# MAJOR ESTATE AND GIFT TAX ISSUES

## HEARINGS

BEFORE THE

## SUBCOMMITTEE ON ESTATE AND GIFT TAXATION

OF THE

## COMMITTEE ON FINANCE UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

FIRST SESSION

ON

**S. 395, S. 404, S. 574 and S. 858**

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# MAJOR ESTATE AND GIFT TAX ISSUES

MAY 1, 1981

U.S. SENATE,
COMMITTEE ON FINANCE,
SUBCOMMITTEE ON ESTATE AND GIFT TAXATION,
*Washington, D.C.*

The committee met, pursuant to notice, at 9 a.m., in room 2221, Dirksen Senate Office Building, Hon. Steven D. Symms (chairman of the subcommittee) presiding.

Present: Senators Symms, Dole, Durenberger, Grassley, Byrd, and Boren.

[The press releases announcing this hearing, the bills S. 395, S. 404, S. 574, and S. 858 and description of them follow:]

[Press release, Committee on Finance, April 14, 1981]

FINANCE SUBCOMMITTEE ON ESTATE AND GIFT TAXATION SETS HEARING ON MAJOR ESTATE TAX ISSUES

Senator Steven Symms, Chairman of the Subcommittee on Estate and Gift Taxation of the Senate Committee on Finançe announced today that the Subcommittee will hold a hearing to discuss major estate tax issues on May 1, 1981.

The hearing will begin at 9 a.m. in Room 2221 of the Dirksen Senate Office Building.

In announcing the hearing, Senator Symms noted that there has been increasing concern in Congress over the impact of estate taxes on family farms and businesses. According to Symms, "the original purpose of the estate and gift tax laws was to tax the very wealthy and limit undue concentrations of wealth. It is clear that this purpose has been undermined by the effects of inflation and the complexities of estate tax planning. The result is that the present estate tax unduly burdens small enterprises and may even tend to increase the concentration of wealth as small farms and businesses are absorbed into larger enterprises."

Senator Symms stated that the Subcommittee would hold further hearings that would focus on particular problems of the estate and gift tax laws, such as the special use valuation for farm property and the interaction of estate tax laws with the gift tax. With regard to the May 1 hearing, witnesses are urged to direct their testimony to general problems of the estate and gift tax and the role such taxes play in the American economy.

To focus the issues to be considered at the May 1 hearing, the Subcommittee will review pending bills that are designed to broadly revise the estate and gift tax laws and minimize the burden on small and moderate-size estates. The major issues raised by these bills include:

(1) the amount of the combined estate and gift tax exclusion

(2) the size of the marital deduction

(3) the amount of the annual gift tax exclusion, and the treatment of spouses who contribute substantially to a family enterprise.

The bills that raise these issues are:

*S. 404.*—Introduced by Senator Symms and Senators Jepsen and Boren. Would repeal the Federal estate and gift tax.

*S. 395.*—Introduced by Senators Wallop, Boren, Byrd, Durenberger, Symms, Baucus, Bentsen, Matsunaga, and others. Would increase the Federal estate and gift tax exclusion to $600,000, provide an unlimited marital deduction and make other revisions in the estate and gift tax laws.

*S. 858.*—Introduced by Senator Durenberger and Senator Thurmond. Would increase the Federal estate and gift tax exclusion to $600,000 and revise rules governing the special use valuation.

*S. 574.*—Introduced by Senator Kassenbaum and others. Would allow a marital deduction up to $750,000 and provide a similar deduction for heirs other than the spouse.

Other bills that raise these issues will also be considered. In addition, Senator Symms indicated that his own proposal to repeal the estate and gift tax should focus attention on the question of what goals estate and gift taxes are designed to serve, and whether such taxes are consistent with other objectives of a free society.

*Requests to testify.*—Witnesses who desire to testify at the hearing must submit a written request to Robert E. Lighthizer, Chief Counsel, Committee on Finance, Room 2227 Dirksen Senate Office Building, Washington, D.C. 20510, to be received no later than close of business on April 24, 1981. Witnesses will be notified as soon as practicable thereafter whether it has been possible to schedule them to present oral testimony. If for some reason a witness is unable to appear at the time scheduled, he may file a written statement for the record in lieu of the personal appearance. In such case a witness should notify the Committee of his inability to appear as soon as possible.

*Consolidated testimony.*—Senator Symms urges all witnesses who have a common position or who have the same general interest to consolidate their testimony and designate a single spokesman to present their common viewpoint orally to the Subcommittee. The procedure will enable the Subcommittee to receive a wider expression of views than it might otherwise obtain. Senator Symms urges very strongly that all witnesses exert a maximum effort to consolidate and coordinate their statements.

*Legislative Reorganization Act.*—Senator Symms stated that the Legislative Reorganization Act of 1946, as amended, requires all witnesses appearing before the Committees of Congress "to file in advance written statements of their proposed testimony, and to limit their oral presentations to brief summaries of their argument."

Witnesses scheduled to testify should comply with the following rules:

(1) A copy of the statement must be filed not later than noon on the last business day before the witness is scheduled to appear.

(2) All witnesses must include with their written statement a summary of the principal points included in the statement.

(3) The written statements must be typed on letter-size paper (not legal size) and at least 100 copies must be submitted by noon on Thursday, April 30, 1981.

(4) Witnesses should not read their written statements to the Subcommittee, but ought instead to confine their oral presentations to a summary of the points included in the statement.

*Written statements.*—Witnesses who are not scheduled to make an oral presentation, and others who desire to present their views to the Subcommittee, are urged to prepare a written statement for submission and inclusion in the printed record on the hearings. These written statements should be typewritten, not more than 25 double-spaced pages in length, and mailed with five (5) copies to Robert E. Lighthizer, Chief Counsel, Committee on Finance, Room 2227 Dirksen Senate Office Building, Washington, D.C. 20510, not later than Friday, May 15, 1981.

# BACKGROUND AND DESCRIPTION OF BILLS (S. 395, S. 404, S. 574, AND S. 858) RELATING TO ESTATE AND GIFT TAXES

PREPARED FOR THE USE OF THE

COMMITTEE ON FINANCE

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

## INTRODUCTION

The Senate Finance Committee's Subcommittee on Estate and Gift Taxation has scheduled a hearing on May 1, 1981, regarding the purposes and effects of the Federal estate and gift taxes in general and particularly as they affect farms and other small businesses.

This pamphlet, prepared in connection with the hearing, contains five parts. The first part is a summary of present law and the bills described in the pamphlet. The second part provides a brief description of the present estate and gift tax laws. The third part provides background information, including a short history of the estate and gift tax laws, and data on the number and size of estates subject to tax and the burdens of the tax. The fourth part provides a discussion of the issues involved in considering modifications to the Federal estate and gift tax laws, including a discussion of the arguments for and against various modifications to the estate and gift tax laws. Part five provides a description of four bills, S. 404, S. 858, S. 395, and S. 574, that would modify the Federal estate and gift tax laws in some manner.

# I. SUMMARY

## Present Law

Under present law, there is imposed a gift tax on lifetime transfers and an estate tax on deathtime transfers. In addition, a generation-skipping tax is imposed on certain transfers which benefit more than one generation but would not be subject to estate or gift tax upon the termination of the interests of the older generation.

Under the Tax Reform Act of 1976, the estate and gift taxes were unified so that a single progressive rate schedule is applied to cumulative lifetime and deathtime transfers. Under the unified rate schedule, the rates range from 18 percent on the first $10,000 of taxable transfers to 70 percent on taxable transfers in excess of $5 million. A unified credit of $47,000 is allowed against an individual's estate and gift tax liabilities. With a unified credit of $47,000 and the existing rate schedule, there is no estate or gift tax on transfers of up to $175,625. In addition, a limited credit is allowed, for estate tax purposes, for State death taxes.

Present law allows an annual exclusion, for gift tax purposes, of $3,000 per donee. In addition, in the case of a qualified disclaimer by a donee or heir, the donee or heir is not deemed to have made a gift. A qualified disclaimer can arise only where the disclaimer is effective under applicable State law.

A limited deduction is allowed in computing the estate and gift taxes for certain transfers to spouses (i.e., the marital deduction). An unlimited deduction is allowed for estate and gift tax purposes for certain transfers for charitable, etc., purposes (i.e., the charitable deduction). In addition, deductions are allowed for estate tax purposes for certain transfers to orphans.

The estate tax provisions also allow certain real property used in the trade or business of farming or in other closely held trades or businesses to be valued at its current use value rather than its highest and best use value. The maximum reduction in the value of the real property by reason of the special valuation provision is $500,000. The estate tax benefits of the special valuation provision are recaptured in whole or in part if the heir ceases using the land as a farm or in the closely held business within 15 years of the decedent's death.

Present law contains two provisions allowing the installment payment of estate taxes attributable to closely held businesses. Under the more limited provision (Code sec. 6166), payments can be made over a 15-year period and there is a special 4-percent interest rate on the estate tax attributable to the first $1 million of interests in closely held businesses. Under the broader provision (Code sec. 6166A), payments can be made over a 10-year period and no special interest rate applies.

## Summary of Bills

### 1. S. 404—Senator Symms

The bill would repeal the estate, gift, and generation-skipping taxes as of December 31, 1981.

### 2. S. 858—Senator Durenberger

The bill would increase the unified credit for estate tax purposes to $192,800, beginning in 1982.

The bill also would increase gradually the unified credit for gift tax purposes beginning in 1981 until 1985 when it would be $192,800. With a unified credit of $192,800 and the existing rate schedule, there would be no estate or gift tax on transfers aggregating $600,000.

The bill would also repeal the $500,000 limitation of present law which restricts the maximum reduction in value from the current use valuation rule. The bill would reduce the recapture period from 15 to 10 years. The bill also would make several changes which broaden eligibility for current use valuation and reduce the instances where recapture occurs.

The bill would also allow a reduced interest rate, not to exceed 6 percent, on the installment payment of estate tax attributable to interests in closely held businesses.

These changes would be effective generally after December 31, 1981.

### 3. S. 395—Senators Wallop, Boren, Byrd (Va.), and others

The bill would reduce the estate and gift tax rates so that they would range from 10 percent on the first $25,000 of taxable transfers to 60 percent of taxable transfers in excess of $5 million effective after December 31, 1980. The bill also would increase the unified credit gradually beginning in 1981 until 1985 when the unified credit would be $124,750. With a unified credit of $124,750 and the revised rate schedule, there would be no estate or gift tax on transfers aggregating $600,000.

The bill would also allow an unlimited marital deduction for both estate and gift tax purposes and would increase the annual gift tax exclusion from $3,000 to $10,000 effective after December 31, 1981.

The bill would repeal the $500,000 limitation of present law which restricts the maximum reduction in value from the current use valuation rule. The bill would reduce the recapture period from 15 years to 10 years. The bill also would make several changes which broaden the eligibility for current use valuation and reduce the instance where recapture occurs. These changes would be effective after December 31, 1981.

The bill would make several other changes to the estate and gift tax laws. The bill would provide that the value of gifts made within 3 years of the decedent's death are to be included in the gross estate at their value at the time of gift instead of the estate tax valuation date. The bill would allow a donor to elect to use only a portion of his unified credit against his gift tax liability in order to permit beginning the running of the statute of limitations on the gift's value. The bill would combine the two provisions of present law (Code secs. 6166 and 6166A) allowing the installment payment of estate tax attributable

to interests in closely held businesses. Lastly, the bill would provide that a disclaimer would be considered as qualified (and, therefore, not result in a taxable gift) where the disclaimer does not transfer an interest under applicable local law and the disclaiming party timely transfers the interest to the person to whom the property would have passed if the disclaiming party had predeceased the holder of legal title of the interest. These changes would be effective after December 31, 1980.

**4. S. 574—Senator Kassebaum**

The bill would allow a limited deduction of $750,000 for certain property used in the trade or business of farming or other closely held trade or business which passes to the decedent's spouse or a qualified heir of the decedent. There would be recapture of the estate tax benefit from the deduction if the property ceases being used by the spouse or heir as a farm or in the closely held business. The deduction would be effective after December 31, 1980.

## II. PRESENT LAW

Under present law, there is imposed a gift tax on lifetime transfers and an estate tax on death-time transfers. Under the Tax Reform Act of 1976, the estate and gift taxes were unified so that a single progressive rate schedule is applied to cumulative lifetime and death-time transfers.

### 1. Rates, unified credit, and computation of tax

Under the unified estate and gift tax rate schedule, rates range from 18 percent on the first $10,000 in taxable transfers to 70 percent on taxable transfers in excess of $5 million.[1]

The amount of gift tax payable (for any calendar quarter or year, as the case may be) is determined by applying the unified rate schedule to cumulative lifetime taxable transfers and then subtracting the taxes payable on the lifetime transfers made for past taxable periods. This amount then is reduced by any available unified credit (and certain other credits) to determine the amount of gift tax liability for that period.

The amount of estate tax generally is determined by applying the unified rate schedule to the aggregate cumulative post-1976 lifetime and death-time transfers and then subtracting the post-1976 gift taxes payable on the lifetime transfers. (In essence, death-time transfers are treated as the last taxable gift by the decedent.) This amount then is reduced by any remaining unified credit and by certain other credits (discussed below) in determining the amount of estate tax liability.

The unified credit presently is $47,000.[2] With a unified credit of $47,000 and the existing rate schedule, there is no estate or gift tax on transfers of up to $175,625.[3]

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[1] Prior to the Tax Reform Act of 1976, there were separate rate schedules for the estate and gift taxes. The gift tax rates were approximately ¾ths of the estate tax rates. The Tax Reform Act of 1976 combined the separate rate schedules into a unified transfer rate schedule.

[2] Prior to the Tax Reform Act of 1976, there was a $30,000 lifetime exemption for gift tax purposes and a $60,000 exemption for estate tax purposes. The Tax Reform Act of 1976 converted the estate and gift tax exemptions into a unified credit. With a unified credit, the gift or estate tax first is computed without any exemption and then the unified credit is subtracted to determine the gift or estate tax liability. The $47,000 unified credit established by the Tax Reform Act of 1976 was phased in over a five-year period as follows: $30,000 for 1977, $34,000 for 1978, $38,000 for 1979, $42,500 for 1980, and $47,000 for 1981 and thereafter.

[3] Note that the effect of the unified credit is, in essence, to reduce the rates of tax on the first $175,625 of transfers to zero and to subject transfers in excess of that amount to tax at the rates based upon cumulative transfers including that amount. Thus, the lowest rate at which tax liability is actually incurred under the estate and gift tax is 32 percent.

## 2. Transfers subject to tax: taxable gifts and the gross estate

### *Gift tax*

The gift tax is imposed on any transfer of property by gift whether made directly or indirectly and whether made in trust or otherwise. The amount of the taxable gift is determined by the fair market value of the property on the date of gift. In addition, the exercise or the failure to exercise certain powers of appointment are also subject to the gift tax.

Present law provides an annual exclusion of $3,000 ($6,000 where the nondonor spouse consents to split the gift) of transfers of present interests in property for each donee. In addition, certain transfers of interests in qualified pension plans are excluded from the tax. In the case of the creation of a tenancy by the entirety (including a joint tenancy) in real property by spouses, present law postpones any taxable gift until the termination of the tenancy unless the spouses elect to treat the creation as a gift.

### *Estate tax*

Under present law, all property included in the "gross estate" of the decedent is subject to tax. The gross estate generally includes the value of all property in which a decedent has an interest at his death (Code sec. 2031).[4] The amount included in the gross estate is generally the fair market value of the property at the date of the decedent's death, unless the executor elects to value all property in the gross estate at the alternate valuation date (which is six months after the date of the decedent's death) (Code sec. 2032).[5]

In addition, the gross estate includes the value of certain properties not owned by the decedent at the time of his death if certain circumstances are met. These include, generally, transfers for less than adequate and full consideration if (1) the decedent retained the beneficial enjoyment of the property during his life (Code sec. 2036) or the power to alter, amend, revoke, or terminate a previous lifetime transfer (Code sec. 2038), (2) the property was transferred within three years of death (Code sec. 2035), (3) the property was previously transferred during the decedent's lifetime but the transfer takes effect at the death of the decedent (Code sec. 2037), and (4) interests in certain annuities (other than certain interests in qualified retirement plans) (Code sec. 2039). In addition, the gross estate includes the value of property subject to certain general powers of appointment possessed by the decedent (Code sec. 2041). Lastly, the gross estate includes the proceeds of life insurance on the decedent if the insurance proceeds are receivable by the executor of the decedent's estate or the decedent possessed an incident of ownership in the policy (Code sec. 2042).

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[4] Special rules (discussed below in Part II.3.) are provided for jointly held property.

[5] See below (Part II.4.) for a discussion of the special method permitted for the valuation of real estate used in certain farms and other closely-held businesses under Code section 2032A.

### 3. Jointly held property

The present estate tax provisions contain several special rules governing the treatment of jointly held property for estate tax purposes. These rules apply to forms of ownership where there is a right of survivorship upon the death of one of the joint tenants. They do not apply to community property or property owned as tenants in common.

In general, under these rules, the gross estate includes the value of property held jointly at the time of the decedent's death by the decedent and another person or persons with the right of survivorship, except that portion of the property that was acquired by the other joint owner, or owners, for adequate and full consideration in money or money's worth, or by bequest or gift from a third party. The decedent's estate has the burden of proving that the other joint owner, or owners, acquired their interests for consideration, or by bequest or gift. Consideration furnished by the surviving joint owner, or owners, does not include money or property shown to have been acquired from the decedent for less than a full and adequate consideration in money or money's worth.

The Tax Reform Act of 1976 provided special rules for certain qualified joint interests held in joint tenancy by the decedent and his spouse. If a decedent owns a qualified joint interest, one-half of the value of such interest is included in the gross estate of the decedent at the date of the decedent's death (or alternate valuation date), regardless of which joint tenant furnished the consideration. An interest is a qualified joint interest only if the following requirements are satisfied: (1) the interest must have been created by the decedent or his spouse, or both; (2) in the case of personal property, the creation of the joint interest must have been a completed gift for purposes of the gift tax provisions; (3) in the case of real property, the donor must have elected to treat the creation of the joint tenancy as a taxable event at that time (even though no gift tax is actually paid because of the annual exclusion, marital deduction, or use of the unified credit); and (4) the joint tenants cannot be persons other than the decedent and his spouse.

The Revenue Act of 1978 provided a special rule in cases where both spouses owning jointly held property used in a farm or other trade or business materially participate in the operation of the farm or other trade or business. Under the law prior to the 1978 Act, the husband generally was considered to provide all of the consideration for the acquisition of the jointly held property used on a farm or in other trades or businesses even though the wife materially participated in the operation of the farm or other trade or business. The 1978 Act provided a special rule for excluding a portion of the value of certain jointly owned property by a husband and wife that is used in a farm or other business. The amount excludable is determined by multiplying a percentage rate of 2 percent for each year the surviving spouse materially participated in the business (not to exceed 50 percent) to the excess of the value of the joint interest over the amount attributable to the original consideration furnished. In addition, the amount attributable to the original consideration furnished by the

surviving spouse would be excludable. For this purpose, the amount attributable to the original consideration would consist of the amount of that consideration plus assumed appreciation at the rate of 6 percent simple interest for the period of investment of the consideration. However, the maximum amount by which the value of a joint interest may be reduced under this rule is $500,000.

### 4. Current use valuation

If certain requirements are met, present law allows family farms and real property used in a closely held business to be included in a decedent's gross estate at current use value, rather than full fair market value, provided that the gross estate may not be reduced more than $500,000 (Code sec. 2032A).

An estate may qualify for current use valuation if: (1) the decedent was a citizen or resident of the United States at his death; (2) the value of the farm or closely held business assets in the decedent's estate, including both real and personal property (but reduced by debts attributable to the real and personal property), is at least 50 percent of the decedent's gross estate (reduced by debts and expenses); (3) at least 25 percent of the adjusted value of the gross estate is qualified farm or closely held business real property;[6] (4) the real property qualifying for current use valuation must pass to a qualified heir;[7] (5) such real property must have been owned by the decedent or a member of his family and used or held for use as a farm or closely held business ("a qualified use") for 5 of the last 8 years prior to the decedent's death; and (6) there must have been material participation in the operation of the farm or closely held business by the decedent or a member of his family in 5 years out of the 8 years immediately preceding the decedent's death (Code secs. 2032A (a) and (b)).[8]

If, within 15 years after the death of the decedent (but before the death of the qualified heir), the property is disposed of to nonfamily members or ceases to be used for farming or other closely held business purposes, all or a portion of the Federal estate tax benefits obtained from the reduced valuation will be recaptured by means of a special "additional estate tax" imposed on the qualified heir.

### 5. Allowable deductions

#### *Charitable deduction*

Present law allows a deduction for certain amounts transferred for charitable, etc., purposes in computing both the amount of taxable

[6] For purposes of the 50-percent and 25-percent tests, the value of property is determined without regard to its current use value.

[7] The term "qualified heir" means a member of the decedent's family, including his spouse, lineal descendants, parents, and aunts or uncles of the decedent and their descendants.

[8] In the case of qualifying real property where the material participation requirement is satisfied, the real property which qualifies for current use valuation includes the farmhouse, or other residential buildings, and related improvements located on qualifying real property if such buildings are occupied on a regular basis by the owner or lessee of the real property (or by employees of the owner or lessee) for the purpose of operating or maintaining the real property or the business conducted on the property. Qualified real property also includes roads, buildings, and other structures and improvements functionally related to the qualified use.

gifts and the taxable estate. The deduction is allowed for amounts transferred to the United States or any State or local government, to certain organizations organized and operated exclusively for charitable, etc., purposes, and to certain organizations of war veterans. Where the charitable transfer is an interest that is less than the entire interest in property (*e.g.*, a remainder interest), present law requires that the gift take certain specified forms in order to be deductible.

### *Marital deduction*

Both the gift tax and the estate tax allow a limited deduction for certain amounts transferred from one spouse to another spouse. The original purpose of the marital deduction[9] was generally to equate the tax treatment of property ownership in common law states with the tax treatment in community law states. In a community law state, one-half of all community property generally is owned for tax purposes by each spouse even though only one spouse generated the income to acquire the property. In a common law state, the property is considered owned for tax purposes by the spouse who generated the income to acquire the property. Because a progressive rate structure taxes one large accumulation of wealth more heavily than two smaller accumulations, residents in community property states were taxed less heavily than residents in common law states prior to the adoption of the marital deduction.

Under the marital deduction as first adopted in 1948, a donor was allowed a marital deduction for gift tax purposes equal to one-half of the property transferred to his spouse. For estate tax purposes, the estate was allowed a deduction for property transferred to the spouse of the decedent up to one-half of the adjusted gross estate.[10] The adoption of the marital deduction allowed one spouse to transfer one-half of his wealth to the other spouse free of estate or gift taxes and, thus, residents of common law states can achieve roughly the same tax treatment as residents of community law states.

The Tax Reform Act of 1976 modified the marital deduction for both estate and gift tax purposes to allow a 100-percent deduction for limited amounts of property passing between spouses. Under these new rules, an unlimited gift tax marital deduction is allowed for transfers between spouses for the first $100,000 of gifts. Thereafter, a deduction is allowed for 50 percent of the interspousal transfers in excess of $200,000. For estate tax purposes, the marital deduction was modified to allow a deduction for amounts passing to a surviving spouse equal to the greater of $250,000 or one-half of the decedent's adjusted gross estate. This amount is adjusted by the excess of the amount of the unlimited marital gift tax deduction over one-half of lifetime gifts to the surviving spouse.

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[9] The marital deduction was first adopted by the Revenue Act of 1948.

[10] Under both the gift and estate tax marital deduction, deductions are not allowed for so-called "terminable interest". Terminable interests generally are created where an interest in property passes to the spouse and another interest in the same property passes from the donor or decedent to some other person for less than full and adequate consideration. For example, an income interest to the spouse would not qualify for the marital deduction where the remainder interest is transferred to a third party. In general, the adjusted gross estate is the gross estate less deductions other than the marital and charitable deductions.

