lafayette College
Lehigh University
Moravian College
Susquehanna University
Swarthmore College
Valley Forge Military Academy & Junior College
Villanova University
Westminster College
Wilkes College

RHODE ISLAND

Brown University
Providence College
Rhode Island School of Design
University of Rhode Island

SOUTH CAROLINA

Clemson University
Converse College
Erskine College
Furman University
Newberry College
Presbyterian College
Wofford College

SOUTH DAKOTA

Augustana College

TENNESSEE

Carson Newman College
Fisk University
University of Tennessee
Union University
University of the South
Vanderbilt University

TEXAS

Abilene Christian College
Baylor College of Medicine
Baylor University
Howard Payne College
Huston-Tillotson College
Rice University
St. Mary's University
Texas Christian University
Trinity University
University of Houston

VERMONT

Bennington College
Middlebury College
Norwich University

VIRGINIA

College of William & Mary
Emory & Henry College
Ferrum College
Old Dominion University
Roanoke College
Sweet Briar College
University of Richmond
University of Virginia
Virginia Military Institute
Virginia Polytechnic Institute
Virginia Union University

WASHINGTON

Gonzaga University
Seattle University
University of Puget Sound
Walla Walla College
Washington State University
Whitman College

WEST VIRGINIA

Davis & Elkins College

WISCONSIN

Beloit College
Carroll College
Concordia College
Marquette University
Medical College of Wisconsin
Milwaukee School of Engineering

WYOMING

University of Wyoming

APPENDIX B—SURVEY QUESTIONNAIRE

Survey of Patterns of Giving to Higher Education, 1973-74

Sponsored by the American Council on Education

The following part of the questionnaire is designed [illegible] further information with regard to bequests and deferred gifts. In sections A & B [illegible] the figures furnished should agree in total with the sum of the figures reported in Part V, line 2 of the CFAE questionnaire. In section C the figures should agree in total with Part V, line 3 of the CFAE form.

PART I

A. Source of Bequests	Size	Number of bequests	Dollar total
1. Specific Bequests	Less than $5,000		
	$5,000 or more		
2. Residuary Bequests	Less than $5,000		
	$5,000 or more		
3. Unrestricted	Less than $5,000		
	$5,000 or more		
TOTAL			*

B. Nature of Bequests	Size	Number of bequests	Dollar total
1. Cash	Less than $5,000		
	$5,000 or more		
2. Securities	Less than $5,000		
	$5,000 or more		
3. Real Estate	Less than $5,000		
	$5,000 or more		
4. Other property	Less than $5,000		
	$5,000 or more		
TOTAL			*

C. Deferred Gifts	Size	Number of transactions	Dollar total
1. Charitable remainder Annuity Trusts	Less than $5,000		
	$5,000 or more		
2. Charitable remainder Unitrust	Less than $5,000		
	$5,000 or more		
3. Pooled Income Fund Contracts	Less than $5,000		
	$5,000 or more		
4. Other	Less than $5,000		
	$5,000 or more		
TOTAL			**

*This total should agree with the sum of the amounts shown in Part V, line 2 of the [illegible] report to the CFAE. If it does not, please explain the difference in the space provided on the right.

**This total should agree with the amount shown in Part V, line 3 of the [illegible] report to the CFAE. If it does not, please explain the difference in the space provided on the right.

SPECIAL INSTRUCTION FOR PART II

[illegible]

SPECIAL INSTRUCTION FOR PART III

[illegible]

Explanation:

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UNDER [illegible]

SOURCES OF VOLUNTARY SUPPORT	NUMBER OF TRANSACTIONS	1 CASH	NUMBER OF TRANSACTIONS	2 SECURITIES	NUMBER OF TRANSACTIONS	3 REAL ESTATE	NUMBER OF TRANSACTIONS	4 OTHER	5 TOTAL COL 1 THRU 4
1 [illegible]		$		$		$		$	$
2 [illegible]		$		$		$		$	$
								TOTAL	$

UNDER [illegible]

SOURCES OF VOLUNTARY SUPPORT	NUMBER OF TRANSACTIONS	1 CASH	NUMBER OF TRANSACTIONS	2 SECURITIES	NUMBER OF TRANSACTIONS	3 REAL ESTATE	NUMBER OF TRANSACTIONS	4 OTHER	5 TOTAL COL 1 THRU 4
1 [illegible]		$		$		$		$	$
2 [illegible]		$		$		$		$	$
								TOTAL	$

PART II
SUPPORT FOR CURRENT OPERATIONS ONLY

OVER [illegible]									
NUMBER OF TRANSACTIONS	6 CASH	NUMBER OF TRANSACTIONS	7 SECURITIES	NUMBER OF TRANSACTIONS	8 REAL ESTATE	NUMBER OF TRANSACTIONS	9 OTHER	10 TOTAL COL. 6 THRU 9	11 TOTAL SUPPORT FOR CURRENT OPERATIONS COL. 5 PLUS 10
	$		$		$		$	$	$
	$		$		$		$	$	$
								TOTAL $	GRAND TOTAL $

PART III
SUPPORT FOR CAPITAL PURPOSES ONLY

OVER [illegible]									
NUMBER OF TRANSACTIONS	6 CASH	NUMBER OF TRANSACTIONS	7 SECURITIES	NUMBER OF TRANSACTIONS	8 REAL ESTATE	NUMBER OF TRANSACTIONS	9 OTHER	10 TOTAL COL. 6 THRU 9	11 TOTAL SUPPORT FOR CURRENT OPERATIONS COL. 5 PLUS 10
	$		$		$		$	$	$
	$		$		$		$	$	$
								TOTAL $	GRAND TOTAL $