*Expenses, indebtedness, taxes, and losses*

In addition to the charitable and marital deductions, deductions are allowed, for estate tax purposes, for certain administrative expenses of the estate, certain indebtedness of the decedent, and certain taxes other than estate, succession, legacy, or inheritance taxes (Code sec. 2053). A deduction also is allowed for casualty losses incurred by the decedent's estate (Code sec. 2054).

*Orphans' deduction*

Present law also allows a limited estate tax deduction for amounts passing to an orphan child of the decedent. The deduction is limited to $5,000 for each year that the orphan child is under age 21 on the date of the decedent's death.

**6. Credits against tax**

In addition to the unified credit, there are several credits allowed which directly reduce the amount of the state tax. Two of the most important are the credit for tax on prior transfers and the credit for State death taxes.

*Credit for tax on prior transfers*

Where property includible in the decedent's gross estate has recently been subject to a previous Federal estate tax, a credit is allowed for all or a portion of that previous Federal estate tax. The amount of the credit is reduced the longer the period of time between the previous Federal estate tax and the death of the decedent. After 10 years, there is no credit (Code sec. 2013).

*State death tax credit*

A limited credit is allowed against the Federal estate tax for the amount of any estate, inheritance, legacy, or succession taxes actually paid to any State or the District of Columbia on account of any property included in the gross estate (Code sec. 2011). The amount of the credit varies with the size of the taxable estate and ranges from zero percent on small estates to 16 percent on estates exceeding approximately $10 million.[11]

**7. Generation-skipping tax**

Under the Federal estate tax law, the gross estate generally includes only interests in property owned by the decedent at his death. Where an individual was given only an income interest in property for life, the gross estate of the individual does not include the value of the property generating the income because the income interest terminates at his death and, consequently, the decedent did not own any interest in such property at his death. Moreover, the rules requiring inclusion of

[11] The maximum limitation on the amount of the State death tax credit is essentially a percentage of the rates of Federal estate tax that existed after World War I. After that war, there was pressure to repeal the estate tax. Instead of repealing the tax, Congress adopted the State death tax credit. The effect of the credit is to provide additional revenues to the States. Indeed, most States impose an additional tax commonly referred to as a "pick up" or "make up" tax, equal to the difference between the maximum State death tax credit and any inheritance or other succession taxes the State imposes. The effect of the "pick up tax" is to insure maximum revenues for the State without otherwise increasing the total death taxes paid by the decedent's estate and his heirs.

property where the decedent retained a life estate in previously transferred property do not apply in such a case because the income beneficiary did not create the income interest in himself. Consequently, it is possible under the Federal estate tax law to transfer the beneficial enjoyment from one generation to another without estate tax (i.e., to skip a generation) by simply providing the intermediate generation with an income interest.

In order to prevent the avoidance of the Federal gift or estate taxes through the use of generation-skipping arrangements, Congress enacted the generation-skipping tax provisions as part of the Tax Reform Act of 1976. Under that Act, a new generation-skipping tax was added to the Internal Revenue Code. The tax is imposed on generation-skipping transfers under a trust or similar arrangement [12] upon the distribution of the trust assets to a generation-skipping heir (for example, a great-grandchild of the transferor) or upon the termination of an intervening interest in the trust (for example, the termination of an interest held by the transferor's grandchild).

Basically, a generation-skipping trust is one which provides for a splitting of the benefits between two or more generations which are younger than the generation of the grantor of the trust. The generation-skipping tax is not imposed in the case of outright transfers. In addition, the tax is not imposed if the grandchild has (1) nothing more than a right of management over the trust assets or (2) a limited power to appoint the trust assets among the lineal descendants of the grantor.

The tax is substantially equivalent to the tax which would have been imposed if the property had been actually transferred outright to each successive generation. For example, where a trust is created for the benefit of the grantor's grandchild, with remainder to the great-grandchild, then, upon the death of the grandchild, the tax is computed by adding the grandchild's portion of the trust assets to the grandchild's estate and taxable gifts and computing the tax at the grandchild's marginal transfer tax rate. In other words, for purposes of determining the amount of the tax, the grandchild is treated as a "deemed transferor" of the trust property.

The grandchild's marginal estate tax is used as a measuring rod for purposes of determining the tax imposed on the generation-skipping transfer, but the grandchild's estate is not liable for the payment of the tax. Instead, the tax must generally be paid out of the proceeds of the trust property. However, the trust is entitled to any unused portion of the grandchild's unified transfer tax credit, the credit for tax on prior transfers, the charitable deduction (if part of the trust property is left to charity), the credit for State death taxes, and a deduction for certain administrative expenses. In addition, the value of the grandchild's gross estate is increased by the generation-skipping transfer for marital deduction purposes.

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[12] For purposes of these rules, trust equivalents include life estates, estates for years, certain insurance and annuity contracts, and other arrangements where there is a splitting of the beneficial enjoyment of assets between generations.

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## 8. Taxation of nonresident aliens

### *Gift tax*

The Federal gift tax is imposed on nonresident aliens with respect to tangible real and personal property located within the United States. The regular gift tax rates apply. The rules are essentially the same as for citizens, except that the charitable deduction generally is allowed only for transfers to domestic charities and no marital deduction is allowed.

### *Estate tax*

Present law imposes a separate estate tax on nonresident aliens (Code secs. 2101 to 2108). The tax is imposed only on the part of the gross estate that is situated in the United States. Deductions for expenses, indebtedness, taxes, and losses are allowed only for the proportion of the gross estate located within the United States. As in the case of the gift tax, the charitable deduction is allowed only for transfers to domestic charities and no marital deduction is allowed. There is a separate rate schedule which ranges from 6 percent on the first $100,000 in taxable estate to 30 percent on taxable estates of over $20 million. The unified credit is $3,600. Present law also imposes a special tax if a decedent loses his United States citizenship within 10 years of his death and one of the principal purposes of changing his citizenship was to avoid Federal estate, gift, or income taxes.

# III. BACKGROUND AND LEGISLATIVE HISTORY

## 1. History of the Estate and Gift Taxes[1]

### 1797 to 1915

The first Federal involvement with an estate tax began in 1797 when Congress enacted a stamp tax on legacies, probates of wills and letters of administration. The stamp tax lasted until 1802 when it was repealed.

As a method of raising revenue to finance the Civil War, Congress enacted an inheritance tax[2] in 1862. Rates ranged up to 5 percent. The tax was repealed in 1870.

The next Federal estate tax[3] was imposed by the War Revenue Act of 1898. Rates ranged to 15 percent and there was an exemption of $10,000. The tax was repealed in 1902.

### 1916 to present

#### *1916–1942*

The Revenue Act of 1916 imposed an estate tax that has remained in force until the present, although it has been modified in numerous ways since then. The 1916 estate tax rates ranged from one percent on small estates to ten percent on estates over $5 million. An exemption of $50,000 was allowed.

Between 1916 and 1942, the estate tax rates were raised or lowered on several occasions. The estate tax rates were raised twice in 1917. After these changes, the rates ranged from 2 percent on small estates to 25 percent on estates over $10 million. The Revenue Act of 1918 modified the estate tax by exempting estates of less than $1 million from the tax.

The Revenue Act of 1924 made several changes to the estate tax laws. It raised the top estate tax rate to 40 percent on estates over $10 million. It allowed a limited credit for State death taxes. The Revenue Act of 1924 also imposed a gift tax for the first time.

The Revenue Act of 1926 reduced the estate tax rates and repealed the gift tax. The maximum rate was reduced to 20 percent for estates

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[1] For a more detailed history of the Federal estate and gift taxes, see Howard Zaritsky, "Federal Estate, Gift and Generation-Skipping Taxes: A Legislative History and a Description of Current Law", CRS Report No. 80–76A (April 10, 1980).

[2] An inheritance tax is a tax imposed upon an individual's privilege of inheriting property from a decedent. Typically, the rates of an inheritance tax vary with the closeness of the familial relationship between the decedent and the heir. The rate schedule is applied separately to each heir. In contrast, an estate tax is a tax imposed on the decedent upon the privilege of leaving property to his heirs. The rate schedule is applied once to all property passing (or deemed to pass) at the decedent's death, regardless of the number of heirs or their familial relationship to the decedent.

[3] The Income Tax Act of 1894 treated gifts and inheritances as income and, thus, the tax was technically not an estate tax. The 1894 Income Tax Act was held unconstitutional in 1895.

over $10 million. The estate tax exemption was increased from $50,000 to $100,000, and the maximum credit for State death taxes was increased to 80 percent of the Federal estate tax.

The Revenue Act of 1932 increased the estate tax rates, reduced the exemption to $50,000, and reenacted the gift tax. The top marginal rate under the 1932 Act was 45 percent on estates over $10 million. The gift tax rates were established at three-fourths of the estate tax rates, and there was an annual exclusion of $5,000 and a lifetime exemption of $50,000.

The Revenue Act of 1934 increased the top marginal estate tax rate to 60 percent on estates over $10 million. The Revenue Act of 1935 increased the top marginal rate to 70 percent on estates over $10 million and reduced the estate and gift tax exemptions to $40,000.

The Revenue Act of 1941 increased the estate and gift tax rates from 3 percent on small estates to 77 percent on estates over $10 million. The Revenue Act of 1942 modified the estate and gift exemptions and exclusions. Under the 1942 Act, the estate tax exemption was set at $60,000 and the gift tax exemption was set at $30,000. The annual gift tax exclusion was reduced from $5,000 to $3,000.

### *1943 to present*

The rates and exemptions established by the Revenue Act of 1941 and 1942 remained in effect until the Tax Reform Act of 1976. The only other major change to the estate and gift taxes during this period was the introduction of the marital deduction by the Revenue Act of 1948. The purpose of the marital deduction was generally to equate the tax treatment in common law states with the tax treatment in community law states.

The Tax Reform Act of 1976 modified the estate and gift tax laws in a number of ways. The most significant are as follows:[4] (1) it unified the estate and gift tax laws into a single cumulative transfer tax system based on combined lifetime and deathtime transfers;[5] (2) the rates were changed so that they began at 18 percent on small estates and increased to 70 percent on estates of over $5 million; (3) the gift tax and estate tax exemptions were combined and changed into a unified credit of $47,000, which allowed combined lifetime and deathtime transfers of $175,625 to be free from estate or gift taxes; (4) the marital deduction was increased to 100 percent of the first $100,000 of gifts and the first $250,000 of legacies and bequests to the spouse; (5) special valuation methods were provided for the valuation of certain real estate used in farming or in other closely held businesses; and (6) a generation-skipping tax was imposed.

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[4] The Tax Reform Act of 1976 also revised the income tax treatment of inherited property by providing that the basis of inherited property in the hands of the heir was the same as the basis of the property in the hands of the decedent with certain adjustments (i.e., a "carryover basis"). Under prior law, the basis of inherited property was its fair market value on the date of the decedent's death (or alternate valuation date, if elected). The carryover basis rules of the 1976 Act were repealed retroactively by the Crude Oil Windfall Profits Tax Act of 1980.

[5] Prior to the Tax Reform Act of 1976, the amount of lifetime transfers generally did not affect the amount of estate tax because there were separate rate schedules for both the gift tax and the estate tax. Under the unified system of the Tax Reform Act of 1976, deathtime transfers, in essence, are treated as the last gift of the decedent under a single rate schedule.

## 2. Estate and Gift Tax as a Source of Revenue

### Federal revenues

Prior to 1916, estate taxes were used primarily to raise revenue. Since 1916, the estate and gift taxes have been used to raise revenues and for other purposes. (See the discussion in Part IV, below.) Table 1 compares the revenue from the estate tax as a percent of all Federal revenues from the period 1925 to the present. As indicated, estate taxes have accounted for less than 2 percent of Federal revenues since World War II. Table 2 provides estimates of the revenues from estate and gift taxes from 1981 to 1985 based upon existing rates and credits.

TABLE 1.—ESTATE TAX REVENUES AS A PERCENT OF TOTAL FEDERAL REVENUE, SELECTED YEARS—1925 TO PRESENT

[Dollar amounts are in millions]

| Year | Net estate tax[1] | Total Federal revenue[2] | Percent of revenues attributable to estate tax |
|---|---|---|---|
| 1925 | $86 | $3, 641 | 2. 4 |
| 1930 | 39 | 4, 058 | 1. 0 |
| 1935 | 154 | 3, 706 | 4. 2 |
| 1940 | 250 | 6, 879 | 3. 6 |
| 1945 | 531 | 50, 162 | 1. 1 |
| 1950 | 484 | 40, 940 | 1. 2 |
| 1955 | 778 | 65, 469 | 1. 2 |
| 1961 | 1, 619 | 94, 389 | 1. 7 |
| 1963 | 1, 841 | 106, 560 | 1. 7 |
| 1966 | 2, 414 | 130, 856 | 1. 8 |
| 1970 | 3, 000 | 193, 743 | 1. 5 |
| 1977 | 4, 979 | 357, 762 | 1. 4 |
| 1981 (est.) | 7, 263 | 608, 840 | 1. 2 |

[1] Calendar year receipts (Note: calendar year receipts of estate tax generally are received in the next subsequent fiscal year.)
[2] Fiscal year receipts.

TABLE 2.—ESTIMATES OF FEDERAL ESTATE AND GIFT TAX REVENUES, FISCAL YEARS 1981–1985

[Millions of dollars]

| | 1981 | 1982 | 1983 | 1984 | 1985 |
|---|---|---|---|---|---|
| Estate tax | 6, 667 | 7, 263 | 8, 149 | 9, 056 | 9, 924 |
| Gift tax | 242 | 281 | 331 | 387 | 446 |
| Total | 6, 909 | 7, 544 | 8, 480 | 9, 443 | 10, 370 |

### State revenues

As indicated above (see part II), present law allows a limited credit against Federal estate tax for death taxes paid to a State. Typically, most States impose an inheritance tax and, in addition, impose an estate tax, commonly called a "pick up" or "make up" tax, equal to the difference between the maximum State death tax credit and any inheritance taxes imposed on property passing from the decedent. Table 3 sets forth the aggregate amount of the State death tax credit for the period 1925 to the present. This can be considered an additional burden of the Federal estate tax, although the revenue goes to the State governments, not the Federal government.

TABLE 3.—CREDIT FOR STATE INHERITANCE TAXES PAID, SELECTED YEARS—1925 TO PRESENT

[Millions]

| Year: | *Amount* |
|---|---|
| 1925 | $11 |
| 1930 | 113 |
| 1935 | 44 |
| 1940 | 45 |
| 1945 | 65 |
| 1950 | 49 |
| 1955 | 86 |
| 1961 | 196 |
| 1963 | 208 |
| 1966 | 280 |
| 1970 | 333 |
| 1977 | 552 |
| 1981 (est.) | 896 |

## 3. Historical Distribution of the Estate Tax

Table 4 provides a comparison from 1925 until the present of (1) the number of estate tax returns filed; (2) the number of estates paying estate tax, expressed as an absolute number and as a percentage of all decedents dying in that year; (3) the aggregate dollar amount of gross estate of all estate tax returns filed for that year; (4) the aggregate dollar amount of taxable estate of all estates paying tax for that year; (5) the aggregate dollar amount of estate tax paid for that year; and (6) the average estate tax rate of estates paying tax during that year.

TABLE 4.—SELECTED FEDERAL ESTATE TAX DATA, SELECTED YEARS—1925 TO PRESENT

[Dollar amounts are in millions]

| Year | Number of returns | Taxable returns: Number | Taxable returns: Percent of all decedents | Gross estate | Taxable estate | Net estate tax | Average tax rate |
|---|---|---|---|---|---|---|---|
| 1925 | 14, 013 | 10, 642 | 0. 8 | $2, 958 | $1, 621 | $86 | 5. 3 |
| 1930 | 8, 798 | 7, 028 | 0. 5 | 4, 109 | 2, 377 | 39 | 1. 6 |
| 1935 | 11, 110 | 8, 655 | 0. 6 | 2, 435 | 1, 317 | 154 | 11. 7 |
| 1940 | 15, 435 | 12, 907 | 0. 9 | 2, 633 | 1, 479 | 250 | 16. 9 |
| 1945 | 15, 898 | 13, 869 | 1. 0 | 3, 437 | 1, 900 | 531 | 27. 9 |
| 1950 | 25, 858 | 17, 411 | 1. 2 | 4, 918 | 1, 917 | 484 | 25. 2 |
| 1955 | 36, 595 | 25, 143 | 1. 6 | 7, 467 | 2, 991 | 778 | 26. 0 |
| 1961 | 64, 538 | 45, 439 | 2. 7 | 14, 622 | 6, 014 | 1, 619 | 26. 9 |
| 1963 | 78, 393 | 55, 207 | 3. 0 | 17, 007 | 7, 071 | 1, 841 | 26. 0 |
| 1966 | 97, 339 | 67, 404 | 3. 6 | 21, 936 | 9, 160 | 2, 414 | 26. 4 |
| 1970 | 133, 944 | 93, 424 | 4. 9 | 29, 671 | 11, 662 | 3, 000 | 25. 7 |
| 1977 | 200, 747 | 139, 115 | 7. 3 | 48, 202 | 20, 904 | 4, 979 | 23. 8 |
| 1981 (est.) | 111, 733 | 55, 672 | 2. 8 | 53, 542 | 39, 357 | 7, 263 | 18. 5 |

# IV. DISCUSSION OF ISSUES

## 1. Summary of Purposes of Estate and Gift Taxes

One of the issues to be discussed at the hearing is whether there should be modifications to the present estate and gift tax structure. An understanding of the purposes of the estate and gift taxes should be helpful in determining whether the present structure should be modified.

### Estate and gift taxes as a revenue source

Prior to 1916, the estate taxes were used principally to raise revenue, most often in times of war. While other purposes for the taxes also have existed since 1916, the amount of revenue raised by estate and gift taxes has been significant in absolute dollar amounts. See Tables 1 and 2 above. For 1981, the amount of revenue raised by the estate and gift taxes is roughly equal to the amount of revenues raised by excise taxes for the highway trust fund. Moreover, the relative amount of revenue raised by estate and gift taxes has been relatively uniform for over three decades. However, the amount of revenue raised by estate and gift taxes is a relatively small portion of total revenues (estimated to be slightly over one percent in 1981).

In addition, through the operation of the State death tax credit, the Federal estate and gift taxes provide revenues to the States. (See Table 3.) However, it is not possible to determine the amount of State revenue resulting from the Federal imposition of estate and gift taxes because it is impossible to determine the amount of death taxes that States would impose on their citizens if the Federal estate tax were repealed or reduced.

### Estate and gift taxes to implement certain social goals

Since 1916, estate and gift taxes also have been used as a method of implementing certain social goals. The most important goal is increasing social and economic mobility by reducing large accumulations of wealth. Many people believe that the opportunities available to one generation should not be determined, beyond a certain point, by the social and economic position of their ancestors. Taxing large transfers of wealth is one way of increasing social and economic mobility. In response, it can be argued that wealth transfers are only one of many ways by which ancestors can improve the social and economic positions of their descendants and that it is unfair to impose a tax on only one source of unequal opportunity.

Proponents of estate and gift taxes also argue that persons with large accumulations of wealth can use that wealth to have a disproportionate input into the processes of government.[1]

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[1] It would appear that this argument is more likely to be true in the case of nondiversified accumulations of wealth.

### Role in overall tax system

Under present law, there are three major types of taxes imposed directly on individuals: the income tax, social security taxes, and estate and gift taxes. Social security taxes are imposed only on limited amounts of earned income and, therefore, can be characterized as a regressive tax (i.e., the average rate of tax decreases as income increases). On the other hand, the income tax rates are progressive (i.e., average rates increase with increases in income). However, the fact that many of the provisions of the income tax laws that provide incentives for particular kinds of investment or activity are more extensively used by individuals with higher incomes offsets some of the progressivity of the income tax rates. Table 5 sets forth the average combined social security and income tax rates by expanded income class.

TABLE 5.—EFFECTIVE TAX RATES BY EXPANDED INCOME CLASS, 1981 INCOME LEVELS

| Expanded income | Number of returns (thousands) | Expanded income (millions) | Income tax liability (millions) | Social security tax (millions) | Average effective tax rate (percent) |
|---|---|---|---|---|---|
| Below $5,000 | 18, 144 | $38, 782 | −$157 | $2, 804 | 6. 8 |
| $5,000–$10,000 | 16, 128 | 120, 233 | 6, 381 | 6, 518 | 10. 7 |
| $10,000–$15,000 | 13, 413 | 166, 112 | 16, 317 | 9, 141 | 15. 3 |
| $15,000–$20,000 | 10, 875 | 189, 741 | 22, 987 | 10, 900 | 17. 9 |
| $20,000–$30,000 | 16, 977 | 419, 530 | 58, 558 | 24, 238 | 19. 7 |
| $30,000–$50,000 | 13, 650 | 511, 729 | 85, 706 | 26, 538 | 21. 9 |
| $50,000–$100,000 | 3, 609 | 232, 033 | 51, 631 | 7, 595 | 25. 5 |
| $100,000–$200,000 | 637 | 84, 489 | 24, 125 | 1, 335 | 30. 1 |
| $200,000–$500,000 | 141 | 39, 585 | 12, 468 | 291 | 32. 2 |
| $500,000–$1,000,000 | 18 | 11, 694 | 3, 607 | 34 | 31. 1 |
| Over $1,000,000 | 7 | 16, 786 | 5, 035 | 13 | 30. 1 |
| Total | 93, 599 | 1, 830, 722 | 286, 659 | 89, 407 | 20. 5 |

Note: Details may not add to totals due to rounding.

Proponents of estate and gift taxes argue that these taxes are necessary to achieve an appropriate amount of progressivity for the overall tax system. To the extent that combined social security and income taxes are less progressive, individuals are more likely to accumulate larger amounts of wealth which would be subject to the estate and gift taxes.

Another argument for the estate and gift taxes involves the basis to an heir in assets acquired from a decedent. Under present law, the basis to an heir in assets acquired from a decedent is "stepped up" to its fair market value at the decedent's death or alternative valuation date if elected (Code sec. 1014). As a result, any appreciation that occurs while the asset was held by the decedent is not subject to the income tax. Proponents of this rule argue that this result is appropriate because the assets are subject to the estate tax and, consequently, there would be double taxation if the appreciation were also subject to the income tax.

### 2. Proposals for Repeal of Estate and Gift Taxes

The issue of whether Federal estate and gift taxes should be repealed involves a weighing of competing objectives. The arguments for and against repeal may be summarized as follows:

**Arguments for repeal**

Proponents for repeal of the estate and gift taxes argue that estate and gift taxes operate as a large disincentive to work and to save. This is said to be especially true in higher income classes where the desire to benefit one's heirs may be the most important motivation to earn income and to save. Proponents of repeal argue that the amount of revenues derived from estate and gift taxes is relatively small. (See Table 1.) This is especially relevant in light of the undesirable effects of the taxes. First, proponents of repeal argue that death is a very inopportune time to impose a tax because the needs for cash are typically high at that time, especially since death generally is not a planned event. Second, the tax often results in the forced sale of family heirlooms, farms, or closely held businesses. This forced sale often results in more concentration of ownership of these assets. Third, proponents of repeal argue that large overhead costs arise from the tax because of the efforts of individuals to arrange their affairs to minimize their estate tax and because of the high costs of valuing assets. Lastly, proponents of repeal either reject the purposes of the taxes (see Part IV.A, above) or believe that the arguments for repeal outweigh these purposes.

**Arguments against repeal**

Opponents of repeal argue that the purposes for which the estate and gift taxes originally were imposed (see Part IV.A.) are just as valid today as when the taxes originally were enacted. They argue that repeal of the estate and gift taxes would aid only the richest persons in the country. (See Table 1, above.) They point out that, while the revenue from estate and gift taxes is not large compared with other sources of revenue (see Table 1), the absolute dollar amount of revenues derived from the taxes is substantial (see table 2). Opponents argue that repeal of the Federal estate and gift tax would result in revenue loss to the States from the State "pick up" estate tax. Opponents of repeal also note that the estate and gift taxes affect the amount of repeal further argue that repeal would significantly reduce charitable bequests.[3]

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[3] Present law allows an unlimited deduction for gifts and bequests to charitable organizations (Code secs. 2055 and 2522). It is not possible to determine how much of an effect that this has on amounts transferred to charities. However, in 1976, the total charitable deductions taken on estate tax returns was $2,993 million.

### 3. General Reductions in Estate and Gift Taxes

The issue of whether to reduce estate and gift taxes generally also depends upon a weighing of competing objectives. In addition, the manner in which any reduction is to be achieved (e.g., rate reductions versus increases in the unified credit) depends upon a balancing of objectives. On the one hand, because of the nature of the transfer tax base,[4] increases in the unified credit would involve a relatively large loss of revenue but would not substantially affect the other purposes of the taxes. On the other hand, decreases in the top marginal tax rates would have less relative revenue effect but would substantially affect the ability of the tax to fulfill its other objectives. Tables 6 through 11 set forth the distribution of the estate tax by wealth class under present law (with an exemption equivalent of $175,625) and with unified credits with exemption equivalents of $250,000, $500,000, $600,000, $750,000, and $800,000, respectively.

The arguments regarding general reductions in the estate and gift taxes can be summarized as follows:

#### Arguments for reduction

Proponents of general reductions in estate and gift taxes argue that inflation has increased the dollar value of individuals' wealth, but not their real value. As a result, the estate and gift taxes have become progressively higher and affect larger and larger segments of society. The effect of inflation on the estate and gift tax structure is said to have been particularly severe on farms and closely held businesses, which often must be sold to pay the tax. Moreover, proponents of reduction in the form of a higher unified credit argue that increases in the unified credit will not substantially undermine the social purposes of the tax.

#### Arguments against reduction

Opponents of general reductions argue that reductions in the present estate and gift tax structure would be regressive because only the top three percent of all individuals pay the tax. (See Table 1.) Moreover, opponents argue that, since the present level of unified credit became applicable in 1981, the amount of the present unified credit has not been substantially undermined by the effects of inflation.

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[4] A diagram of the transfer tax base would show a wide, relatively short pyramid.

TABLE 6.—ESTIMATED ESTATE TAX RETURNS, TAXABLE RETURNS, AND ESTATE TAX LIABILITY OF RESIDENT DECEDENTS, BY SIZE OF GROSS ESTATE, CALENDAR YEAR 1981

[Dollar amounts in millions]

| Size of gross estate | Number of returns | Taxable returns | Taxable returns as a percent of resident decedents | Tax liability | Tax as percent of total |
|---|---|---|---|---|---|
| $175,000–$500,000 | 87, 174 | 37, 417 | 1. 9 | $1, 301 | 17. 9 |
| $500,000–$1,000,000 | 15, 819 | 13, 288 | . 7 | 1, 625 | 22. 4 |
| $1–$2,000,000 | 5, 709 | 3, 290 | . 2 | 1, 377 | 19. 0 |
| $2–$3,000,000 | 1, 451 | 802 | (1) | 705 | 9. 7 |
| $3–$5,000,000 | 902 | 502 | (1) | 711 | 9. 8 |
| $5–$10,000,000 | 488 | 272 | (1) | 782 | 10. 8 |
| Over $10,000,000 | 190 | 101 | (1) | 762 | 10. 5 |
| Total | 111, 733 | 55, 672 | 2. 8 | 7, 263 | 100. 0 |

[1] Less than one-tenth of 1 percent.

TABLE 7.—ESTIMATED ESTATE TAX RETURNS, TAXABLE RETURNS, AND ESTATE TAX LIABILITY OF RESIDENT DECEDENTS UNDER PROPOSED $250,000 EXEMPTION EQUIVALENT CREDIT, BY SIZE OF GROSS ESTATE, CALENDAR YEAR 1981

[Dollar amounts in millions]

| Size of gross estate | Number of returns | Taxable returns | Taxable returns as a percent of resident decedents | Tax liability | Tax as percent of total | Revenue loss |
|---|---|---|---|---|---|---|
| $175,000–$500,000 | 42,414 | 14,663 | 0.7 | $491 | 8.3 | $810 |
| $500,000–$1,000,000 | 11,362 | 8,825 | .4 | 1,236 | 21.0 | 389 |
| $1–$2,000,000 | 5,709 | 3,141 | .2 | 1,266 | 21.5 | 111 |
| $2–$3,000,000 | 1,451 | 780 | (1) | 678 | 11.5 | 27 |
| $3–$5,000,000 | 902 | 482 | (1) | 695 | 11.8 | 16 |
| $5–$10,000,000 | 488 | 265 | (1) | 774 | 13.1 | 8 |
| Over $10,000,000 | 190 | 102 | (1) | 759 | 12.9 | 3 |
| Total | 62,516 | 28,258 | 1.4 | 5,899 | 100.0 | 1,364 |

[1] Less than one-tenth of 1 percent.

TABLE 8.—ESTIMATED ESTATE TAX RETURNS, TAXABLE RETURNS, AND ESTATE TAX LIABILITY OF RESIDENT DECEDENTS UNDER PROPOSED $500,000 EXEMPTION EQUIVALENT CREDIT, BY SIZE OF GROSS ESTATE, CALENDAR YEAR 1981.

[Dollar amounts in millions]

| Size of gross estate | Number of returns | Taxable returns | Taxable returns as a percent of resident decedents | Tax liability | Tax as percent of total | Revenue loss |
|---|---|---|---|---|---|---|
| $175,000–$500,000 | | | | | | $1,301 |
| $500,000–1,000,000 | 15,820 | 4,891 | 0.2 | $332 | 8.4 | 1,293 |
| $1–$2,000,000 | 5,709 | 2,866 | .1 | 900 | 22.8 | 477 |
| $2–$3,000,000 | 1,451 | 750 | (1) | 585 | 14.8 | 120 |
| $3–$5,000,000 | 902 | 454 | (1) | 638 | 16.2 | 73 |
| $5–$10,000,000 | 488 | 252 | (1) | 742 | 18.8 | 40 |
| Over $10,000,000 | 190 | 93 | (1) | 746 | 18.9 | 16 |
| Total | 24,560 | 9,306 | .5 | 3,944 | 100.0 | 3,319 |

[1] Less than one-tenth of 1 percent.

**TABLE 9.—ESTIMATED ESTATE TAX RETURNS, TAXABLE RETURNS, AND ESTATE TAX LIABILITY OF RESIDENT DECEDENTS UNDER PROPOSED $600,000 EXEMPTION EQUIVALENT CREDIT BY SIZE OF GROSS ESTATE, CALENDAR YEAR 1981**

[Dollar amounts in millions]

| Size of gross estate | Number of returns | Taxable returns | Taxable returns as a percent of resident decedents | Tax liability | Tax as percent of total | Revenue loss |
|---|---|---|---|---|---|---|
| $175,000–$500,000 | | | | | | $1, 301 |
| $500,000–$1,000,000 | 11, 362 | 2, 285 | 0. 1 | $139 | 3. 9 | 1, 486 |
| $1–$2,000,000 | 5, 709 | 2, 777 | . 1 | 749 | 21. 3 | 629 |
| $2–$3,000,000 | 1, 451 | 745 | (1) | 546 | 15. 5 | 159 |
| $3–$5,000,000 | 902 | 443 | (1) | 614 | 17. 5 | 97 |
| $5–$10,000,000 | 488 | 250 | (1) | 729 | 20. 7 | 53 |
| Over $10,000,000 | 190 | 91 | (1) | 741 | 21. 1 | 21 |
| Total | 20, 102 | 6, 591 | . 3 | 3, 518 | 100. 0 | 3, 745 |

[1] Less than one-tenth of 1 percent.

TABLE 10.—ESTIMATED ESTATE TAX RETURNS, TAXABLE RETURNS, AND ESTATE TAX LIABILITY OF RESIDENT DECEDENTS UNDER PROPOSED $750,000 EXEMPTION EQUIVALENT CREDIT, BY SIZE OF GROSS ESTATE, CALENDAR YEAR 1981

[Dollar amounts in millions]

| Size of gross estate | Number of returns | Taxable returns | Taxable returns as a percent of resident decedents | Tax liability | Tax as percent of total | Revenue loss |
|---|---|---|---|---|---|---|
| $175,000–$500,000 | | | | | | $1, 301 |
| $500,000–$10,00,000 | 4, 675 | 658 | (1) | $21 | 0. 7 | 1, 604 |
| $1–$2,000,000 | 5, 709 | 2, 566 | 0. 1 | 534 | 17. 4 | 843 |
| $2–$3,000,000 | 1, 451 | 730 | (1) | 486 | 15. 9 | 219 |
| $3–$5,000,000 | 902 | 437 | (1) | 579 | 18. 9 | 132 |
| $5–$10,000,000 | 488 | 248 | (1) | 709 | 23. 1 | 73 |
| Over $10,000,000 | 190 | 88 | (1) | 735 | 24. 0 | 27 |
| Total | 13, 415 | 4, 727 | . 2 | 3, 064 | 100. 0 | 4, 199 |

[1] Less than one-tenth of 1 percent.

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TABLE 11.—ESTIMATED ESTATE TAX RETURNS, TAXABLE RETURNS, AND ESTATE TAX LIABILITY OF RESIDENT DECEDENTS UNDER PROPOSED $800,000 EXEMPTION EQUIVALENT CREDIT BY SIZE OF GROSS ESTATE, CALENDAR YEAR 1981

[Dollar amounts in millions]

| Size of gross estate | Number of returns | Taxable returns | Taxable returns as a percent of resident decedents | Tax liability | Tax as percent of total | Revenue loss |
|---|---|---|---|---|---|---|
| $175,000–$500,000 | | | | | | $1,301 |
| $500,000–$1,000,000 | 3,740 | 280 | (1) | $6 | 0.2 | 1,619 |
| $1–$2,000,000 | 5,709 | 2,446 | 0.1 | 464 | 15.8 | 913 |
| $2–$3,000,000 | 1,451 | 726 | (1) | 466 | 15.9 | 239 |
| $3–$5,000,000 | 902 | 437 | (1) | 567 | 19.3 | 144 |
| $5–$10,000,000 | 488 | 246 | (1) | 702 | 23.9 | 80 |
| Over $10,000,000 | 190 | 86 | (1) | 732 | 24.9 | 30 |
| Total | 12,480 | 4,221 | .2 | 2,937 | 100.0 | 4,326 |

[1] Less than one-tenth of 1 percent.

## 4. Reductions in Estate and Gift Taxes Targeted Toward Particular Types of Property

Present law provides special methods for valuing certain real property used for farming purposes or in other closely held trades or businesses (Code sec. 2032A). The issue of whether this provision should be expanded or other reductions targeted toward particular types of assets be adopted also depends upon a balancing of competing objectives. In addition, provisions targeted at particular types of assets raise issues of equity among taxpayers.

The arguments for and against reductions in estate and gift taxes targeted towards particular types of assets may be summarized as follows:

### Arguments for targeted reductions

Proponents for targeted estate and gift tax reductions argue that the advantages of maintaining family ownership of particular types of assets, such as farm and closely held businesses, outweigh any advantages from the estate and gift tax structure. Moreover, changes in values and the sizes of economically viable farms and closely held businesses have increased the impact of the estate and gift tax on these businesses. Proponents argue that the relatively low cash flow of this type of assets justifies allowing the asset more favorable treatment. Without such treatment, the low cash producing capacity of the asset often would require its sale to pay the tax. This is said to be true particularly in the case of closely held businesses where the productivity of the business is often dependent upon the personal efforts of the decedent, who can no longer be involved in the business.

### Arguments against targeted reductions

Opponents of targeted estate and gift tax reductions argue that special treatment for certain types of assets creates serious inequities between taxpayers. It permits the heirs of one decedent to be better treated than heirs of other decedents simply because of the nature of the decedent's wealth. Moreover, opponents argue that, in many cases such as farm land, there has been true appreciation that exceeds the general rate of inflation. The problem with farms and closely held businesses is often a liquidity problem and it is argued that liquidity problems do not justify reductions in the estate tax.[5]

[5] The following summary of this argument was presented by Professor Michael Graetz of the University of Virginia School of Law in hearings before the Committee on Ways and Means on March 23, 1976:

". . . In recent years, the value of farmland has risen at a rate faster than the rate of increase of prices generally. While the wealth of large segments of the American people has been eroded by inflation, the wealth of farmers generally—in constant dollars—has increased.

* * * * * * *

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

Another argument against selective reductions is that they encourage wealthy individuals to buy the favored assets for estate tax purposes which could drive up the price of the asset. For example, special estate tax treatment of farmland could drive up its price and make it difficult for farmers to buy farmland.

## 5. Increases in Marital Deduction

Present law provides a limited marital deduction for estate and gift tax purposes for amounts passing between spouses. One of the issues to be raised at the hearing will be whether the existing limitations on the marital deduction should be increased or removed entirely.

The arguments for and against increases in the marital deduction can be summarized as follows:

### Arguments for increased marital deductions

Proponents of increased marital deductions argue that there should be no tax imposed on transfers between spouses since a husband and wife should be treated as a single economic unit for estate and gift tax purposes, as they generally are for income tax purposes. Moreover, since the adoption of the generation-skipping tax, the objectives of the estate and gift tax are considered met if the tax is imposed once each generation. An increased marital deduction would not allow generation skipping. Finally, proponents argue that an increased marital deduction would simplify significantly the taxation of jointly held property of a husband and wife.

### Arguments against increased marital deduction

Opponents of an increased marital deduction argue that the purpose of the marital deduction was to equate generally the tax treatment of property in common law states with community law states, and that increasing the marital deduction would not further that purpose. In addition, opponents argue that increasing the marital deduction may result in one spouse giving all his or her property to the other spouse which, under a progressive tax structure, may actually increase the total estate and gift taxes paid by the couple.

## 6. Increases in the Annual Gift Tax Exclusion

Present law allows an annual $3,000 per donee exclusion from the gift tax. In addition, spouses can consent to split their gifts so that a couple can give up to $6,000 per donee per year without gift tax. Another of the issues to be raised at the hearing are proposals to increase the annual gift tax inclusion.

The arguments for and against increasing the exclusion may be summarized as follows:

### Arguments for increased gift tax exclusion

Proponents of increasing the annual gift tax exclusion argue that inflation has substantially eroded the real value of the exemption since its value was last established in 1942. As a result, proponents argue that it is not possible to give a child an automobile or a college education without exceeding the annual exclusion.

### Arguments against increased gift tax exclusion

Opponents of an increase in the gift tax exclusion argue that this provision is used as a method of significantly reducing overall estate and gift taxes. They note that the intent of the exclusion was to exempt relatively small gifts, such as weddings, Christmas and birthday gifts from tax, but that practice has been to exclude these types of gifts in addition to the annual $3,000 amount. Any increase in the size of the exemption would allow substantial reduction in estate and gift tax liabilities because of the typical large number of family members as donees.[6] Moreover, if there is a general agreement that gifts of items such as automobiles and college educations should not be subject to tax, then an increased exclusion for consummable items would allow this result without allowing substantial avoidance of estate and gift taxes generally.

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[6] For example, assume that an elderly couple has three children, each of whom is married and each of whom has three children. In such a case, there would be 15 potential donees. If the annual exclusion were increased to $10,000 ($20,000 per couple), it would be possible for the couple to give away $300,000 per year without gift or estate tax.

## V. DESCRIPTION OF BILLS

### 1. S. 404—Senator Symms

### Repeal of Estate, Gift, and Generation-Skipping Taxes

***Present law***

Under present law, a gift tax is imposed on inter vivos transfers and an estate tax is imposed on death-time transfers. The rates of tax begin at 18 percent on the first $10,000 of transfers and reach 70 percent for transfers in excess of $5 million. Deductions are allowed for transfers to spouses (marital deduction) and to charities (charitable deduction). In addition, gift and estate taxes can be reduced by a unified credit of $47,000 (which permits the transfer of $175,625 free of gift or estate tax). In addition, present law imposes a generation-skipping tax on transfers if beneficiaries of more than one generation receive interests in the transfer.

***Explanation of the bill***

The bill would repeal the estate, gift, and generation-skipping transfer taxes. In addition to several conforming changes to other provisions of the Code, the bill also would provide that—

(1) Expenses of the decedent's last illness, paid within 1 year of the death, would be deductible under section 213 in computing the decedent's income tax for the year of his death as if they had been paid when incurred; and

(2) Section 303, which accords capital gains treatment for amounts received in redemptions of corporate stock to pay death taxes and administration expenses, would be repealed.

***Effective date***

The provisions of the bill would apply with respect to decedents dying after December 31, 1981, and to gifts made after that date.

***Revenue effect***

It is estimated that this bill would reduce budget receipts by $117 million in fiscal year 1982, by $8,480 million in fiscal year 1983, by $9,443 million in fiscal year 1984, and by $10,370 million in fiscal year 1985.

## 2. S. 858—Senator Durenberger

### Increase in Unified Estate and Gift Tax Credit, Current Use Valuation of Farms or Other Business Real Property, and Reduced Interest Rates on Extended Payments of Estate Taxes

#### a. Rate schedules and unified credit

***Present law***

Under present law, the estate and gift tax rates range from 18 percent on the first $10,000 in taxable transfers to 70 percent on taxable transfers in excess of $5 million. The estate or gift liability is computed by first computing the gross gift or estate tax (without any exemption) and then subtracting the unified credit to determine the amount of gift or estate tax. The amount of the unified credit is $47,000. With a unified credit of $47,000, there would be no estate or gift tax on transfers of up to $175,625.

***Explanation of provisions***

The bill would increase the unified credit for estate tax purposes to $192,800 beginning in 1982. The bill also would increase over a 4-year period the amount of the unified credit for gift tax purposes from $47,000 to $192,800. With a unified credit of $192,800, there would be no estate or gift tax on transfers aggregating approximately $600,000. The bill would make conforming changes to the estate tax filing return requirements. The bill does not alter the present rate schedule.

***Effective date***

These provisions of the bill would be effective for gifts made, and decedents dying, after December 31,1981.

#### b. Special valuation of farm or other business real property

***Present law***

If certain requirements are met, present law allows family farms and real property used in a closely held business to be included in a decedent's gross estate at current use value, rather than full fair market value, provided that the gross estate may not be reduced by more than $500,000 (Code sec. 2032A).

An estate may qualify for current use valuation if: (1) the decedent was a citizen or resident of the United States at his death; (2) the value of the farm or closely held business assets in the decedent's estate, including both real and personal property (but reduced by debts attributable to the real and personal property), is at least 50 percent of the decedent's gross estate (reduced by debts and expenses); (3) at least 25 percent of the adjusted value of the gross estate is qualified farm or closely held business real property; [1] (4) the

[1] For purposes of the 50 percent and 25 percent tests, the value of property is determined without regard to its current use value.

real property qualifying for current use valuation must pass to a qualified heir;[2] (5) such real property must have been owned by the decedent or a member of his family and used or held for use as a farm or closely held business ("a qualified use") for 5 of the last 8 years prior to the decedent's death; and (6) there must have been material participation in the operation of the farm or closely held business by the decedent or a member of his family in 5 years out of the 8 years immediately preceeding the decedent's death (Code secs. 2032A (a) and (b)).[3]

If, within 15 years after the death of the decedent (but before the death of the qualified heir), the property is disposed of to nonfamily members or ceases to be used for farming or other closely held business purposes, all or a portion of the Federal estate tax benefits obtained by virtue of the reduced valuation will be recaptured by means of a special "additional estate tax" imposed on the qualified heir.

*Explanation of provisions*

This provision would make several modifications to the rules relating to the current use valuation of farm and other business real property for estate tax purposes.

First, the bill would provide that the material participation requirement for qualification for current use valuation need only be met until the date upon which the decedent retires or becomes disabled.

Second, the bill would provide an "active management" qualification test, rather than a material participation test, with respect to farm or other business real property included in the gross estate if the property had been inherited from a spouse and had qualified for current use valuation in that spouse's estate. "Active management" is defined to mean the making of the management decisions of a business, other than the daily operating decisions.

Third, in the case of woodlands, the bill would provide that qualification for special valuation can be attained if the decedent or a member of his family is engaged in the "active management" of the woodlands for the 10-year period prior to his death.

Fourth, the period during which the benefits from reduced valuation could be recaptured would be reduced from 15 years to 10 years. The current rules applicable after the tenth year would be repealed.

Fifth, the bill would provide that recapture of the benefits from reduced valuation would not occur where an agent of the qualified heir engages in the active management of the property in the case of all farming property or where the qualified heir was a surviving spouse

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[2] The term "qualified heir" means a member of the decedent's family, including his spouse, lineal descendants, parents, and aunts or uncles of the decedent and their descendants.

[3] In the case of qualifying real property where the material participation requirement is satisfied, the real property which qualifies for current use valuation includes the farmhouse, or other residential buildings, and related improvements located on qualifying real property if such buildings are occupied on a regular basis by the owner or lessee of the real property (or by employees of the owner or lessee) for the purpose of operating or maintaining the real property or the business conducted on the property. Qualified real property also includes roads, buildings, and other structures and improvements functionally related to the qualified use.

of the decedent, a minor student or is disabled in the case of other property.

Sixth, the $500,000 limit on the reduction of the decedent's gross estate would be repealed. Consequently, the current use value, computed under section 2032A, would be substituted on the estate tax return for the full fair market value.

Seventh, the bill would expressly provide that an exchange pursuant to Code section 1031 of the qualified real property solely for real property to be used for the same qualified use as the original qualified real property would not trigger a recapture of the benefits from reduced valuation. If, however, the like-kind exchange under Code section 1031 were not entirely for qualified property, then a proportionate amount of the recapture tax would be payable.

Eighth, a qualified heir would not be required to make an election to secure the benefits of the special rules for involuntary conversions.

Ninth, the bill would provide that if there is no comparable land from which to determine the average annual gross cash rental, then the average net share rental could be substituted for the average gross cash rental in applying the formula valuation method. The net share rental would be (1) the value of the produce grown on the leased land received by the lessor, reduced by (2) the cash operating expenses of growing the produce that are paid, under the terms of the lease, by the lessor.

Finally, the bill would provide that, upon the recapture of the estate tax benefits, the basis of the property would be increased to its fair market value on the date of the decedent's death.[4]

### *Effective date*

Generally, these provisions would be effective for estates of decedents dying after December 31, 1981, except that the provision permitting cash rentals to family members would apply for all years after December 31, 1976.

## c. Reduced interest rates on extended payments of estate taxes

### *Present law*

Code section 6166, as added by the Tax Reform Act of 1976, provides a 15-year period for the payment of the estate tax attributable to a decedent's interest in a closely held business (including a farm). Under this provision, an executor may elect to defer principal payments for up to 5 years from the due date of the estate tax return. However, interest for the first 5 years is payable annually. Thereafter, pursuant to the executor's initial election, the principal amount of the estate tax liability may be paid in from 2 to 10 annual installments. A special 4-percent interest rate is allowed on the estate tax attributable to the first $1 million of closely held business property, and interest on amounts of estate tax in excess of this amount is at the regular rate for interest on deferred payments (currently 12 percent).

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[4] Technical modifications would be necessary to the bill to clarify that the basis is stepped up to its value as of the decedent's death and to insure that the current use value is not double counted in determining basis.

***Explanation of provision***

If the time for payment of the tax is extended under Code section 6166, a reduced rate of interest would apply to that amount of tax attributable to closely held property which is in excess of the amount eligible for the four-percent rate. Under the provision, the applicable interest rate would be the lesser of (1) six percent or (2) 90 percent of the statutory rate for interest on deferred payments.

***Effective date***

This provision would be applicable to the estates of decedents dying after December 31, 1981.

**d. Revenue effect of the bill**

It is estimated that this bill would reduce budget receipts by a negligible amount in fiscal years 1981 and 1982, by $4,362 million in fiscal year 1983, by $4,879 million in fiscal year 1984, and by $5,459 million in fiscal year 1985.

### 3. S. 395—Senators Wallop, Boren, Byrd (Va.), and others Reduction in Estate and Gift Tax Rates, Increase in Unified Credit, Unlimited Marital Deduction, Increase in Gift Tax Exclusion, Current Use Valuation of Farms and Other Business Real Property, and Other Modifications to the Estate and Gift Taxes

#### a. Rate schedules and unified credit

***Present law***

Under present law, the estate and gift tax rates range from 18 percent for the first $10,000 in taxable transfers to 70 percent on taxable transfers in excess of $5 million. The estate or gift tax liability is determined by first computing the gross gift or estate tax (without any exemption) and then subtracting the unified credit to determine the amount of gift or estate tax. The amount of the unified credit is $47,000. With a unified credit of $47,000, there is no estate or gift tax on transfers of up to $175,625.

Under present law, the statute of limitations on the value of a gift does not begin to run until a gift tax return is filed upon which tax is paid. Also, under present law, any unused unified credit must be used to reduce the gift tax payable. A donor cannot elect not to use a portion of the unified credit otherwise available. As a result, the statute of limitations on the value of gifts does not begin to run until the entire unified credit has been used.

***Explanation of provisions***

The bill would reduce the estate and gift tax rates and widen the applicable brackets so that rates would range from 10 percent on the first $25,000 in taxable transfers to 60 percent on taxable transfers in excess of $5 million.

The bill also would increase, over a 5-year period, the amount of the unified estate and gift tax credit from $47,000 to $124,750. With a unified credit of $124,750, there would be no estate or gift tax (under the revised rate schedule) on transfers aggregating $600,000. The bill would make conforming changes to the estate tax filing requirements.

The bill would allow the donor to elect to use any portion of the unified credit with respect to a particular gift. As a result, a donor could elect to pay some gift tax with respect to a particular gift and begin the running of the statute of limitations on its valuation.

***Effective date***

These provisions of the bill would be effective for gifts made, and decedents dying, after December 31, 1980.

### b. Marital deduction

#### *Present law*

Under present law, an unlimited gift tax marital deduction is allowed for transfers between spouses for the first $100,000 of gifts. Thereafter, a deduction is allowed for 50 percent of the interspousal lifetime transfers in excess of $200,000.

In addition, an estate tax marital deduction is allowed for the value of property passing from a decedent to the surviving spouse for the greater of $250,000 or one-half of the decedent's adjusted gross estate. This amount is adjusted by the excess of the amount of unlimited marital gift tax deduction over one-half of the lifetime gifts to the surviving spouse.

Under these provisions, transfers of community property or terminable interests generally do not qualify for either the gift or estate tax marital deduction.

#### *Explanation of provision*

The bill would provide an unlimited marital deduction for both estate and gift tax purposes. The bill would not change the present law rule that transfers of terminable interests do not qualify for the marital deduction.

#### *Effective date*

This provision would be effective for decedents dying after December 31, 1981, in the case of the estate tax marital deduction, and for gifts made after December 31, 1981, in the case of the gift tax marital deduction.

### c. Gift tax exclusion

#### *Present law*

Under present law, an annual exclusion of $3,000 per donee[1] is allowed with respect to gifts of present interests in property (Code sec. 2503(b)).

A gift made by a husband or wife may, with the consent of both, be treated for gift tax purposes as made one-half by each (Code sec. 2513). The full annual exclusion is allowed with respect to each spouse's one-half share of gifts of present interests in property. Thus, in these cases, a donor may make up to $6,000 in excludible transfers to a donee during a calendar year.

#### *Explanation of provision*

The provision would increase the gift tax annual exclusion to $10,000 per donee.

#### *Effective date*

This provision of the bill would be effective for gifts made after December 31, 1981.

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[1] The annual exclusion has been $3,000 since January 1, 1943. When the gift tax was first enacted under the Revenue Act of 1932, the amount of the annual exclusion was $5,000. The annual exclusion was reduced to $4,000 in 1938 and then was reduced further to its present $3,000 amount under the Revenue Act of 1942.

### d. Current use valuation of farm or other business real property

#### *Present law*

If certain requirements are met, present law allows family farms and real property used in a closely held business to be included in a decedent's gross estate at current use value, rather than full fair market value, provided that the gross estate may not be reduced by more than $500,000 (Code sec. 2032A).

An estate may qualify for current use valuation if: (1) the decedent was a citizen or resident of the United States at his death; (2) the value of the farm or closely held business assets in the decedent's estate including both real and personal property (but reduced by debts attributable to the real and personal property), is at least 50 percent of the decedent's gross estate (reduced by debts and expenses); (3) at least 25 percent of the adjusted value of the gross estate is qualified farm or closely held business real property;[2] (4) the real property qualifying for current use valuation must pass to a qualified heir;[3] (5) such real property must have been owned by the decedent or a member of his family and used or held for use as a farm or closely held business ("a qualified use") for 5 of the last 8 years prior to the decedent's death; and (6) there must have been material participation in the operation of the farm or closely held business by the decedent or a member of his family in 5 years out of the 8 years immediately preceding the decedent's death (Code secs. 2032A (a) and (b)).[4]

If, within 15 years after the death of the decedent (but before the death of the qualified heir), the property is disposed of to nonfamily members or ceases to be used for farming or other closely held business purposes, all or a portion of the Federal estate tax benefits obtained by virtue of the reduced valuation will be recaptured by means of a special "additional estate tax" imposed on the qualified heir.

#### *Explanation of provisions*

This provision would make several modifications to the rules relating to the current use valuation of farm and other business real property for estate tax purposes.

First, the bill would provide that the material participation requirement for qualification for current use valuation need only be met until the date upon which the decedent retires or becomes disabled. In addition, the required trade or business use could be that of the decedent or a member of the decedent's family.

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[2] For purposes of the 50 percent and 25 percent tests, the value of property is determined without regard to its current use value.

[3] The term "qualified heir" means a member of the decedent's family, including his spouse, lineal descendants, parents, and aunts or uncles of the decedent and their descendants.

[4] In the case of qualifying real property where the material participation requirement is satisfied, the real property which qualifies for current use valuation includes the farmhouse, or other residential buildings, and related improvements located on qualifying real property if such buildings are occupied on a regular basis by the owner or lessee of the real property (or by employees of the owner or lessee) for the purpose of operating or maintaining the real property or the business conducted on the property. Qualified real property also includes roads, buildings, and other structures and improvements functionally related to the qualified use.

Second, the bill would provide an "active management" qualification test, rather than a material participation test, with respect to farm or other business real property included in the gross estate if the property had been inherited from a spouse and had qualified for current use valuation in that spouse's estate. "Active management" is defined to mean the making of the management decisions of a business, other than the daily operating decisions.

Third, in the case of woodlands, the bill would provide that qualification for special valuation can be attained if the decedent or a member of his family is engaged in the "active management" of the woodlands for the 10-year period prior to his death.

Fourth, the period during which the benefits from reduced valuation could be recaptured would be reduced from 15 years to 10 years. The current rules applicable after the tenth year would be repealed.

Fifth, the bill would provide that recapture of the benefits from reduced valuation would not occur where an agent of the qualified heir engages in the active management of the property in the case of all farming property or where the qualified heir was a surviving spouse of the decedent, a minor, a student or is disabled in the case of other property.

Sixth, the $500,000 limit on the reduction of the decedent's gross estate would be repealed. Consequently, the current use value, computed under Code section 2032A, would be substituted on the estate tax return for the full fair market value.

Seventh, the bill would expressly provide that an exchange pursuant to Code section 1031 of the qualified real property solely for real property to be used for the same qualified use as the original qualified real property would not trigger a recapture of the benefits from reduced valuation. If, however, the like-kind exchange under Code section 1031 were not entirely for qualified property, then a proportionate amount of the recapture tax would be payable.

Eighth, a qualified heir would not be required to make an election to secure the benefits of the special rules for involuntary conversions.

Ninth, the bill would provide that, instead of using gross cash rentals from actual tracts of comparable land, the gross rental value of comparable land could be used in applying the formula valuation method. This change would allow the use of crop share rentals.

Finally, the bill would provide that, upon the recapture of the estate tax benefits, the basis of the property would be increased to its fair market value on the date of the decedent's death.[5]

### *Effective date*

This provision would be effective for estates of decedents dying after December 31, 1981.

## e. Coordination of provisions permitting deferred payment of estate tax where estate consists largely of interests in closely held business

### *Present law*

Under present law, two overlapping provisions permit deferred payment of estate taxes attributable to interests in closely held busi-

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[5] Technical modifications would be necessary to the bill to clarify that the basis is stepped up to its value as of the decedent's death and to insure that the current use value is not double counted in determining basis.

nesses. If the value of the closely held business (reduced by allowable expenses, losses, and indebtedness) exceeds 65 percent of the value of the gross estate, the applicable estate taxes may be deferred up to 15 years (annual interest payments for five years, followed by up to ten annual installments of principal and interest) (Code sec. 6166). If the value of the closely held business exceeds either 35 percent of the gross estate or 50 percent of the taxable estate, the applicable taxes may be paid in up to ten annual installments (Code sec. 6166A). Under both provisions, all payments are accelerated if there is a failure to timely pay any installment, or if there is a disposition of a specified fraction of the value of decedent's interest in the business. This fraction is one-third in the case of Code section 6166 and one-half in the case of Code section 6166A.

Under current income tax law, if more than 50 percent of the gross estate (reduced by allowable expenses, losses, and indebtedness) consists of stock in a single corporation, redemption of all or portion of that stock to pay estate taxes, funeral and administration expenses, will be treated as capital gain instead of dividend income.

*Explanation of provision*

Under the bill, Code section 6166A would be repealed and the provision of present law allowing for the payment of estate taxes over a 15-year period would be expanded to include all estates in which the value of a closely held business (or businesses) included in the decedent's estate exceeds 35 percent of the value of the gross estate or 50 percent of the taxable estate. Also, the provision relating to the qualified redemption of stock to pay the estate tax would apply if the value of the closely held business met the same test.

The bill would also permit the disposition of up to 50 percent of the business interest before accelerating payments.

*Effective date*

This provision would be effective for estates of decedents dying after December 31, 1980.

**f. Estate tax treatment of transfers made within three years of death**

*Present law*

Under present law, transfers made by a decedent within three years of death are included in the decedent's gross estate without regard to whether the gifts were actually made in contemplation of death. However, an exception to this rule applies for transfers of property (other than a transfer with respect to a life insurance policy) where no gift tax return was required to be filed with respect to the gift.

When a gift made within three years of the decedent's death is required to be included in the decedent's gross estate, it is valued at the time of the decedent's death. However, a credit is allowed against the estate tax for any gift tax paid by the decedent on the gift. Generally, the net effect of these two rules is to include in the gross estate the appreciation in value of the property from the date of the gift until the date of death.

*Explanation of provision*

The bill would provide that the value of gifts which are includible in the gross estate by reason of being made within three years of death

is to be their value on the date of gift instead of their value at the date of death. The estate will continue to receive a credit for any gift taxes imposed on the gift. Thus, the net effect of the bill would be to subject the gift to the gift tax at its value at the time of gift and to exclude any appreciation in value from the date of gift to the date of death from the estate tax.

*Effective date*

This provision would be applicable to the estates of decedents dying after December 31, 1980.

**g. Disclaimers**

*Present law*

Under present law, in the case of a qualified disclaimer by a donee or heir, the donee or heir is not deemed to have made a gift. A disclaimer is qualified, for purposes of the Federal estate law, if among other criteria, the disclaimer is effective under local law to divest the disclaimant of ownership (Code sec. 2518).

*Explanation of provision*

Under the bill, a disclaimer that is not effective to pass title under local law would still be considered a qualified disclaimer for estate and gift tax purposes if the disclaimant timely transfers the property interest to the person who would have received the property had the disclaimant predeceased the original holder.

*Effective date*

The provision would be effective with respect to transfers made after December 31, 1980.

**h. Revenue effect of the bill**

It is estimated that the provisions of the bill would reduce budget receipts for fiscal years 1981–1985 as follows:

[In millions of dollars]

| Item | Fiscal year— 1981 | 1982 | 1983 | 1984 | 1985 |
|---|---|---|---|---|---|
| Unified credit and rate schedule | (1) | 2,490 | 4,072 | 5,052 | 5,949 |
| Unlimited marital deduction [2] | | | 100 | 100 | 100 |
| $10,000 gift exclusion [2] | | (1) | 50 | 50 | 50 |
| Changes in current use valuation [2] | | 300 | 300 | 300 | 300 |
| Other miscellaneous provisions [2] | (1) | 50 | 50 | 50 | 50 |
| Total revenue effect of the bill | (1) | 2,840 | 4,572 | 5,552 | 6,449 |

[1] Less than $50 million.
[2] Additional revenue loss after unified credit and new rate schedule are in place.

## 4. S. 574—Senator Kassebaum

### Estate Tax Deduction for Transfers of Qualified Tangible Property to Decedent's Spouse and Certain Other Heirs

***Present law***

*Current use valuation*

If certain requirements are met, present law allows family farms and real property used in a closely held business to be included in a decedent's gross estate at its current use value, rather than full fair market value, provided that the gross estate may not be reduced by more than $500,000 (Code sec. 2032A).

An estate may qualify for current use valuation if: (1) the decedent was a citizen or resident of the United States at his death; (2) the value of the farm or closely held business assets in the decedent's estate, including both real and personal property (but reduced by debts attributable to the real and personal property), is at least 50 percent of the decedent's gross estate (reduced by debts and expenses); (3) at least 25 percent of the adjusted value of the gross estate is qualified farm or closely held business real property;[1] (4) the real property qualifying for current use valuation must pass to a qualified heir;[2] (5) such real property must have been owned by the decedent or a member of his family and used or held for use as a farm or closely-held business ("a qualified use") for 5 of the last 8 years prior to the decedent's death; and (6) there must have been material participation in the operation of the farm or closely held business by the decedent or a member of his family in 5 years out of the 8 years immediately preceding the decedent's death (Code secs. 2032A (a) and (b)).[3]

If, within 15 years after the death of the decedent (but before the death of the qualified heir), the property is disposed of to nonfamily members or ceases to be used for farming or other closely held business purposes, all or a portion of the Federal estate tax benefits obtained by virtue of the reduced valuation will be recaptured by means of a special "additional estate tax" imposed on the qualified heir.

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[1] For purposes of the 50 percent and 25 percent tests, the value of property is determined without regard to its current use value.

[2] The term "qualified heir" means a member of the decedent's family, including his spouse, lineal descendants, parents, and aunts or uncles of the decedent and their descendants.

[3] In the case of qualifying real property where the material participation requirement is satisfied, the real property which qualifies for current use valuation includes the farmhouse, or other residential buildings, and related improvements located on qualifying real property if such buildings are occupied on a regular basis by the owner or lessee of the real property (or by employees of the owner or lessee) for the purpose of operating or maintaining the real property or the business conducted on the property. Qualified real property also includes roads, buildings, and other structures and improvements functionally related to the qualified use.



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*Marital deduction*

Under present law, an unlimited gift tax marital deduction is allowed for transfers between spouses for the first $100,000 of gifts. Thereafter, a deduction is allowed for 50 percent of the interspousal lifetime transfers in excess of $200,000.

In addition, an estate tax marital deduction is allowed for the value of property passing from a decedent to the surviving spouse for the greater of $250,000 or one-half of the decedent's adjusted gross estate. This amount is adjusted by the excess of the amount of unlimited marital gift tax deduction over one-half of the lifetime gifts to the surviving spouse.

***Explanation of the bill***

Under the bill, an estate tax deduction would be allowed for the amount of qualified tangible property passing to the decedent's spouse or other qualified heirs. The deduction would be limited to the sum of (1) $750,000 with respect to qualified tangible property passing to the decedent's spouse, and (2) $750,000 with respect to all qualified tangible property passing to qualified heirs other than the decedent's spouse.

Qualified tangible property would be defined as all tangible property (other than cash) located in the United States which, on the date of death, was being used for a qualified use, provided that at least 50 percent of the gross estate consists of the adjusted value of such property which (1) was being used for a qualified use on the date of death, and (2) passed from the decedent to a qualified heir. In addition, to the extent that an interest in intangible property represents an interest in qualified tangible property which is real property, the intangible interest would be treated as an interest in qualified tangible property.

Definitions of "qualified use," "qualified heir," and "adjusted value" would be determined pursuant to Code section 2032A (which deals with current use valuation). The tax treatment of such property upon involuntary conversion, disposition, and recapture, also would be determined pursuant to Code section 2032A, except that the amount of the recapture would be reduced on a monthly basis if the recapture occurs after five years.

This deduction would supplement benefits available under present law through current use valuation and marital deductions, but only to the extent that the interest in qualified tangible property is included in determining the value of the gross estate and is not otherwise deductible under present law.

***Effective date***

The provisions of the bill would be effective with respect to the estates of decedents dying after December 31, 1980.

***Revenue effect***

It is estimated that this bill would reduce budget receipts by $140 million in fiscal year 1982, by $156 million in fiscal year 1983, by $174 million in fiscal year 1984 and by $194 million in fiscal year 1985.

97TH CONGRESS
1ST SESSION

# S. 395

To amend the Internal Revenue Code of 1954 to provide estate and gift tax equity for family enterprises, and for other purposes.

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IN THE SENATE OF THE UNITED STATES

FEBRUARY 5 (legislative day, JANUARY 5), 1981

Mr. WALLOP (for himself, Mr. BOREN, Mr. HARRY F. BYRD, JR., Mr. PERCY, Mr. HELMS, Mr. DOMENICI, Mr. SYMMS, Mr. BAUCUS, Mr. TOWER, Mr. HEFLIN, Mr. BENTSEN, Mr. HAYAKAWA, Mr. PRYOR, Mr. LUGAR, Mr. ANDREWS, Mr. DURENBERGER, Mr. THURMOND, Mr. ZORINSKY, Mr. MATHIAS, Mr. NICKLES, Mr. BURDICK, Mr. ABDNOR, and Mr. MATSUNAGA) introduced the following bill; which was read twice and referred to the Committee on Finance

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# A BILL

To amend the Internal Revenue Code of 1954 to provide estate and gift tax equity for family enterprises, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 **SECTION 1. SHORT TITLE; AMENDMENT OF 1954 CODE.**
4 (a) SHORT TITLE.—This Act may be cited as the
5 "Family Enterprise Estate and Gift Tax Equity Act".

1 (b) AMENDMENT OF 1954 CODE.—Except as otherwise
2 expressly provided, whenever in this Act an amendment or
3 repeal is expressed in terms of an amendment to, or repeal of,
4 a section or other provision, the reference shall be considered
5 to be made to a section or other provision of the Internal
6 Revenue Code of 1954.

7 **SEC. 2. CHANGES IN RATE SCHEDULES.**

8 (a) IN GENERAL.—Subsection (c) of section 2001 (relat-
9 ing to the rate schedule) is amended by striking out the table
10 contained therein and inserting in lieu thereof the following
11 new table:

| "If the amount with respect to which the tentative tax to be computed is: | The tentative tax is: |
|---|---|
| Not over $25,000 | 10 percent of such amount. |
| Over $25,000 but not over $50,000 | $2,500, plus 15 percent of the excess of such amount over $25,000. |
| Over $50,000 but not over $125,000 | $6,250, plus 18 percent of the excess of such amount over $50,000. |
| Over $125,000 but not over $250,000 | $19,750, plus 20 percent of the excess of such amount over $125,000. |
| Over $250,000 but not over $500,000 | $44,750, plus 22 percent of the excess of such amount over $250,000. |
| Over $500,000 but not over $750,000 | $99,750, plus 25 percent of the excess of such amount over $500,000. |
| Over $750,000 but not over $1,000,000. | $162,250, plus 28 percent of the excess of such amount over $750,000. |
| Over $1,000,000 but not over $1,250,000. | $232,250, plus 31 percent of the excess of such amount over $1,000,000. |
| Over $1,250,000 but not over $1,500,000. | $309,750, plus 33 percent of the excess of such amount over $1,250,000. |
| Over $1,500,000 but not over $2,000,000. | $392,250, plus 35 percent of the excess of such amount over $1,500,000. |
| Over $2,000,000 but not over $2,500,000. | $567,250, plus 39 percent of the excess of such amount over $2,000,000. |

| "If the amount with respect to which the tentative tax to be computed is: | The tentative tax is: |
|---|---|
| Over $2,500,000 but not over $3,000,000. | $762,250, plus 43 percent of the excess of such amount over $2,500,000. |
| Over $3,000,000 but not over $3,500,000. | $977,250, plus 47 percent of the excess of such amount over $3,000,000. |
| Over $3,500,000 but not over $4,000,000. | $1,212,250, plus 51 percent of the excess of such amount over $3,500,000. |
| Over $4,000,000 but not over $4,500,000. | $1,467,250, plus 55 percent of the excess of such amount over $4,000,000. |
| Over $4,500,000 but not over $5,000,000. | $1,742,250, plus 59 percent of the excess of such amount over $4,500,000. |
| Over $5,000,000 | $2,037,250, plus 60 percent of the excess of such amount over $5,000,000.". |

1 (b) EFFECTIVE DATE.—The amendments made by this
2 section shall apply to estates of decedents dying after Decem-
3 ber 31, 1980.

4 SEC. 3. INCREASE IN UNIFIED CREDIT.

5 (a) CREDIT AGAINST ESTATE TAX.—

6 (1) IN GENERAL.—Subsection (a) of section 2010
7 (relating to unified credit against estate tax) is amend-
8 ed by striking out "$47,000" and inserting in lieu
9 thereof "$124,750".

10 (2) CONFORMING AMENDMENTS.—

11 (A) Subsection (b) of section 2010 is amend-
12 ed to read as follows:

13 "(b) PHASE-IN OF CREDIT.—

| "In the case of decedents dying in: | "Subsection (a) shall be applied by substituting for '$124,750' the following amount: |
|---|---|
| 1981 | $29,750 |
| 1982 | 55,750 |
| 1983 | 77,750 |
| 1984 | 99,750.". |

1 (B) Subsection (a) of section 6018 (relating
2 to estate tax returns by executors) is amended—
3 (i) by striking out "$175,000" in para-
4 graph (1) and inserting in lieu thereof
5 "$600,000"; and
6 (ii) by striking out paragraph (3) and in-
7 serting in lieu thereof the following:
8 "(3) PHASE-IN OF FILING REQUIREMENT
9 AMOUNT.—

| "In the case of decedents dying in: | "Paragraph (1) shall be applied by substituting for '$600,000' the following amount: |
|---|---|
| 1981 | $175,000 |
| 1982 | 300,000 |
| 1983 | 400,000 |
| 1984 | 500,000.". |

10 (b) CREDIT AGAINST GIFT TAX.—
11 (1) IN GENERAL.—Paragraph (1) of section
12 2505(a) (relating to unified credit against gift tax) is
13 amended by striking out "$47,000" and inserting in
14 lieu thereof "$124,750".
15 (2) CONFORMING AMENDMENT.—Subsection (b)
16 of section 2505 is amended to read as follows:

1 "(b) PHASE-IN OF CREDIT.—

| "In the case of gifts made in: | "Subsection (a) shall be applied by substituting for '$124,750' the following amount: |
|---|---|
| 1981 | $29,750 |
| 1982 | 55,750 |
| 1983 | 77,750 |
| 1984 | 99,750.". |

2 (c) EFFECTIVE DATES.—The amendments made—

3 (1) by subsection (a) shall apply to the estates of

4 decedents dying after December 31, 1980, and

5 (2) by subsection (b) shall apply to gifts made

6 after such date.

7 **SEC. 4. UNLIMITED MARITAL DEDUCTION.**

8 (a) ESTATE TAX DEDUCTION.—

9 (1) IN GENERAL.—Section 2056 (relating to be-

10 quests, etc. to surviving spouses) is amended—

11 (A) by striking out subsection (c) and redes-

12 ignating subsection (d) as subsection (c); and

13 (B) by striking out "subsections (b) and (c)"

14 in subsection (a) and inserting in lieu thereof

15 "subsection (b)".

16 (2) CONFORMING AMENDMENT.—Paragraph (3) of

17 section 2057(e) (defining property passing from a dece-

18 dent) is amended by striking out "2056(d)" and insert-

19 ing in lieu thereof "2056(c)".

20 (b) GIFT TAX DEDUCTION.—

1 (1) IN GENERAL.—Subsection (a) of section 2523
2 (relating to gift to spouse) is amended to read as fol-
3 lows:
4 "(a) ALLOWANCE OF DEDUCTION.—Where a donor
5 who is a citizen or resident transfers during the calendar
6 quarter by gift an interest in property to a donee who at the
7 time of the gift is the donor's spouse, there shall be allowed
8 as a deduction in computing taxable gifts for the calendar
9 quarter an amount with respect to such interest equal to its
10 value.".
11 (2) TECHNICAL AMENDMENT.—Section 2523 is
12 amended by striking out subsection (f).
13 (c) EFFECTIVE DATES.—The amendments made—
14 (1) by subsection (a) shall apply to the estates of
15 decedents dying after December 31, 1981, and
16 (2) by subsection (b) shall apply to gifts made
17 after such date.
18 **SEC. 5. INCREASE IN ANNUAL GIFT TAX EXCLUSION.**
19 (a) IN GENERAL.—Subsection (b) of section 2503 (relat-
20 ing to exclusions from gifts) is amended by striking out
21 "$3,000" and inserting in lieu thereof "$10,000".
22 (b) EFFECTIVE DATE.—The amendment made by this
23 section shall apply to gifts made after December 31, 1981.

1 SEC. 6. VALUATION OF CERTAIN FARM, ETC., REAL
2 PROPERTY.
3 (a) DEFINITION OF QUALIFIED REAL PROPERTY.—
4 Subsection (b) of section 2032A (defining qualified real prop-
5 erty) is amended—
6 (1) by inserting "by the decedent or a member of
7 the decedent's family" after "qualified use" each place
8 it appears in paragraph (1), and
9 (2) by adding at the end thereof the following new
10 paragraphs:
11 "(4) RETIRED AND DISABLED DECEDENTS.—
12 "(A) IN GENERAL.—If, on the date of death
13 of the decedent, the decedent did not otherwise
14 meet the requirements of paragraph (1)(C) with
15 respect to any property, and the decedent—
16 "(i) was eligible to receive old-age
17 benefits under title II of the Social Security
18 Act, or
19 "(ii) was disabled for a continuous
20 period ending on such date,
21 then paragraph (1)(C) shall be applied by substi-
22 tuting 'the date on which the decedent became
23 eligible to receive old-age benefits under title II of
24 the Social Security Act or became disabled' for
25 'the date of the decedent's death'.

1 "(B) DISABLED DEFINED.—For purposes of
2 subparagraph (A), an individual shall be disabled
3 if such individual has a mental or physical impair-
4 ment which renders him unable to materially par-
5 ticipate in the operation of the farm or other busi-
6 ness.
7 "(5) SPECIAL RULE FOR SPOUSES WHO ARE
8 QUALIFIED HEIRS.—In the case of any qualified real
9 property which was acquired by a qualified heir who is
10 the spouse of the decedent and which does not other-
11 wise meet the requirements of paragraph (1)(C) upon
12 the death of such spouse, such real property shall be
13 treated as meeting the requirements of paragraph
14 (1)(C) if such spouse was engaged in the active man-
15 agement of the operation of the business at all times
16 during—
17 "(A) the 10-year period ending on the date
18 of death of the spouse, or
19 "(B) the period beginning on the date of
20 death of the decedent and ending on the date of
21 death of the spouse.
22 "(6) SPECIAL RULE FOR CERTAIN WOOD-
23 LANDS.—In the case of real property used for a farm-
24 ing purpose described in subparagraph (C) of subsection
25 (e)(5) which does not otherwise meet the requirements

1 of subparagraph (A), (B), or (C) of paragraph (1), such
2 real property shall be treated as meeting the require-
3 ments of any such subparagraph if, at all times during
4 the 10-year period ending on the date of the decedent's
5 death, such real property was owned by the decedent
6 or a member of the decedent's family and used for such
7 farming purpose.".

8 (b) DISPOSITIONS AND FAILURES TO USE FOR QUALI-
9 FIED USE.—

10 (1) 10-YEAR HOLDING PERIOD.—

11 (A) IN GENERAL.—Subsection (c) of section
12 2032A (relating to tax treatment of dispositions
13 and failures to use for qualified use) is amended—

14 (i) by striking out "15 years" in para-
15 graph (1) and inserting in lieu thereof "10
16 years", and

17 (ii) by striking out paragraph (3) and re-
18 designating paragraphs (4) through (7) as
19 paragraphs (3) through (6).

20 (B) CONFORMING AMENDMENTS.—Para-
21 graph (2) of section 2032A(h) (relating to treat-
22 ment of replaced property) is amended—

23 (i) by striking out in subparagraph (A)
24 all that follows "involuntarily converted,"
25 and inserting in lieu thereof the following:

1 "except that with respect to such qualified
2 replacement property the 10-year period
3 under paragraph (1) of subsection (c) shall be
4 extended by any period, beyond the 2-year
5 period referred to in section 1033(a)(2)(B)(i),
6 during which the qualified heir was allowed
7 to replace the qualified real property,", and
8 (ii) by striking out "(7)" in subpara-
9 graph (C) and inserting in lieu thereof "(6)".
10 (2) CESSATION OF QUALIFIED USE.—
11 (A) IN GENERAL.—Paragraph (6) of section
12 2032A(c) (defining cessation of qualified use), as
13 redesignated by paragraph (1), is amended to read
14 as follows:
15 "(6) CESSATION OF QUALIFIED USE.—For pur-
16 poses of paragraph (1)(B)—
17 "(A) IN GENERAL.—Real property shall
18 cease to be used for the qualified use if—
19 "(i) such property ceases to be used for
20 the qualified use set forth in subparagraph
21 (A) or (B) of subsection (b)(2) under which
22 the property qualified under subsection (b), or
23 "(ii) except as provided in subparagraph
24 (B) or (C), during any period of 8 years
25 ending after the date of the decedent's death

1 and before the date of the death of the quali-
2 fied heir, there had been periods aggregating
3 3 years or more during which—
4 "(I) in the case of periods during
5 which the property was held by the de-
6 cedent (other than periods during which
7 the decedent was an individual de-
8 scribed in subsection (b)(4)(A)(i) or (ii)),
9 there was no material participation by
10 the decedent or any member of the
11 family in the operation of the farm or
12 other business, and
13 "(II) in the case of periods during
14 which the property was held by any
15 qualified heir, there was no material
16 participation by such qualified heir or
17 any member of his family in the oper-
18 ation of the farm or other business.
19 "(B) 10-YEAR ACTIVE MANAGEMENT.—If
20 an eligible qualified heir elects, at such time and
21 in such manner as the Secretary may prescribe, to
22 have the provisions of this subparagraph apply to
23 any real property—

1 "(i) the provisions of clause (ii) of sub-
2 paragraph (A) shall not apply to such proper-
3 ty, and
4 "(ii) such property shall cease to be
5 used for the qualified use if the fiduciary or
6 the eligible qualified heir or any member of
7 his family did not take part in the active
8 management of the farm or other business at
9 all times during the period beginning on the
10 date of death of the decedent and ending on
11 the earlier of—
12 "(I) the date of death of the quali-
13 fied heir, or
14 "(II) the date which is 10 years
15 from date of death of the decedent.
16 "(C) SPECIAL RULE FOR WOODLANDS.—
17 The provisions of clause (ii) of subparagraph (A)
18 shall not apply in the case of real property with
19 respect to which the qualified use under which the
20 property qualified under subsection (b) was used
21 for a farming purpose described in subparagraph
22 (C) of subsection (e)(5).
23 "(D) ELIGIBLE QUALIFIED HEIR.—For pur-
24 poses of this paragraph, the term 'eligible quali-

1 fied heir' means a qualified heir who, on the date
2 of death of the decedent—
3 "(i) is the spouse of the decedent,
4 "(ii) has not attained the age of 21,
5 "(iii) is a student described in subpara-
6 graph (A) or (B) of section 151(e)(4), or
7 "(iv) was disabled (within the meaning
8 of subsection (b)(4)(B)) for a continuous
9 period ending on such date.".
10 (B) CONFORMING AMENDMENT.—Subsection
11 (e) of section 2032A (relating to definitions and
12 special rules) is amended by adding at the end
13 thereof the following new paragraph:
14 "(12) ACTIVE MANAGEMENT.—The term 'active
15 management' means the making of the management
16 decisions of a business (other than the daily operating
17 decisions).".
18 (c) REPEAL OF $500,000 LIMITATION.—Subsection (a)
19 of section 2032A (relating to value based on use under which
20 property qualifies) is amended to read as follows:
21 "(a) VALUE BASED ON USE UNDER WHICH PROP-
22 ERTY QUALIFIES.—If—
23 "(1) the decedent was (at the time of his death) a
24 citizen or resident of the United States; and

1 "(2) the executor elects the application of this
2 section and files the agreement referred to in subsec-
3 tion (d)(2),
4 then, for purposes of this chapter, the value of qualified real
5 property shall be its value for the use under which it quali-
6 fies, under subsection (b), as qualified real property.".
7 (d) EXCHANGE OF QUALIFIED REAL PROPERTY.—
8 (1) IN GENERAL.—Section 2032A (relating to
9 valuation of certain farm, etc., real property) is amend-
10 ed by adding at the end thereof the following new sub-
11 section:
12 "(i) EXCHANGES OF QUALIFIED REAL PROPERTY.—
13 "(1) TREATMENT OF PROPERTY EXCHANGED.—
14 "(A) IN GENERAL.—If an interest in quali-
15 fied real property is exchanged—
16 "(i) no tax shall be imposed by subsec-
17 tion (c) on such exchange if the interest in
18 qualified real property is exchanged solely
19 for an interest in qualified exchange property
20 in a transaction which qualifies under section
21 1031(a), or
22 "(ii) if clause (i) does not apply, the
23 amount of the tax imposed by subsection (c)
24 on such exchange shall be the amount deter-
25 mined under subparagraph (B).

1 "(B) AMOUNT OF TAX WHERE PROPERTY
2 RECEIVED IS NOT SOLELY AN INTEREST IN
3 QUALIFIED EXCHANGE PROPERTY.—The amount
4 determined under this subparagraph with respect
5 to any exchange is the amount of tax which (but
6 for this subsection) would have been imposed on
7 such exchange reduced by an amount equal to
8 that portion of such tax which is attributable to
9 the amount of the interest in qualified exchange
10 property received by the taxpayer.
11 "(2) TREATMENT OF QUALIFIED EXCHANGE
12 PROPERTY.—For purposes of subsection (c)—
13 "(A) any interest in qualified exchange prop-
14 erty shall be treated in the same manner as if it
15 were a portion of the interest in qualified real
16 property which was exchanged, and
17 "(B) any tax imposed by subsection (c) on
18 the exchange shall be treated as a tax imposed on
19 a partial disposition.
20 "(3) QUALIFIED EXCHANGE PROPERTY.—For
21 purposes of this subsection, the term 'qualified ex-
22 change property' means real property which is to be
23 used for the qualified use set forth in subparagraph (A)
24 or (B) of subsection (b)(2) under which the real prop-

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1 erty exchanged therefor originally qualified under sub-
2 section (a).".
3 (2) CONFORMING AMENDMENTS.—
4 (A) Paragraph (1) of section 2032A(f) (relat-
5 ing to statute of limitations) is amended—
6 (i) by inserting "or exchange" after
7 "conversion",
8 (ii) by inserting "or (i)" after "(h)", and
9 (iii) by inserting "or of the exchange of
10 property" after "replace".
11 (B) Paragraph (2) of section 6324B(c) (relat-
12 ing to special liens) is amended by inserting "and
13 qualified exchange property (within the meaning
14 of section 2032A(i)(3))" before the period at the
15 end thereof.
16 (e) ELECTIÓN REQUIREMENT OF SPECIAL RULES
17 FOR INVOLUNTARY CONVERSIONS REPEALED.—Section
18 2032A(h) (relating to special rules for involuntary conver-
19 sions of qualified real property) is amended—
20 (1) by striking out "and the qualified heir makes
21 an election under this subsection" in paragraph (1)(A);
22 and
23 (2) by striking out paragraph (5).

1 (f) METHOD OF VALUING FARMS.—Paragraph (7) of
2 section 2032A(e) of the Internal Revenue Code of 1954 is
3 amended to read as follows:
4 "(7) METHOD OF VALUING FARMS.—
5 "(A) IN GENERAL.—Unless the executor
6 elects to have the value of the farm for farming
7 purposes determined under paragraph (8), the
8 value of a farm for farming purposes shall be de-
9 termined by dividing—
10 "(i) the excess of the amount of the
11 average annual gross rental value of the
12 qualified real property used for farming pur-
13 poses over the amount of the average annual
14 State and local real estate taxes for such
15 qualified real property, by
16 "(ii) the average annual effective inter-
17 est rate for all new Federal Land Bank
18 loans.
19 For purposes of the preceding sentence, each
20 average annual computation shall be made on the
21 basis of the 5 most recent calendar years ending
22 before the date of the decedent's death.
23 "(B) APPLICATION.—Unless the executor so
24 elects otherwise, subparagraph (A) shall apply re-
25 gardless of whether the qualified real property or

1 any portion thereof has in fact been rented or
2 whether such qualified real property has been
3 rented on a cash, crop shares, or other basis.".
4 (g) BASIS UPON RECAPTURE.—Paragraph (3) of sec-
5 tion 1014(a) (relating to basis of property acquired from a
6 decedent) is amended by inserting "(increased by the value of
7 any interest in such property (determined for purposes of this
8 chapter without regard to this section) with respect to which
9 an additional estate tax is imposed under section
10 2032A(C)(1))" after "section".
11 (h) EFFECTIVE DATE.—The amendments made by this
12 section shall apply to the estates of decedents dying after
13 December 31, 1981.
14 SEC. 7. ESTATE TAX TREATMENT OF TRANSFERS MADE
15 WITHIN 3 YEARS OF DECEDENT'S DEATH.
16 (a) IN GENERAL.—Section 2035 (relating to adjust-
17 ments for gifts made within 3 years of decedent's death) is
18 amended by adding the following new subsection at the end
19 thereof:
20 "(d) VALUATION OF GIFTS.—For purposes of subsec-
21 tion (a), the value of property included in the gross estate by
22 reason of subsection (a) shall be the value of such property at
23 the time of its transfer. The preceding sentence shall not
24 apply to a transfer of an interest in property which is in-
25 cluded in the value of the gross estate under section 2036,

1 2037, 2038, 2041, or 2042 or would have been included
2 under any of such sections if such interest had been retained
3 by the decedent.".
4 (b) EFFECTIVE DATE.—The amendments made by this
5 section shall apply to gifts made after December 31, 1980.
6 **SEC. 8. ELECTION TO PAY GIFT TAX.**
7 (a) IN GENERAL.—Section 2505 (relating to unified
8 credit against gift tax) is amended by adding at the end there-
9 of the following new subsection:
10 "(e) ELECTION TO PAY GIFT TAX.—
11 "(1) IN GENERAL.—An individual may elect with
12 respect to any calendar quarter not to have the credit
13 allowed by subsection (a) apply with respect to gifts
14 made during such quarter.
15 "(2) ELECTION.—Any election under paragraph
16 (1) shall be made at the same time as the return re-
17 quired to be filed for such quarter under section 6019
18 is filed and shall be in such form and manner as the
19 Secretary may by regulations prescribe.
20 "(3) EFFECT OF ELECTION.—For purposes of
21 subsection (a)(2), the amount of any credit which does
22 not apply by reason of an election under paragraph (1)
23 shall not be treated as an amount allowable as a credit
24 under this section.".

1 (b) EFFECTIVE DATE.—The amendment made by sub-
2 section (a) shall apply to gifts made after December 31,
3 1980.

4 SEC. 9. COORDINATION OF EXTENSIONS OF TIME FOR PAY-
5 MENT OF ESTATE TAX WHERE ESTATE CON-
6 SISTS LARGELY OF INTEREST IN CLOSELY
7 HELD BUSINESS.

8 (a) ELIGIBILITY REQUIREMENTS.—Paragraph (1) of
9 section 6166(a) (relating to alternate extension of time for
10 payment of estate tax where estate consists largely of inter-
11 est in closely held business) is amended to read as follows:
12 "(1) IN GENERAL.—If the value of an interest in
13 a closely held business which is included in determin-
14 ing the gross estate of a decedent who was (at the date
15 of his death) a citizen or resident of the United States
16 exceeds—
17 "(A) 35 percent of the value of the gross
18 estate, or
19 "(B) 50 percent of the taxable estate, of such
20 decedent,
21 the executor may elect to pay part or all of the tax
22 imposed by section 2001 in 2 or more (but not exceed-
23 ing 10) equal installments.".
24 (b) COORDINATION WITH SECTION 303.—

1 (1) IN GENERAL.—Subparagraph (A) of section
2 303(b)(2) (relating to relationship of stock to decedent's
3 estate) is amended by striking out all that follows
4 "gross estate" the first place it appears and inserting
5 in lieu thereof "exceeds—
6 "(i) 35 percent of the value of the gross
7 estate of the decedent, or
8 "(ii) 50 percent of the value of the tax-
9 able estate of the decedent.".
10 (2) CONFORMING AMENDMENT.—Subparagraph
11 (B) of section 303(b)(2) is amended to read as follows:
12 "(B) SPECIAL RULE FOR STOCK IN 2 OR
13 MORE CORPORATIONS.—For purposes of subpara-
14 graph (A), stock of 2 or more corporations, with
15 respect to each of which there is included in de-
16 termining the value of the decedent's gross estate
17 more than 20 percent in value of the outstanding
18 stock, shall be treated as the stock of a single
19 corporation. For purposes of the 20-percent re-
20 quirement of the preceding sentence, stock which,
21 at the decedent's death, represents the surviving
22 spouse's interest in property held by the decedent
23 and the surviving spouse as community property
24 or as joint tenants, tenants by the entirety, or
25 tenants in common shall be treated as having

1 been included in determining the value of the de-
2 cedent's gross estate.".
3 (c) ACCELERATION OF PAYMENT.—
4 (1) AMOUNT OF DISPOSITION.—Subparagraph (A)
5 of section 6166(g)(1) (relating to acceleration of pay-
6 ment in the case of disposition of interest or with-
7 drawal of funds from a business) is amended by striking
8 out "one-third" each place it appears and inserting in
9 lieu thereof "50 percent".
10 (2) FAILURE TO PAY INSTALLMENT.—Paragraph
11 (3) of section 6166(g) (relating to failure to pay install-
12 ments) is amended to read as follows:
13 "(3) FAILURE TO PAY INSTALLMENT.—
14 "(A) IN GENERAL.—If any installment under
15 this section is not paid on or before the date fixed
16 for its payment by this section (including any ex-
17 tension of time for the payment of such install-
18 ment), the unpaid portion of the tax payable in in-
19 stallments shall be paid upon notice and demand
20 from the Secretary.
21 "(B) PAYMENT WITHIN 6 MONTHS.—If any
22 installment under this section is not paid on or
23 before the date determined under subparagraph
24 (A) but is paid within 6 months of such date—

1 "(i) the provisions of subparagraph (A)
2 shall not apply with respect to such pay-
3 ment,
4 "(ii) the provisions of section 6601(j)
5 shall not apply with respect to the determi-
6 nation of interest on such payment, and
7 "(iii) there is imposed a penalty in an
8 amount equal to the product of—
9 "(I) 5 percent of the principal
10 amount of such payment, multiplied by
11 "(II) the number of months (or
12 fractions thereof) after such date and
13 before payment is made.
14 The penalty imposed under clause (iii) shall be
15 treated in the same manner as a penalty imposed
16 under subchapter B of chapter 68.".
17 (d) REPEAL OF SECTION 6166A.—Section 6166A (re-
18 lating to extension of time for payment of estate tax where
19 estate consists largely of interest in a closely held business) is
20 hereby repealed.
21 (e) TECHNICAL AMENDMENTS.—
22 (1) Sections 303(b)(1)(C), 2204(c), and 6161(a)(2)
23 are each amended by striking out "or 6166A" each
24 place it appears.

1 (2) Paragraph (2) of section 2011(c) is amended
2 by striking out "6161, 6166 or 6166A" and inserting
3 in lieu thereof "6161 or 6166".
4 (3) Subsections (a) and (b) of section 2204 are
5 each amended by striking out "6166 or 6166A" and
6 inserting in lieu thereof "or 6166".
7 (4) Subsection (b) of section 2621 is amended—
8 (A) by striking out "sections 6166 and
9 6166A (relating to extensions" and inserting in
10 lieu thereof "section 6166 (relating to extension",
11 and
12 (B) by striking out "SECTIONS 6166 AND
13 6166A" in the subsection heading and inserting in
14 lieu thereof "SECTION 6166".
15 (5)(A) Subsection (a) of section 6166 is amended
16 by striking out paragraph (4).
17 (B) The section heading for section 6166 is
18 amended by striking out "ALTERNATE".
19 (C) The table of sections for subchapter B of
20 chapter 62 is amended by striking out the items relat-
21 ing to sections 6166 and 6166A and inserting in lieu
22 thereof the following:

"Sec. 6166. Extension of time for payment of estate tax where estate consists largely of interest in closely held business.".

1 (6)(A) Subsections (a), (c)(2), and (e) of section
2 6324A are each amended by striking out "or 6166A"
3 each place it appears.
4 (B) Paragraphs (3) and (5) of section 6324A(d)
5 are each amended by striking out "or 6166A(h)".
6 (C) The section heading for section 6324A is
7 amended by striking out "OR 6166A".
8 (D) The table of sections for subchapter C of
9 chapter 64 is amended by striking out "or 6166A" in
10 the item relating to section 6324A.
11 (7) Subsection (d) of section 6503 is amended by
12 striking out "6163, 6166, or 6166A" and inserting in
13 lieu thereof "6163 or 6166".
14 (8) Subsection (a) of section 7403 is amended by
15 striking out "or 6166A(h)".
16 (f) EFFECTIVE DATE.—The amendments made by this
17 section shall apply to the estates of decedents dying after
18 December 31, 1980.
19 **SEC. 10. DISCLAIMERS.**
20 (a) IN GENERAL.—Subsection (c) of section 2518 (relat-
21 ing to disclaimers) is amended by adding at the end thereof
22 the following new paragraph:
23 "(3) DISCLAIMERS INEFFECTIVE UNDER STATE
24 LAW.—For purposes of subsection (b)(4), an interest

1 shall be treated as passing without any direction on the
2 part of the person making the disclaimer if—
3 "(A) the disclaimer meets the requirements
4 of paragraphs (1), (2), and (3) of subsection (b),
5 "(B) the disclaimer does not result in the
6 passing of the interest under the applicable State
7 law, and
8 "(C) the person transfers the interest to the
9 person to whom the interest would have passed
10 had the person making the disclaimer died before
11 the holder of legal title of such interest before the
12 last date on which the disclaimer must be re-
13 ceived under subsection (b)(2).".
14 (b) EFFECTIVE DATE.—The amendment made by sub-
15 section (a) shall apply to transfers creating an interest in the
16 person disclaiming made after December 31, 1980.

II

97TH CONGRESS
1ST SESSION

# S. 404

To amend the Internal Revenue Code of 1954 to repeal the estate and gift taxes.

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IN THE SENATE OF THE UNITED STATES

FEBRUARY 5 (legislative day, JANUARY 5), 1981

Mr. SYMMS (for himself, Mr. JEPSEN, and Mr. BOREN) introduced the following bill; which was read twice and referred to the Committee on Finance

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# A BILL

To amend the Internal Revenue Code of 1954 to repeal the estate and gift taxes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 **SECTION 1. REPEAL OF ESTATE AND GIFT TAXES.**
4 (a) IN GENERAL.—The Internal Revenue Code of 1954
5 is amended by striking out subtitle B (relating to estate and
6 gift taxes).
7 (b) CLERICAL AMENDMENT.—The analysis of subtitles
8 contained in subsection (d) of the first section of such Code is
9 amended by striking out the item relating to subtitle B.

1 SEC. 2. CONFORMING AMENDMENTS.

2 (a) AMENDMENTS OF SUBTITLE A.—

3 (1) Subsection (d) of section 213 of the Internal
4 Revenue Code of 1954 (relating to special rule for de-
5 cedents) is amended to read as follows:

6 "(d) SPECIAL RULE FOR DECEDENTS.—For purposes
7 of subsection (a), expenses for the medical care of the
8 taxpayer which are paid out of his estate during the 1-year
9 period beginning with the day after the date of his death shall
10 be treated as paid by the taxpayer at the time incurred.".

11 (2) Subpart A of part I of subchapter C of such
12 Code (relating to effects of corporate distributions and
13 adjustments on recipients) is amended—

14 (A) by striking out section 303 (relating to
15 distributions and redemption of stock to pay death
16 taxes), and

17 (B) by striking out the item relating to
18 section 303 in the analysis of sections for such
19 subpart.

20 (3) Subsection (e) of section 305 of such Code (re-
21 lating to cross references) is amended by striking out
22 paragraph (2) and by redesignating (3) as paragraph
23 (2).

24 (4) Subsection (e) of section 351 of such Code (re-
25 lating to cross references) is amended by striking out

1 paragraph (3) and by redesignating paragraph (4) as
2 paragraph (3).
3 (5) Subsection (f) of section 356 of such Code (re-
4 lating to transactions involving gift or compensation) is
5 amended to read as follows:
6 "(f) TRANSACTIONS INVOLVING COMPENSATION.—

**"For special rules for a transaction described in section 354, 355, or this section, but which has the effect of the payment of compensation, see section 61(a)(1).".**

7 (6) Subsection (e) of section 406 of such Code (re-
8 lating to treatment as employee under related provi-
9 sions) is amended by striking out paragraphs (4) and
10 (5).
11 (7) Subsection (e) of section 407 of such Code (re-
12 lating to treatment as employee under related provi-
13 sions) is amended by striking out paragraphs (4) and
14 (5).
15 (8) Subsection (d) of section 508 of such Code (re-
16 lating to disallowance of certain charitable, etc., deduc-
17 tions) is amended by striking out "642(c), 2055,
18 2106(a)(2), or 2522," each place it appears and insert-
19 ing in lieu thereof "or 642(c),".
20 (9) Section 642 of such Code (relating to special
21 rules for credits and deductions) is amended by striking
22 out subsection (g).

1 (10) Section 691 of such Code (relating to recipi-
2 ents of income in respect of decedents) is amended by
3 striking out subsections (c) and (d).
4 (11) Paragraph (2) of section 996(e) of such code
5 (relating to adjustment to basis) is amended by striking
6 out the second sentence.
7 (12) Section 1014 of such Code (relating to basis
8 of property acquired from a decedent) is amended—
9 (A) by striking out subsection (a) and insert-
10 ing in lieu thereof the following:
11 "(a) IN GENERAL.—Except as otherwise provided in
12 this section, the basis of property in the hands of a person
13 acquiring the property from a decedent or to whom the prop-
14 erty passed from a decedent shall, if not sold, exchanged, or
15 otherwise disposed of before the decedent's death by such
16 person, be the fair market value of the property at the date of
17 the decedent's death.", and
18 (B) by striking out subsection (d) and insert-
19 ing in lieu thereof the following:
20 "(d) DECEDENT'S DYING AFTER DECEMBER 31,
21 1981.—In the case of a decedent dying after December 31,
22 1981, the first sentence of paragraph (9) of subsection (b)
23 shall not apply.".

1 (13) Section 1015 of such Code (relating to basis
2 of property acquired by gifts and transfers in trust) is
3 amended by striking out subsection (d).
4 (14) Section 1016 of such Code (relating to ad-
5 justments to basis) is amended by striking out subsec-
6 tion (c), and by redesignating subsections (d) and (e) as
7 subsections (c) and (d).
8 (15) Part II of subchapter O of chapter 1 of such
9 Code (relating to basis rules of general application) is
10 amended—
11 (A) by striking out section 1023 and by
12 redesignating section 1024 as 1023, and
13 (B) by striking out the last 3 items in the
14 analysis of sections for such part and inserting in
15 lieu thereof the following:

"Sec. 1023. Cross references.".

16 (16) Part III of subchapter O of chapter 1 of such
17 Code (relating to common nontaxable exchanges) is
18 amended—
19 (A) by striking out section 1040 (relating to
20 use of farm, etc., real property to satisfy pecuni-
21 ary bequest), and
22 (B) by striking out the item relating to sec-
23 tion 1040 in the analysis of sections for such part.

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1 (17) Section 1101 of such Code (relating to distri-
2 butions pursuant to bank holding company act) is
3 amended by striking out paragraph (5) of subsection (a)
4 and paragraph (5) of subsection (b) and inserting in lieu
5 thereof the following:
6 "(5) DISTRIBUTIONS INVOLVING COMPENSA-
7 TION.—

**"In the case of a distribution to which paragraph (1) or (2) applies, but which has the effect of the payment of compensation, see section 61.".**

8 (b) AMENDMENTS OF SUBTITLE D.—
9 (1) Section 4947 of such Code (relating to
10 application of taxes to certain nonexempt trusts) is
11 amended—
12 (A) by striking out "642(c), 2055, 2106(a)(2)
13 or 2522" each place it appears in such section
14 and inserting in lieu thereof the following: "or
15 642(c)", and
16 (B) by striking out "2055(e)(2)(B), or
17 2522(c)(2)(B)," in subparagraph (A) of subsection
18 (a)(2).
19 (2) Paragraph (4) of section 4948(c) of such Code
20 (relating to disallowance of certain charitable deduc-
21 tions) is amended by striking out "642(c), 2055,
22 2106(a)(2), or 2522," and inserting in lieu thereof "or
23 642(c),".

1 (c) AMENDMENTS OF SUBTITLE F.—
2 (1) Part II of subchapter A of chapter 61 of
3 such Code (relating to tax returns or statements) is
4 amended—
5 (A) by striking out subpart C, and
6 (B) by striking out the item relating to sub-
7 part C in the analysis of subparts for such part.
8 (2) Subpart A of part III of subchapter A of
9 chapter 61 of such Code (relating to information re-
10 turns) is amended—
11 (A) by striking out "EXECUTOR OR" in the
12 caption of section 6036,
13 (B) by striking out "and every executor (as
14 defined in section 2203)," in section 6036,
15 (C) by striking out section 6039A,
16 (D) by striking out "executor or" in the item
17 relating to section 6036 in the analysis of sections
18 for such subpart, and
19 (E) by striking out the item relating to sec-
20 tion 6039A in the analysis of sections for such
21 subpart.
22 (3) Section 6040 of such Code (relating to cross
23 references) is amended—
24 (A) by striking out paragraph (2) and

1 (B) by striking out "and 2016" in paragraph
2 (3).
3 (4) Subchapter B of chapter 62 of such Code (re-
4 lating to extensions of time for payment) is amended—
5 (A) by striking out sections 6163, 6166, and
6 6166A, and
7 (B) by striking out the items relating to sec-
8 tions 6163, 6166, and 6166A in the analysis of
9 sections for such subchapter.
10 (5) Subchapter B of chapter 63 of such Code (re-
11 lating to deficiency procedures in the case of income,
12 estate, gift, and certain excise taxes) is amended—
13 (A) by striking out ", Estate, Gift," in the
14 caption for such subchapter,
15 (B) by striking out "income, estate, and gift
16 taxes imposed by subtitles A and B" in subsection
17 (a) of section 6211 (relating to definition of a defi-
18 ciency) and inserting in lieu thereof "income taxes
19 imposed by subtitle A",
20 (C) by striking out "subtitle A or B" in sec-
21 tions 6211(b)(2), 6212(a), 6213(a), 6213(f) (1) and
22 (2), and 6214(d) and inserting in lieu thereof
23 "subtitle A",
24 (D) by striking out "AND GIFT" in the cap-
25 tion of section 6212(b)(1),

1 (E) by striking out paragraph (3) of section
2 6212(b),
3 (F) by striking out paragraph (2) of section
4 6213(g) and inserting in lieu thereof the following:

**"(2) For assessments without regard to restrictions imposed by this section in the case of recovery of foreign income taxes, see section 905(c).",**

5 (G) by striking out subsection (b) of section
6 6214 and inserting in lieu thereof the following:
7 "(b) JURISDICTION OVER OTHER YEARS.—The Tax
8 Court in redetermining a deficiency of income tax for any
9 taxable year shall consider such facts with relation to the
10 taxes for other years as may be necessary correctly to rede-
11 termine the amount of such deficiency, but in so doing shall
12 have no jurisdiction to determine whether or not the tax for
13 any other year has been overpaid or underpaid.", and
14 (H) by striking out ", estate, gift," in the
15 item relating to subchapter B in the analysis of
16 subchapters for chapter 63 of such Code.
17 (6) Section 6314 of such Code (relating to receipt
18 for taxes) is amended—
19 (A) by striking out subsection (b), and
20 (B) by striking out subsection (c) and insert-
21 ing in lieu thereof the following:
22 "(c) CROSS REFERENCES.—

**"For a receipt required to be furnished by employer to employee with respect to employment taxes, see section 6051.".**

1 (7) Subchapter C of chapter 64 of such Code (re-
2 lating to lien for taxes) is amended—
3 (A) by striking out sections 6323, 6324, and
4 6324A, and
5 (B) by striking out the items relating to sec-
6 tions 6324, 6324A, and 6324B in the analysis of
7 sections for such subchapter.
8 (8) Section 6325 of such Code (relating to release
9 of lien or discharge of property) is amended—
10 (A) by striking out subsection (c), and
11 (B) by inserting "or" at the end of paragraph
12 (1) of subsection (d),
13 (C) by striking out ", or" at the end of para-
14 graph (2) of subsection (d) and inserting in lieu
15 thereof a period, and
16 (D) by striking out paragraph (3) of subsec-
17 tion (d).
18 (9) Subsection (e) of section 6501 of such Code
19 (relating to substantial omission of items) is amended
20 by striking out paragraph (2) and by redesignating
21 paragraph (3) as paragraph (2).
22 (10) Section 6503 of such Code (relating to sus-
23 pension of running of period of limitations) is amended
24 by striking out subsection (d).

1 (11) Section 6504 of such Code (relating to cross
2 references) is amended by striking out paragraph (5).
3 (12) Subsection (h) of section 6511 of such Code
4 (relating to cross references) is amended by striking out
5 paragraph (2).
6 (13) Section 6601 of such Code (relating to inter-
7 est on underpayment, nonpayment, or extensions of
8 time for payment of tax) is amended—
9 (A) by striking out ", ESTATE, GIFT," in
10 the caption of subsection (c), and
11 (B) by striking out subsection (j) and redesig-
12 nating subsection (k) as subsection (j).
13 (14) Subsection (c) of section 6612 of such Code
14 (relating to cross references) is amended by striking out
15 "section 2011(c) (relating to refunds due to a credit for
16 State taxes), 2014(e) (relating to refunds attributable
17 to foreign tax credits), and inserting in lieu thereof
18 "section".

19 **SEC. 3. TECHNICAL CHANGES.**

20 The Secretary of the Treasury shall, within 90 days
21 after the date of enactment of this Act, submit to the Com-
22 mittee on Ways and Means of the House of Representatives,
23 and to the Committee on Finance of the Senate, a draft of
24 any technical and conforming changes in the Internal
25 Revenue Code of 1954 which are necessary to reflect

1 throughout such Code the changes in the substantive provi-
2 sions of law made by this Act.

3 **SEC. 4. EFFECTIVE DATE.**

4 The amendments made by this Act shall apply with re-
5 spect to the estates of decedents dying after December 31,
6 1981, and with respect to gifts made after such date.

II

97TH CONGRESS
1ST SESSION

# S. 574

To amend the Internal Revenue Code of 1954 to allow the estate of a decedent a deduction for certain bequests of interests in property used in farms or other trades or businesses, and for other purposes.

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IN THE SENATE OF THE UNITED STATES

FEBRUARY 26 (legislative day, FEBRUARY 16), 1981

Mrs. KASSEBAUM introduced the following bill; which was read twice and referred to the Committee on Finance

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# A BILL

To amend the Internal Revenue Code of 1954 to allow the estate of a decedent a deduction for certain bequests of interests in property used in farms or other trades or businesses, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That this Act may be cited as the "Family Enterprise Pres-
4 ervation Act".
5 SEC. 2. (a) Part IV of subchapter A of chapter 11 of the
6 Internal Revenue Code of 1954 (relating to taxable estate) is

1 amended by adding at the end thereof the following new sec-
2 tion:

3 "SEC. 2058. BEQUESTS, ETC. OF CERTAIN PROPERTY USED
4 FOR FARMING, ETC.

5 "(a) ALLOWANCE OF DEDUCTION.—

6 "(1) IN GENERAL.—For purposes of the tax im-
7 posed by section 2001, the value of the taxable estate
8 shall be determined by deducting from the value of the
9 gross estate an amount equal to the value of any inter-
10 est in qualified tangible property which passes or has
11 passed from the decedent to a qualified heir, but only
12 to the extent that such interest—

13 "(A) is included in determining the value of
14 the gross estate, and

15 "(B) is not excluded under this part (without
16 regard to this section) in determining the value of
17 the taxable estate.

18 "(2) LIMITATION.—The amount allowable as a
19 deduction under paragraph (1) shall not exceed—

20 "(A) $750,000 with respect to interests in
21 qualified tangible property which pass or have
22 passed to the spouse of the decedent, and

23 "(B) $750,000 with respect to all such inter-
24 ests which pass or have passed to all qualified
25 heirs of the decedent other than the spouse.

1 "(b) QUALIFIED TANGIBLE PROPERTY.—For purposes
2 of this section—
3 "(1) IN GENERAL.—The term 'qualified tangible
4 property' means tangible property (other than money)
5 located in the United States which, on the date of
6 death of the decedent, was being used for a qualified
7 use, but only if 50 percent or more of the adjusted
8 value of the gross estate of the decedent consists of the
9 adjusted value of tangible property (other than money)
10 which—
11 "(A) on the date of the decedent's death,
12 was being used for a qualified use, and
13 "(B) passed from the decedent to a qualified
14 heir of the decedent.
15 "(2) CERTAIN INTANGIBLE PROPERTY INCLUD-
16 ED.—An interest in intangible property shall be treat-
17 ed as an interest in qualified tangible property to the
18 extent such interest represents an interest in, or in
19 connection with, any qualified tangible property which
20 is real property. Such interests include any mineral in-
21 terest, easement, or other similar interest.
22 "(3) QUALIFIED USE, ETC.—The terms 'qualified
23 use' and 'adjusted value' have the meanings given such
24 terms by section 2032A(b).

1 "(c) TAX TREATMENT OF DISPOSITIONS AND FAIL-
2 URE TO USE FOR QUALIFIED USE.—
3 "(1) IMPOSITION OF ADDITIONAL ESTATE
4 TAX.—If, within 15 years after the decedent's death
5 and before the death of the qualified heir—
6 "(A) the qualified heir disposes of any inter-
7 est in qualified tangible property (other than by a
8 disposition to a member of his family), or
9 "(B) the qualified heir ceases to use for the
10 qualified use the qualified tangible property which
11 was passed from the decedent,
12 then there is hereby imposed an additional estate tax.
13 "(2) AMOUNT OF ADDITIONAL TAX.—
14 "(A) IN GENERAL.—The amount of the ad-
15 ditional tax imposed by paragraph (1) with respect
16 to any interest shall be the amount equal to the
17 adjusted tax difference with respect to the estate.
18 "(B) ADJUSTED TAX DIFFERENCE WITH RE-
19 SPECT TO THE ESTATE.—For purposes of sub-
20 paragraph (A), the term 'adjusted tax difference
21 with respect to the estate' means the excess of
22 what would have been the estate tax liability but
23 for subsection (a) over the estate tax liability. For
24 purposes of this subparagraph, the term 'estate
25 tax liability' means the tax imposed by section

1 2001 reduced by the credits allowable against
2 such tax.
3 "(C) PARTIAL DISPOSITIONS.—For purposes
4 of this paragraph, where the qualified heir dis-
5 poses of a portion of the interest passing to such
6 heir (or a predecessor qualified heir) or there is a
7 cessation of use of such a portion, the adjusted
8 tax difference with respect to the estate taken
9 into account with respect to the transaction in-
10 volving the second or any succeeding portion shall
11 be reduced by the amount of the tax imposed by
12 this subsection with respect to all prior transac-
13 tions involving portions of such interest.
14 "(3) PHASEOUT OF ADDITIONAL TAX BETWEEN
15 5TH AND 15TH YEARS.—If the date of the disposition
16 or cessation referred to in paragraph (1) occurs more
17 than 60 months and less than 180 months after the
18 date of the death of the decedent, the amount of the
19 tax imposed by this subsection shall be reduced (but
20 not below zero) by 10 percent for each period of 12
21 full months after such 60 months and before the dispo-
22 sition or cessation.
23 "(4) ONLY 1 ADDITIONAL TAX IMPOSED WITH
24 RESPECT TO ANY 1 PORTION.—In the case of an in-
25 terest passing from any decedent, if subparagraph (A)

1 or (B) of paragraph (1) applies to any portion of an in-
2 terest, subparagraph (B) or (A), as the case may be, of
3 paragraph (1) shall not apply with respect to the same
4 portion of such interest.

5 "(5) DUE DATE.—The additional tax imposed by
6 this subsection shall become due and payable on the
7 day which is 6 months after the date of the disposition
8 or cessation referred to in paragraph (1).

9 "(6) LIABILITY FOR TAX; FURNISHING OF
10 BOND.—The qualified heir shall be personally liable for
11 the additional tax imposed by this subsection with re-
12 spect to his interest unless the heir has furnished bond
13 which meets the requirements of subsection (d)(2).

14 "(7) CESSATION OF QUALIFIED USE.—For pur-
15 poses of paragraph (1)(B), real property shall cease to
16 be used for the qualified use if such property ceases to
17 be used for the qualified use set forth in subparagraph
18 (A) or (B) of subsection (b)(2) of section 2032A under
19 which the property qualified under subsection (b).

20 "(d) DEFINITIONS; SPECIAL RULES.—For purposes of
21 this section—

22 "(1) QUALIFIED HEIR, ETC.—The terms 'quali-
23 fied heir' and 'member of family' have the meanings
24 given such terms by section 2032A(e).

1 "(2) BOND IN LIEU OF PERSONAL LIABILITY.—If
2 the qualified heir makes written application to the Sec-
3 retary for determination of the maximum amount of the
4 additional tax which may be imposed by subsection (c)
5 with respect to the qualified heir's interest, the Secre-
6 tary (as soon as possible, and in any event within 1
7 year after the making of such application) shall notify
8 the heir of such maximum amount. The qualified heir,
9 on furnishing a bond in such amount and for such
10 period as may be required, shall be discharged from
11 personal liability for any additional tax imposed by sub-
12 section (c) and shall be entitled to a receipt or writing
13 showing such discharge.
14 "(3) INVOLUNTARY CONVERSIONS.—Under regu-
15 lations prescribed by the Secretary, rules similar to the
16 rules under section 2032A(h) shall apply to the invol-
17 untary conversion of an interest in qualified tangible
18 property.
19 "(4) PROPERTY PASSING FROM THE DECE-
20 DENT.—The determination of whether an interest in
21 property passes to any person shall be made in accord-
22 ance with section 2056(d).".
23 (b)(1) Section 6324B of the Internal Revenue Code of
24 1954 (relating to special lien for additional estate tax attrib-
25 utable to farm, etc. valuation) is amended—

1 (A) by inserting "or qualified tangible property
2 (within the meaning of section 2058(b))" after "section
3 2032A(b))" in subsection (a),
4 (B) by inserting "or the adjusted tax difference
5 with respect to the estate (within the meaning of sec-
6 tion 2058(c))" after "2032A(c)(2)(B))" in subsection
7 (a),
8 (C) by inserting "or the deduction is allowed
9 under section 2058" after "section 2032A" the first
10 place it appears in subsection (b),
11 (D) by inserting "or section 2058(c)" after
12 "2032A" in subsection (b)(1), and
13 (E) by inserting "or 2058(c)" after "2032A(c)" in
14 subsection (b)(1).
15 (2) Section 2013(f) of such Code (relating to credit for
16 tax on prior transfers) is amended—
17 (A) by inserting "or 2058" after "2032A" each
18 place it appears in the text and heading, and
19 (B) by inserting "or 2058(c)" after "2032A(c)"
20 each place it appears.
21 (c) The table of sections for part IV of subchapter A of
22 chapter 11 of the Internal Revenue Code of 1954 is amended
23 by adding at the end thereof the following new item:

"Sec. 2058. Bequests, etc. of certain property used for farming, etc.".

1 SEC. 3. The amendments made by this Act shall apply
2 to the estates of decedents dying after December 31, 1980.

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II

97TH CONGRESS
1ST SESSION

# S. 858

To amend the Internal Revenue Code of 1954 to provide estate tax equity for family farms and other enterprises, and for other purposes.

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## IN THE SENATE OF THE UNITED STATES

APRIL 1 (legislative day, FEBRUARY 16), 1981

Mr. DURENBERGER introduced the following bill; which was read twice and referred to the Committee on Finance

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# A BILL

To amend the Internal Revenue Code of 1954 to provide estate tax equity for family farms and other enterprises, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 **SECTION 1. SHORT TITLE: AMENDMENT OF 1954 CODE.**
4 (a) SHORT TITLE.—This Act may be cited as the
5 "Family Farm Protection Act of 1981".
6 (b) AMENDMENT OF 1954 CODE.—Except as otherwise
7 expressly provided, whenever in this Act an amendment or
8 repeal is expressed in terms of an amendment to, or repeal of,

1 a section or other provision, the reference shall be considered
2 to be made to a section or other provision of the Internal
3 Revenue Code of 1954.

4 **SEC. 2. INCREASE IN UNIFIED CREDIT.**

5 (a) CREDIT AGAINST ESTATE TAX.—
6 (1) IN GENERAL.—Subsection (a) of section 2010
7 (relating to unified credit against estate tax) is amend-
8 ed by striking out "$476,000" and inserting in lieu
9 thereof "$192,800".
10 (2) CONFORMING AMENDMENTS.—
11 (A) Subsection (b) of section 2010 is re-
12 pealed.
13 (B) Subsection (a) of section 6018 (relating
14 to estate tax returns by executors) is amended—
15 (i) by striking out "$175,000" in para-
16 graph (1) and inserting in lieu thereof
17 "$600,000",
18 (ii) by striking out paragraph (3), and
19 (iii) by redesignating paragraph (4) as
20 paragraph (3).
21 (b) CREDIT AGAINST GIFT TAX.—
22 (1) IN GENERAL.—Paragraph (1) of section
23 2505(a) (relating to unified credit against gift tax) is
24 amended by striking out "$47,000" and inserting in
25 lieu thereof "$192,800".

1 (2) CONFORMING AMENDMENT.—Subsection (b)
2 of section 2505 is amended to read as follows:
3 "(b) PHASE-IN OF CREDIT.—

| "In the case of gifts made in: | Subsection (a)(1) shall be applied by substituting for '$192,800' the following amount: |
|---|---|
| 1981 | $47,000 |
| 1982 | 70,800 |
| 1983 | 96,300 |
| 1984 | 121,800.". |

4 SEC. 3. SPECIAL USE VALUATION RULES.
5 (a) REPEAL OF $500,000 LIMITATION.—Subsection (a)
6 of section 2032A (relating to value based on use under which
7 property qualifies) is amended to read as follows:
8 "(a) VALUE BASED ON USE UNDER WHICH PROPER-
9 TY QUALIFIES.—If—
10 "(1) the decedent was (at the time of his death) a
11 citizen or resident of the United States; and
12 "(2) the executor elects the application of this
13 section and files the agreement referred to in subsec-
14 tion (d)(2),
15 then, for purposes of this chapter, the value of qualified real
16 property shall be its value for the use under which it quali-
17 fies, under subsection (b), as qualified real property.".
18 (b) CLARIFICATION OF RENTAL TO FAMILY
19 MEMBER.—Paragraph (1) of section 2032A(b) is amended by
20 adding at the end thereof the following sentence: "For pur-
21 poses of this paragraph, real property shall not be treated as

1 property not being used for a qualified use merely because
2 the decedent leased such property to a member of the dece-
3 dent's family for a fixed or variable rental.".
4 (c) DEFINITION OF QUALIFIED REAL PROPERTY.—
5 Subsection (b) of section 2032A (defining qualified real prop-
6 erty) is amended by adding at the end thereof the following
7 new paragraphs:
8 "(4) RETIRED AND DISABLED DECEDENTS.—
9 "(A) IN GENERAL.—If, on the date of death
10 of the decedent, the decedent did not otherwise
11 meet the requirements of paragraph (1)(C) with
12 respect to any property, and the decedent—
13 "(i) was eligible to receive old-age
14 benefits under title II of the Social Secrity
15 Act, or
16 "(ii) was disabled for a continuous
17 period ending on such date,
18 then paragraph (1)(C) shall be applied by substituting
19 'the date on which the decedent became eligible to re-
20 ceive old-age benefits under title II of the Social Secu-
21 rity Act or became disabled' for 'the date of the dece-
22 dent's death'.
23 "(B) DISABLED DEFINED.—For purposes of
24 subparagraph (A), an individual shall be disabled
25 if such individual has a mental or physical impair-

1 ment which renders him unable to materially par-
2 ticipate in the operation of the farm or other busi-
3 ness.

4 "(5) SPECIAL RULE FOR SPOUSES WHO ARE
5 QUALIFIED HEIRS.—In the case of any qualified real
6 property which was acquired by a qualified heir who is
7 the spouse of the decedent and which does not other-
8 wise meet the requirements of paragraph (1)(C) upon
9 the death of such spouse, such real property shall be
10 treated as meeting the requirements of paragraph
11 (1)(C) if such spouse was engaged in the active man-
12 agement of the operation of the business at all times
13 during—

14 "(A) the 10-year period ending on the date
15 of death of the spouse, or

16 "(B) the period beginning on the date of
17 death of the decedent and ending on the date of
18 death of the spouse.

19 "(6) SPECIAL RULE FOR CERTAIN WOOD-
20 LANDS.—In the case of real property used for a farm-
21 ing purpose described in subparagraph (C) of subsection
22 (e)(5) which does not otherwise meet the requirements
23 of paragraph (1)(C), such real property shall be treated
24 as meeting the requirements of paragraph (1)(C) if, at

1 all times during the 10-year period ending on the date
2 of the decedent's death—
3 "(A) such real property was owned by the
4 decedent or a member of the decedent's family
5 and used for such farming purpose, and
6 "(B) the decedent or a member of the dece-
7 dent's family was engaged in the active manage-
8 ment of the operation of the business.".
9 (d) DISPOSITIONS AND FAILURES TO USE FOR QUALI-
10 FIED USE.—
11 (1) 10-YEAR HOLDING PERIOD.—
12 (A) IN GENERAL.—Subsection (c) of section
13 2032A (relating to tax treatment of dispositions
14 and failures to use for qualified use) is amended—
15 (i) by striking out "15 years" in para-
16 graph (1) and inserting in lieu thereof "10
17 years", and
18 (ii) by striking out paragraph (3) and re-
19 designating paragraphs (4) through (7) as
20 paragraphs (3) through (6).
21 (B) CONFORMING AMENDMENTS.—Para-
22 graph (2) of section 2032A(h) (relating to treat-
23 ment of replaced property) is amended—
24 (i) by striking out in subparagraph (A)
25 all that follows "involuntarily converted,"

1 and inserting in lieu thereof the following:
2 "except that with respect to such qualified
3 replacement property the 10-year period
4 under paragraph (1) of subsection (c) shall be
5 extended by any period, beyond the 2-year
6 period referred to in section 1033(a)(2)(B)(i),
7 during which the qualified heir was allowed
8 to replace the qualified real property,", and
9 (ii) by striking out "(7)" in subpara-
10 graph (C) and inserting in lieu thereof "(6)".
11 (2) CESSATION OF QUALIFIED USE.—
12 (A) IN GENERAL.—Paragraph (6) of section
13 2032A(c) (defining cessation of qualified use), as
14 redesignated by paragraph (1), is amended to read
15 as follows:
16 "(6) CESSATION OF QUALIFIED USE.—For pur-
17 poses of paragraph (1)(B)—
18 "(A) IN GENERAL.—Real property shall
19 cease to be used for the qualified use if—
20 "(i) such property ceases to be used for
21 the qualified use set forth in subparagraph
22 (A) or (B) of subsection (b)(2) under which
23 the property qualified under subsection (b), or
24 "(ii) except as provided in subparagraph
25 (B), during any period of 8 years ending

1 after the date of the decedent's death and
2 before the date of the death of the qualified
3 heir, there had been periods aggregating 3
4 years or more during which—
5 "(I) in the case of periods during
6 which the property was held by the de-
7 cedent (other than periods during which
8 the decedent was an individual de-
9 scribed in subsection (b)(4)(A) (i) or (ii)),
10 there was no material participation by
11 the decedent or any member of the
12 family in the operation of the farm or
13 other business, and
14 "(II) in the case of periods during
15 which the property was held by any
16 qualified heir, there was no material
17 participation by such qualified heir or
18 any member of his family in the oper-
19 ation of the farm or other business.
20 "(B) 10-YEAR ACTIVE MANAGEMENT.—If
21 an eligible qualified heir elects, at such time and
22 in such manner as the Secretary may prescribe, to
23 have the provisions of this subparagraph apply to
24 any real property—

1 "(i) the provisions of clause (ii) of sub-
2 paragraph (A) shall not apply to such proper-
3 ty, and
4 "(ii) such property shall cease to be
5 used for the qualified use if the fiduciary or
6 the eligible qualified heir or any member of
7 his family did not take part in the active
8 management of the farm or other business at
9 all times during the period beginning on the
10 date of death of the decedent and ending on
11 the earlier of—
12 "(I) the date of death of the quali-
13 fied heir, or
14 "(II) the date which is 10 years
15 from date of death of the decedent.
16 "(C) ELIGIBLE QUALIFIED HEIR.—For pur-
17 poses of this paragraph, the term 'eligible quali-
18 fied heir' means—
19 "(i) any qualified heir with respect to
20 real property the qualified use for which is a
21 farming purpose described in subparagraph
22 (C) of subsection (e)(5), and
23 "(ii) in any other case, a qualified heir
24 who, on the date of death of the decedent—
25 "(I) is the spouse of the decedent,

1 "(II) has not attained the age of
2 21,
3 "(III) is a student described in
4 subparagraph (A) or (B) of section
5 151(e)(4), or
6 "(IV) was disabled (within the
7 meaning of subsection (b)(4)(B)) for a
8 continuous period ending on such
9 date.".
10 (B) CONFORMING AMENDMENT.—Subsection
11 (e) of section 2032A (relating to definitions and
12 special rules) is amended by adding at the end
13 thereof the following new paragraph:
14 "(12) ACTIVE MANAGEMENT.—The term 'active
15 management' means the making of the management
16 decisions of a business (other than the daily operating
17 decisions).".
18 (e) METHOD OF VALUING FARMS.—
19 (1) NET SHARE RENTALS.—
20 (A) IN GENERAL.—Paragraph (7) of section
21 2032A(e) (relating to method of valuing farms) is
22 amended by redesignating subparagraph (B) as
23 subparagraph (C) and by inserting after subpara-
24 graph (A) the following new subparagraph:

1 "(B) VALUE BASED ON NET SHARE RENTAL
2 IN CERTAIN CASES.—
3 "(i) IN GENERAL.—If there is no com-
4 parable land from which the average annual
5 gross rental may be determined, subpara-
6 graph (A)(i) shall be applied by substituting
7 'average net share rental' for 'average gross
8 cash rental'.
9 "(ii) NET SHARE RENTAL.—For pur-
10 poses of this paragraph, the term 'net share
11 rental' means the excess of—
12 "(I) the value of the produce re-
13 ceived by the lessor of the land on
14 which such produce is grown, over
15 "(II) the cash operating expenses
16 of growing such produce which, under
17 the lease, are paid by the lessor.
18 "(iii) DETERMINATION OF AVERAGE
19 NET SHARE RENTAL.—For purposes of this
20 subparagraph, the average net share rental
21 shall be—
22 "(I) the average net share rental
23 for reasonably comparable land pub-
24 lished by the Department of Agricul-
25 ture, an agency of the State in which

1 the land is located, or a college or uni-
2 versity of such State (within the mean-
3 ing of section 511(a)(2)(B)), or
4 "(II) if the average described in
5 subclause (I) is not available, the aver-
6 age net share rental determined on the
7 basis of comparable land located in the
8 locality of such farm.".
9 (B) CONFORMING AMENDMENTS.—
10 (i) Clause (i) of section 2032A(e)(7)(C)
11 (as redesignated by subsection (a)) is amend-
12 ed by inserting ", or where it is established
13 that the average net share rental is not capa-
14 ble of being determined under subparagraph
15 (B)(iii)" after "determined".
16 (ii) Subparagraph (A) of section
17 2032A(e)(7) is amended by striking out "sub-
18 paragraph (B)" and inserting in lieu thereof
19 "subparagraph (C)".
20 (2) COMPARABLE SALES.—Subparagraph (D) of
21 section 2032A(e)(8) (relating to method of valuing
22 closely held business interests, etc.) is amended by
23 striking out "Comparable" and inserting in lieu thereof
24 "Reasonably comparable".
25 (f) EXCHANGE OF QUALIFIED REAL PROPERTY.—

1 (1) IN GENERAL.—Section 2032A (relating to
2 valuation of certain farm, etc., real property) is amend-
3 ed by adding at the end thereof the following new sub-
4 section:
5 "(i) EXCHANGES OF QUALIFIED REAL PROPERTY.—
6 "(1) TREATMENT OF PROPERTY EXCHANGE.—
7 "(A) IN GENERAL.—If an interest in quali-
8 fied real property is exchanged—
9 "(i) no tax shall be imposed by subsec-
10 tion (c) on such exchange if the interest in
11 qualified real property is exchanged solely
12 for an interest in qualified exchange property
13 in a transaction which qualifies under section
14 1031(a), or
15 "(ii) if clause (i) does not apply, the
16 amount of the tax imposed by subsection (c)
17 on such exchange shall be the amount deter-
18 mined under subparagraph (B).
19 "(B) AMOUNT OF TAX WHERE PROPERTY
20 RECEIVED IS NOT SOLELY AN INTEREST IN
21 QUALIFIED EXCHANGE PROPERTY.—The amount
22 determined under this subparagraph with respect
23 to any exchange is the amount of tax which (but
24 for this subsection) would have been imposed on
25 such exchange reduced by an amount equal to

1 that portion of such tax which is attributable to
2 the amount of the interest in qualified exchange
3 property received by the taxpayer.
4 "(2) TREATMENT OF QUALIFIED EXCHANGE
5 PROPERTY.—For purposes of subsection (c)—
6 "(A) any interest in qualified exchange prop-
7 erty shall be treated in the same manner as if it
8 were a portion of the interest in qualified real
9 property which was exchanged, and
10 "(B) any tax imposed by subsection (c) on
11 the exchange shall be treated as a tax imposed on
12 a partial disposition.
13 "(3) QUALIFIED EXCHANGE PROPERTY.—For
14 purposes of this subsection, the term 'qualified ex-
15 change property' means real property which is to be
16 used for the qualified use set forth in subparagraph (A)
17 or (B) of subsection (b)(2) under which the real proper-
18 ty exchange therefor originally qualified under subsec-
19 tion (a).".
20 (2) CONFORMING AMENDMENTS.—
21 (A) Paragraph (1) of section 2032A(f) (relat-
22 ing to statute of limitations) is amended—
23 (i) by inserting "or exchange" after
24 "conversion",
25 (ii) by inserting "or (i)" after "(h)", and

1 (iii) by inserting "or of the exchange of
2 property" after "replace".
3 (B) Paragraph (2) of section 6324B(c) (relat-
4 ing to special liens) is amended by inserting "and
5 qualified exchange property (within the meaning
6 of section 2032A(i)(3))" before the period at the
7 end thereof.
8 (g) ELECTION REQUIREMENT OF SPECIAL RULES FOR
9 INVOLUNTARY CONVERSIONS REPEALED.—Section
10 2032A(h) (relating to special rules for involuntary conver-
11 sions of qualified real property) is amended—
12 (1) by striking out "and the qualified heir makes
13 an election under this subsection" in paragraph (1)(A);
14 and
15 (2) by striking out paragraph (5).
16 (h) BASIS UPON RECAPTURE.—Paragraph (3) of sec-
17 tion 1014(a) (relating to basis of property acquired from a
18 decedent) is amended by inserting "(increased by the value of
19 any interest in such property (determined for purposes of this
20 chapter without regard to this section) with respect to which
21 an additional estate tax is imposed under section
22 2032A(C)(1))" after "section".

1 **SEC. 4. INTEREST RATE ON EXTENDED PAYMENTS OF ESTATE**
2 **TAXES.**
3 Section 6601 (relating to interest on underpayment,
4 nonpayment, or extension of time for payment of tax) is
5 amended by—
6 (a) redesignating subsection (k) (relating to no in-
7 terest on certain adjustments) as subsection (l), and
8 (b) adding immediately after subsection (j) a new
9 subsection (k) to read as follows:
10 "(k) INTEREST RATE ON PORTION OF ESTATE TAX
11 EXTENDED UNDER SECTION 6166.—
12 "(1) IN GENERAL.—If the time for payment of an
13 amount of tax imposed by chapter 11 is extended as
14 provided in section 6166, interest on the portion of
15 such amount which does not qualify for the 4-percent
16 rate under subsection (j), shall (in lieu of the annual
17 rate provided by subsection (a)) be paid at a rate deter-
18 mined under paragraph (2). For purposes of this sub-
19 section, the amount of any deficiency which is prorated
20 to installments payable under section 6166 shall be
21 treated as an amount of tax payable in installments
22 under such section.
23 "(2) INTEREST RATE.—The rate of interest under
24 this subsection shall be the lesser of—
25 "(A) 6 percent, or

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1 "(B) a rate determined in the same manner
2 as under section 6621 except that subsection (c)
3 thereof shall be applied by substituting '75 per-
4 cent' for '90 percent'.
5 The rate determined under subparagraph (B) shall not
6 be less than 4 percent.
7 "(3) TREATMENT OF PAYMENTS.—In any case
8 where this subsection and subsection (j) apply with re-
9 spect to the amount of tax imposed by chapter 11
10 which is extended as provided in section 6166, any
11 payment of a portion of such amount shall be allocated
12 to the 4-percent portion in accordance with paragraph
13 (3) of subsection (j) and any remaining amount shall be
14 treated, for purposes of computing interest for periods
15 after such payment, as reducing the amount to which
16 this subsection applies.", and
17 (c) striking out "For purposes of this subsection,"
18 in paragraph (2) of subsection (j) and inserting in lieu
19 thereof "For purposes of this subsection and subsection
20 (k),".
21 **SEC. 5. EFFECTIVE DATES.**
22 The amendments made by this Act shall apply to the
23 estates of decedents dying after December 31, 1981, except
24 that the amendment made by section 3(b) shall apply to the
25 estates of decedents dying after December 31, 1976.

[Senator Symms, chairman, presiding.]

Senator SYMMS. Our first witness is Senator Durenberger.

Senator Durenberger, we are very glad indeed to have you testify today.

Senator DURENBERGER. Thank you, Mr. Chairman.

## STATEMENT OF HON. DAVID DURENBERGER, A U.S. SENATOR FROM THE STATE OF MINNESOTA

Senator DURENBERGER. Mr. Chairman, I appreciate the opportunity to testify before this subcommittee this morning on S. 858, my Family Farm Protection Act, and other bills relating to the Federal estate tax.

The history of the Federal "death taxes" in the United States closely parallels our country's fights for freedom. Ever since the Stamp Act of 1797 was imposed to raise funds for a national navy, death taxes have been a favorite tool of legislators who needed a quick source of revenue to meet wartime or other unusual expenditures.

The various forms of the death tax imposed during the Civil War, the Spanish-American War and at other times in our history generally adhered to the philosophy that was later to be expressed by President Theodore Roosevelt in 1906.

Roosevelt urged "a progressive tax on all fortunes beyond a certain amount, either given in life or devised or bequeathed upon death to any individual—a tax so framed as to put it out of the power of the owner of one of these enormous fortunes to hand on more than a certain amount to any one individual."

In other words, Roosevelt wanted a tax on the Rockefellers. What has evolved from the Estate Tax of 1916—a tax once again imposed in anticipation of war—is a burden not on the Rockefellers of America but on the John Doe's. Or, to be more accurate, a burden that falls mostly on the widows of the John Doe's.

In the 65-year history of our present death tax the very wealthy have found ways through our increasingly complicated tax code to shelter their estates, while the heirs of those with small and moderate estates find themselves in hock to their own Government.

Frankly, the Federal estate tax is only a small part of our tax system. Death taxes will raise about $7.3 billion in 1981—less than 2 percent of all Federal revenues. That is less than the Federal Government collects from customs duties, for example.

The death tax affects only 3 percent of all estates. But, among those carrying the heaviest burden are family operated farms and businesses. The $175,000 exclusion in the current law ignores the reality of inflation's impact during the last 25 years.

In the last decade alone, the value of Minnesota farmland has increased 440 percent—a figure that is typical of other farm States.

Even in the least productive farming areas of Minnesota, the value of land and machinery often exceeds $175,000.

In the rich farmland of the southern part of the State—an area in which the average price per acre of farmland ranges from $1,526 to $1,750—the land value of the average farm is more than $470,000.

The owners of family operated farms and businesses have been forced to make difficult choices to protect their lifetime of work

from the tax collector. Among other things, it is interesting to note that the number of Minnesota family farmers who incorporated tripled during the 1970's.

Mr. Chairman, on several separate occasions during the 97th Congress, I have sponsored or cosponsored legislation to reform the most oppressive provisions of the Federal estate tax.

I have included estate tax reform in S. 360, the Omnibus Small Business and Family Farm Act, because death taxes have placed the future of these vital and basic enterprises in jeopardy.

I have included estate tax reform in S. 888, the Economic Equity Act because I am outraged by the discriminatory effect of the tax on widows.

Finally, I have introduced S. 858, a comprehensive reform of estate taxes, because I do not believe the National Government has any business taxing death.

This comprehensive reform bill addresses the most pressing problems in the Federal estate tax. It increases the unified credit to exempt the first $600,000 of an estate. It lifts the $500,000 cap on the special use valuation provision so that an entire farm may qualify for special use valuation.

The bill also makes a number of other changes in the special use valuation rules so family farmers may qualify without being caught by the quirks of the law.

And, for the many, many people who do pay estate taxes, I would provide a more fair interest rate on extended payments—the lower of 6 percent or 75 percent of prime—so that farmers who generally make such a low return on their investment will not be forced to sell a portion of their farm just to meet high interest rates.

I recently spent 2 days in Minnesota conducting field hearings in six cities on estate tax reform and other family farm and small business issues. The interest in estate taxes expressed at those hearings is matched by the letters and phone calls I receive virtually every day. The testimony I heard at my hearings and the Minnesotans who take the time to write or call express the depth of this tragedy and national outrage better than I can. I would like to share some of their thoughts with you.

From a crops and beef farmer:

> My grandfather died in 1934 with 867 acres of farmland in his estate which he had operated with his six children. This estate was transferred with no Federal estate tax due.
>
> Moving to the next generation, during my father's working years, he had a farm of 400 acres. He disposed of 80 percent of this some years ago at retirement and now, as he approaches 80 years of age, I would expect his estate to some day pay a moderate Federal estate tax.
>
> Going one generation further, my wife and I and the bank own 280 acres. The situation is that we can't afford to die.

Mr. Chairman, a tax once intended for the wealthy is now falling heavily on low- and moderate-income families. The $600,000 exemption in my bill would compensate for the impact of inflation and protect farmers like the one I have just cited.

Another farmer, this one from southwestern Minnesota, told me this:

> Our personal experience with estate planning has found us incurring substantial dollars in lawyers' and accountants' fees in order to qualify for certain tax requirements.

In addition, the confusion created by the IRS changing their interpretations of unclear Congressional tax laws, leaves us in the state of unrest wondering if we have done the proper estate planning.

My reform of estate taxes won't eliminate the need for this farm family or other person to properly plan for the disposition of an estate. By reforming the estate tax law, though, it will give these people more options and it will state explicitly the intent of Congress in the matter of death taxes.

I was pleased to learn this week that the IRS has taken care of one of the problems my bill addresses. The IRS has informed me that it will reverse an earlier decision and will now allow for special use valuation those farms cash rented to family members.

That is one step in the right direction; we in Congress must now take the other necessary steps.

The concern and frustration of a Fulda, Minn., farmer who wanted to retire is typical. At one of my hearings he told me:

I want to sell my home farm of 160 acres to one of my sons who lives on the farm now. Now I understand that the IRS owns the farm and I have lost my whole freedom on selling it to my son at a reasonable figure, live and let live price.

I will be 76 years old very soon and I don't want to mess around with the farm any more at this age, and he wants to buy it in the worse way. If I had known 10 years ago what I know now, I would of sold it to him when he moved to the farm in 1964 when I moved off to retire somewhat then. My son is 46 years old and don't own a handful of dirt yet at his age. I don't need the farm anymore now.

Mr. Chairman, let me conclude by saying that the Federal death tax is stopping a lot of widows, sons and daughters from owning a handful of dirt. Because of inflation and these death taxes, surviving spouses and heirs find themselves with no other option but to preside over the end of their family farm or business.

I don't believe that was the intention of Congress in 1916 when it imposed the estate tax and I am convinced that it is not the intention of this Congress that now has the opportunity to reform the estate tax.

Mr. Chairman, on behalf of all the people who have asked for help—and on behalf of the many, many people who have given up hope—I urge this subcommittee to take immediate action to address a serious wrong in our system of taxation.

Thank you.

Senator SYMMS. Thank you very much for a very good statement, Senator Durenberger.

Senator DURENBERGER. Thank you, Mr. Chairman.

Senator BOREN. Thank you, Mr. Chairman.

I wish to commend Senator Durenberger for a very fine statement and to associate myself with him and his remarks about our outstanding chairman and the fact we will hope and pray for his leadership in the right direction in this area.

I can't help but think that the President won't, as we really begin to get into detailed deliberation, seriously consider this, because we could phase in the cost of it. I know the costs of S. 395 with the kind of phasein we talk about there don't reach the $3 billion mark until 1984 and they phase in at much, much lower figures.

So, I hope we can work in some realistic way to get our foot in the door in this package, in a way that might be manageable and get it done.

I appreciate your very scholarly, as usual, exposition of this subject.

Senator SYMMS. Senator Byrd.

Senator BYRD. Thank you, Mr. Chairman. I have a statement for the record.

Senator SYMMS. Thank you very much, Senator.

[Senator Byrd's statement along with the statements of Senators Dole, Boren, Grassley, Wallop, Heflin, and Riegle follow:]

STATEMENT OF SENATOR HARRY F. BYRD, JR.

I commend Senator Symms on the timely hearings which he is initiating in the Subcommittee on Estate and Gift Taxation concerning estate tax revisions.

As the Congress considers general tax reductions directed towards individuals and business, it should not overlook the importance of provisions in the estate tax.

When initially developed, the estate tax was viewed as a means of providing revenues for the federal Treasury and as a way of preventing large concentrations of wealth in the hands of a few. Now it has become a major cause in bringing about bigness.

Today, the situation is different.

As a revenue-producing measure, the estate tax contributes a relatively small portion of total federal revenues.

In 1980, estate and gift taxes produced $6.4 billion, less tax receipts than any other form of federal taxation, including customs duties.

In 1981 these receipts are estimated only to increase slightly to $6.9 billion out of total budget receipts of $600.3 billion. This means that in 1981 estate and gift taxes will be only slightly above 1 percent of the total federal revenues raised.

While the social policies of preventing large concentrations of wealth have merit, as a practical matter, sophisticated estate planning techniques for the wealthy have minimized greatly the effect of estate taxes upon the extremely wealthy.

For the small businessman and the farmer, however, the effect of the estate tax is much different.

Often small businesses have one principal owner. All of the individual's assets are tied up in the small business. The estate tax, because of the lack of liquidity of most small businesses, poses a difficult problem for a small business and frequently causes the business to be sold to pay for estate taxes.

Farmers have similar problems. The pressures for land for use other than farming, particularly developmental use, have meant that farmland prices have risen dramatically and that available farmland is shrinking. When today's estate taxes are imposed on family farms, income from the farming operations often is insufficient to pay the estate taxes. The result is the sale of farmland and a reduction in the number of acres available for future farming.

The experience in Virginia is an example of the way in which agricultural resources are diminishing.

Agriculture is a vital and productive part of Virginia's economy. However, in 1959, over one-half of the state's land area was in farms. In 1980, only 39 percent of the land was in farms. Over 3 million acres, or 25 percent of the total land in farms, has shifted away from farming in the last twenty years.

Estate taxes have accelerated this trend and will continue to do so unless revisions are made.

The effect of inflation must also be considered. Inflation has meant that not only farmers and small businessmen feel the bite of estate taxes, but also workers in the middle-income range.

Home prices and the value of other assets which a typical family owns have risen dramatically.

An asset today, for example, a home, worth $70,000 could have a value of $420,000 over the next twenty years if inflation were to continue at a constant 9-percent rate. As we know, inflation has raged at a much higher level and may continue to remain high over the next few years.

As a result, an increasing number of taxpayers will feel the bite of the estate tax, even when their assets have only an inflation-produced increase in value.

I am pleased that the Subcommittee is looking at legislation, S. 395, which I and other members of the Finance Committee have introduced. Prompt attention should be given to this legislation and other measures designed to revise the current estate tax law.

STATEMENT OF SENATOR ROBERT J. DOLE

Mr. Chairman, I appreciate your providing this opportunity to examine the role that estate and gift taxes pay in our system of taxation. When concern over the impact of inheritance taxes reaches the level it has in recent years, Congress is obliged to respond.

Revision of the estate and gift tax laws has continued to interest many taxpayers and practitioners since we passed the Tax Reform Act of 1976. It is evident that the 1976 Act was not a perfect piece of legislation—the carryover basis provision that we repealed last year, and the arguably imprecise rules governing the special use valuation for farm property, are examples of some of the problems that derive from that Act.

Mr. Chairman, it is also hard to escape the conclusion that the unprecedented inflation that has afflicted the country in recent years makes review of the estate and gift tax both timely and appropriate. In 1976 it may have been appropriate to exclude from the estate tax only those estates valued at a maximum of $175,000. Today, largely because of inflation, that figure seems unrealistically low. I am glad to see that the size of the combined estate and gift tax exclusion is an issue that you have specifically cited for the attention of the subcommittee.

When the estate tax burden threatens the continuation of family enterprises—family farms or small businesses—something is clearly wrong. The carryover basis provisions raised a similar concern, and I hope that we have learned something from our experience with carryover basis, I need not remind the members of this subcommittee of the importance of the family farm to our agricultural productivity or to our economy as a whole. Congress acknowledge this importance of the family farm when it repealed carryover basis, as well as when it passed the special use valuation provisions. To the extent that our estate and gift tax laws undermine the viability of the family farm, they must be revised. I hope that the opportunity for that revision comes soon.

Mr. Chairman, it is good to see that five members of Congress who are concerned over the need for estate tax reform are taking the opportunity to present their views to the subcommittee today. Senator Durenberger has introduced legislation to dramatically increase the value of an estate that is exempt from taxation, and he would also make major reforms in the special use valuation. I am also glad to welcome my colleague form Kansas, Senator Kassebaum. Senator Kassebaum proposes to relieve the estate tax burden on close family members by providing a larger deduction for qualified heirs. As was brought out at hearings early this year in the Subcommittee on Aging, the situation of spouses who materially contribute to a family enterprise is not adequately covered by the estate tax laws, and I thank Senator Kassebaum for focusing our attention on this problem.

I would also like to thank Senator Wallop and Senators Byrd and Boren for their continuing advocacy of their proposal, the Family Enterprise Estate and Gift Tax Equity Act, S. 395. Similar legislation was the subject of hearings before the Finance Committee last August, and I appreciate the fact that Senator Wallop and his colleagues continue to press for major estate tax reform. Finally, Mr. Chairman, it would be remiss of me not to congratulate you for scheduling these hearings and for introducing S, 404, which would eliminate the estate and gift tax altogether. That would certainly be a way to resolve the problems that we are going to hear about today from our witnesses. I am not sure that outright repeal will be fiscally feasible in the near future. Perhaps some of the witnessed today, or in future hearings, can address the question of the probable fiscal impact of total repeal. But whether or not repeal is likely, your proposal gives us an excellent opportunity to rethink the goals of the estate and gift tax, and that is all to the good.

Mr. Chairman, I look forward to hearing today's testimony.

STATEMENT BY SENATOR DAVID L. BOREN

One of the most important problems facing our country is the deterioration of the independent family farm and family business. Many people work hard to build up their businesses for their children, and due to the burdens imposed by the present law, their heirs often have to sell the business to strangers in order to pay the estate tax. These federal tax laws are creating formidable barriers to the continuation of independent ownership of independent businesses, industries, and farms.

It is essential that we take prompt action to stop the loss of family businesses through forced sales. That is why several of us have joined together to propose a comprehensive estate and gift tax reform bill—S. 395. It is my hope that we can eventually completely repeal this onerous tax, but I think we all accept the fact that heed must be paid to the size of the federal deficit. Realistically, repeal may be

too costly to achieve this year considering that Congress and the President are attempting to pass a comprehensive tax relief program. But we must take a meaningful first step toward cutting back the burden imposed by the federal estate and gift tax. S. 395 is such a first step.

One of the most important reforms contained in this bill is the repeal of the tax on property transfers between spouses. My first act when I began serving as Governor of Oklahoma was to sign into law a provision which completely ended the collection of any inheritance taxes when one spouse inherits from the other. Now, I am hoping to take the Oklahoma experience and bring it to the federal level.

Under the present federal law, there is a limited marital exemption for property passing from the decedent to the surviving spouse and a limited marital deduction for transfers between spouses. These limitations and restrictions cause a husband or wife to worry about tax consequences every time they transfer property or make a gift from one to the other during their lifetime. Frequently the tax which has to be paid as a result of such a gift or transfer comes at the death of a spouse. At that time, significant sources of income may have disappeared if the spouse passing away was the main wage earner, and the only way to pay such taxes is to sell the property. My Colleagues and I do not believe this is the proper place for our government's tax burden to fall.

Another very important reform provided by this new legislation is to clarify and expand farmland valuation provisions originally provided for in the Tax Reform Act of 1976. Under the rules previous to 1976, when farmers died, their estates were taxed at their "highest and best use." With farmland values rising beyond the land's capacity for farming profits, the heirs were frequently in a position of selling off much of the land to pay the estate tax.

The 1976 Act attempted to ease some of these burdens. The Congress believed that when land was actually used for farming purposes or for other closely-held business purposes, it was inappropriate to value the land on the basis of its potential "highest and best use", especially since it is desirable to encourage the continued use of property for farming and other small businesses. Such a price does not reflect the actual earning capacity of the land.

For these reasons, the law was amended to provide for the "special use" valuation for estate tax purposes in situations involving real property used in farming or in certain other closely-held businesses and trades. Unfortunately, the provision was not drafted to make congressional intent clear. It ended up not providing the relief which was sought. Our legislation corrects those drafting problems, so that "special use" valuation can work.

This bill also contains a 10 percent across-the-board reduction in the rates used for calculating federal estate taxes, and an increase from $175,000 to $600,000 in the amount of property which may pass free of federal estate and gift taxes. The reduction in the rates combined with the increase in the lifetime limit on the amount of property that may pass by gift or bequest will provide needed relief to many modest estates. Many estates which were formerly considered too small to pay estate taxes have been pushed into high tax brackets due to inflation.

Another provision is the estate and gift law which has long needed changing is the $3,000 gift tax annual exclusion. Present law permits a person to exclude from gift taxation up to $3,000 per year in gifts to another individual. This exclusion has not been raised in over 35 years. Of course, the value of property has increased many times over during that time period. We believe that $10,000 would be a more equitable limit on taxation of such gifts.

Ironically, the inheritance tax was first devised to prevent large concentrations of wealth and economic power. Today, it often works in practice to cause more concentration. The small business or small farm often has to be sold to a large corporation because the family has to sell the property to pay the inheritance taxes when the head of the family dies.

Inheritance taxes are causing the number of small businesses and farms to decline. The number of farms has dropped over the last decade from 3 million farms with a farm population of about 10 million to 2 million farms with a population of 7 million. The individual who has worked hard to build a family business should be able to anticipate that he could pass it onto his family to operate instead of having them sell it to pay the inheritance taxes.

We must stop imposing unfair tax burdens which blunt incentives and sap the strength of the free enterprise system.

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## Statement of Senator Charles E. Grassley

Mr. Chairman, I'd like to commend you for your leadership in addressing this important issue and assembling this impressive array of witnesses to offer suggestions on the improvement of the estate tax law.

While I do not favor wholesale repeal of the estate tax, I am firmly committed to major reform of this levy. Inflation and rapid appreciation of agricultural farmland has caused many estates containing agricultural real estate to be pushed into high tax brackets. Many individuals who own homes and small businesses are also facing similar difficulties. Reforming the estate law to alleviate much of this current hardship is one of my highest priorities during the 97th Congress.

I look forward to reading the testimony of these witnesses and I am grateful that the Chairman is focusing the attention of the subcommittee on this matter. It is an issue of great importance to all Americans, I am in the process of working on legislation to reform some of the problems existing within the current law.

When the estate tax burden threatens the continuation of family enterprises—family farms or small businesses—something is clearly wrong. The carryover basis provisions raised a similar concern, and I hope that we have learned something from our experience with carryover basis. I need not remind the members of this subcommittee of the importance of the family farm to our agricultural productivity or to our economy as a whole. Congress acknowledged this importance of the family farm when it repealed carryover basis, as well as when it passed the special use valuation provisions. To the extent that our estate and gift tax laws undermine the viability of the family farm, they must be revised. I hope that the opportunity for that revision comes soon.

Mr. Chairman, it is good to see that five members of Congress who are concerned over the need for estate tax reform are taking the opportunity to present their views to the subcommittee today. Senator Durenberger has introduced legislation to dramatically increase the value of an estate that is exempt from taxation, and he would also make major reforms in the special use valuation. I am also glad to welcome my colleague from Kansas, Senator Kassebaum. Senator Kassebaum proposes to relieve the estate tax burden on close family members by providing a larger deduction for qualified heirs. As was brought out at hearings early this year in the Subcommittee on Aging, the situation of spouses who materially contribute to a family enterprise is not adequately covered by the estate tax laws, and I thank Senator Kassebaum for focusing our attention on this problem.

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## Statement of Senator Malcolm Wallop

Mr. Chairman, I want to commend you for holding this hearing on the Estate and Gift Tax Laws. Estate and Gift taxes have not received the attention they deserve in Congress.

The need to address estate and gift tax issues has become more pressing as inflation drives the value of formerly modest sized estates into higher tax brackets. The burdens created by the combination of the estate tax laws and inflation are especially acute for small family farms and businesses. The long established theories about how the estate tax laws work no longer hold true, and the realities of the situation have proven to be much more cruel. Too often, heavy estate tax burdens make it difficult or impossible for one generation of farmers or small business owners to pass on their operation to the next generation. Even where the estate transfer is accomplished, heavy estate taxes can destroy the financial ability of the succeeding generation to invest in and improve the family owned enterprise. When estate taxes force farmers or family owned businesses to sell out to large corporations, then we have a government policy that changes the economic landscape of this nation.

I am optimistic that these hearings will help the committee and the Congress recognize that the nation needs a change in the estate tax laws so that these provisions do not interfere with the national objective of encouraging the continuation of family farms and small businesses. We need changes in the estate tax laws so that they mesh with other tax efforts to eliminate disincentives to capital formation. I encourage the Subcommittee on Estate and Gift Taxation to approach these goals with an eye toward simplifying the estate and gift tax laws.

Mr. Chairman, over thirty of our colleagues have joined our effort to amend the estate and gift tax laws by cosponsoring S. 395, the Family Enterprise and Estate and Gift Tax Equity Act. This legislation will provide substantial relief from estate taxes by making several important changes in current law. The legislation extends relief to all estates by increasing the unified gift and estate tax credit to $600,000, and applies an across the board cut in estate tax rates. I am particularly interested in the unlimited marital deduction provided in S. 395, which gives recognition to the invaluable support provided by a spouse in maintaining a farm or family owned small business. The legislation also makes important changes in the special use valuation provisions in the estate tax problems faced by family farmers whose main objective is to keep their land as a viable family farm operation.

Mr. Chairman, the estate and gift tax laws are extremely confusing to people who are not actively engaged in handling estate and gift tax issues.

Consequently, the legislation we proposed in this area can be somewhat confusing. In an effort to clarify the effects and intent of S. 395, I have requested the Library of Congress' American Law Division to prepare a section by section analysis of the Family Enterprise Estate and Gift Tax Equity Act of 1981. I request your consent that this fine analysis prepared by Howard Zaritsky be included in the Hearing Record of today's Hearing.

There is a wide array of important estate and gift tax proposals being reviewed by the committee today. Although these bills have some variations in their attempts to amend the estate and gift tax laws, the thrust of our effort is the same; Congress is beginning to recognize the need to bring relief from the burdens of excessive estate and gift taxation. I wholeheartedly lend my full support to this effort and will look forward to working with the members of the Finance Committee and the Administration in addressing these issues in the 97th Congress.

## Analysis of S. 395 (97th Congress): The Family Enterprise Estate and Gift Tax Equity Act

S. 395, the proposed Family Enterprise Estate and Gift Tax Equity Act, was introduced in the 97th Congress on February 5, 1981, by Senators Malcolm Wallop of Wyoming, Charles Percy of Illinois, and Harry F. Byrd of Virginia, in order to reduce the perceived burden imposed on family businesses by the present Federal estate and gift tax laws.[1] The bill contains nine substantive sections. This report will examine and analyze the operation and legal impact of each section of S. 395. This report will not consider purely economic issues, such as the revenue impact of S. 395. It will, however, attempt to point out those instances in which a specific provision of this bill will particularly affect estates of certain sizes or certain asset composition.

### Section 1. Short Title

The bill is known as the Family Enterprise and Gift Tax Equity Act.

### Section 2. Changes in the Rate Schedule

The estate, gift and generation-skipping transfer tax rates are presently graduated from 18 percent on taxable estates under $10,000, to 70 percent on taxable estates over $5 million.[2] The present rate schedules were adopted as part of the Tax Reform Act of 1976, which generally raised the estate tax rates at all rate brackets except the very highest,[3] and raised the gift tax rates at all brackets.[4]

S. 395 would reduce these tax rates at all brackets, for estates of decedents dying after 1980. Under the bill, the estate, gift and generation-skipping transfer tax rates would begin at ten percent, for taxable estates not over $25,000, and would have a maximum rate of 60 percent, for taxable estates over $5 million.

### Section 3. Increase in the Unified Credit

The Tax Reform Act of 1976 replaced the separate $30,000 lifetime gift tax exclusion and $60,000 estate tax exclusion with a $47,000 unified credit.[5] The

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[1] See 127 *Congressional Record* at S1024-1030 (Daily ed. Feb. 5, 1981); on the history of the Federal estate and gift taxes generally, see also C.R.S. Multilithed report 80-76A, "Federal Estate, Gift, and Generation-Skipping Taxes: A Legislative History and a Description of Current Law" (April 10, 1980).

[2] Int. Rev. Code §§ 2001(c), 2502(a) and 2602(a).

[3] Public Law 94-455 § 2001, 94th Cong., 2d Sess. (1976). Prior to the Tax Reform Act of 1976, the rate schedule was graduated from three percent on estates not over $5,000 to a maximum of 77 percent on taxable estates over $10 million. To correlate the pre-1977 rates with the present outside rate brackets, the pre-1977 rate for a taxable estate under $10,000 was three percent for the first $5,000 and seven percent for the second $5,000, and the rate for a taxable estate over $5 million was 67 percent between $5 million and $6 million, 70 percent between $6 million and $7 million, 73 percent between $7 million and $8 million, 76 percent between $8 million and $10 million, and 77 percent for estates above 10 million. Int. Rev. Code, as amended prior to 1976 § 2001.

[4] Prior to the Tax Reform Act of 1976, the gift tax rates were set at three-quarters of the estate tax rate. Int. Rev. Code, as amended prior to 1976 § 2502(a). The 1976 Act made the gift tax rates the same as the estate tax rates.

[5] Int. Rev. Code §§ 2010 and 2505, as added by Public Law 94-455 § 2001(a)(2), 94th Cong., 2d Sess. (1976).

present unified credit is equivalent to an estate and gift tax exclusion of $175,625.[6] To the extent the credit is not utilized during an individual's lifetime to offset gift tax liability, it is available to offset estate tax liability and, in certain instances, the tax on generation-skipping transfers of which the individual is the "deemed transferor."[7]

S. 395 would increase the unified credit to $124,750, equivalent to an exemption of $600,000, when combined with the change in the rate tables. The $124,750 figure would be effective for gifts made after and estates of decedents dying after 1984, and the increase would be phased-in over five years. For gifts made in 1981 and estates of decedents dying in 1981, the credit would be $29,750, equivalent to an exemption of $175,000. For gifts made in 1982 and estates of decedents dying in 1982, the credit would be $55,750, equivalent to an exemption of $300,000. For gifts made in 1983 and estates of decedents dying in 1983, the credit would be $77,750, equivalent to an exemption of $400,000. For gifts made in 1984 and estates of decedents dying in 1984, the credit would be $99,750, equivalent to an exemption of $500,000.

While the change in the unifed credit for 1981 is probably intended to create an exemption equivalence identical to the present credit, it actually reduces the exemption equivalence by $625. The present unified credit is equivalent to an exemption of $175,625, while the proposed $29,750 credit would be equivalent to an exemption of only $175,000.

A corresponding change is made by the bill in the estate tax return filing requirements. Present law requires no estate tax return if the gross estate is not over $175,000.[8] As the enlarged unified credit is phased in over the next five years, S. 395 also phases in a larger return filing exemption level.

Quite obviously, the effect of this increase in the unified credit will be realized by those donors of more than $175,625 in taxable gifts, and those decedents whose taxable estates exceed this figure. Estates of decedents whose assets are transferred principally to a surviving spouse will not benefit from this increased credit until they exceed $425,625, and when considered in conjunction with section 4 of the bill (providing an unlimited marital deduction), will not benefit from this increase at all.

SECTION 4. UNLIMITED MARITAL DEDUCTION

The present estate and gift tax law permit limited tax-free interspousal transfers. These provisions were added by the Revenue Act of 1948, in order to equalize the treatment of spouses in community property states and those in non-community property states.[9]

Under the present gift tax law, a U.S. donor may make tax-free up to $100,000 of post-1976 interspousal taxable gifts. There is no exemption on the next $100,000 of such gifts, but only one-half of all taxable post-1976 interspousal gifts will be taxed after the first $200,000 of such gifts.[10]

The estate tax law permits the greater of $250,000 or one-half of a U.S. decedent's adjusted gross estate [11] to pass to the surviving spouse free of estate tax.[12] Both the estate and gift tax marital deductions are unavailable with respect to transfers of community property [13] and certain "terminable interests" (generally, interests such as life estates, which will lapse or terminate upon some condition or event or with the passage of time).[14]

S. 395 would remove the limitations on both the estate and gift tax marital deductions with respect to gifts made after 1981 and estates of decedents dying after 1981, and permit the full marital deduction for a U.S. donor or decedent's interest in community property transferred to his or her spouse.

Section 4 of S. 395 has the impact of treating a husband and wife as a single unit for estate and gift tax purposes, disregarding interspousal transfers in computing

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[6] The exemption equivalent of the unified credit will be lower for individuals who made taxable gifts before January 1, 1977. Int. Rev. Code §§ 2010(c); see also Technical Advice Memorandum 7939008, in which the I.R.S. ruled privately that the reduction in credit for gifts made between September 8, 1976, and January 1, 1977, is restored when the transfer is included in the donor's gross estate as a gift within three years of death.

[7] Int. Rev. Code §§ 2001(b)(2) and 2602(b)(3).

[8] Int. Rev. Code § 6018(a).

[9] Act of April 2, 1948, 62 Stat. 110.

[10] Int. Rev. Code § 2523(a)(2).

[11] The adjusted gross estate is the gross estate, less deductible expenses, taxes and claims paid by the estate. Int. Rev. Code § 2056(c)(2).

[12] Int. Rev. Code § 2056(c).

[13] Int. Rev. Code §§ 2056(c)(1)(C) and 2523(f). Actually, an estate tax marital deduction is allowed for community property with respect to certain estates under $500,000. Int. Rev. Code § 2056(c)(1)(C).

[14] Int. Rev. Code §§ 2056(b) and 2523(b).

these taxes. The retention of the terminable interest rule is consistent with this rationale, since elimination of the terminable interest rule would permit donors effectively to transfer property outside of the spousal family unit without estate or gift tax.

The unlimited gift and estate tax marital deduction would benefit those persons who make substantial lifetime interspousal gifts or whose estates exceed $600,000 and pass at least partially to a surviving spouse. Decedents whose taxable estates are not more than $600,000 would pay no estate tax because of the unified credit, as increased under S. 395.

The change in the estate tax marital deduction will necessitate changes in many wills and trusts. Many estate plans are predicated upon balancing of the estates of the first and second spouse to die, thereby maximizing the use of the lower estate tax rate brackets and both spouses' unified credits. When the spouse actuarially more likely to die has the greater personal wealth, balancing is accomplished by a transfer to the surviving spouse of one-half of the first spouse's estate in a form which qualifies for the estate tax marital deduction, and a transfer of the other one-half of the decedent's adjusted gross estate to other persons or to the surviving spouse in the form of a terminable interest. The formula by which the estate is divided into these two shares is often couched in terms of the maximum estate tax marital deduction, since the present law now sets one-half of the adjusted gross estate as this maximum. When the estate tax marital deduction becomes unlimited, however, these documents will have to be changed.

The unlimited marital deduction will, on the other hand, permit a surviving spouse to obtain the full value of a deceased spouse's estate for his or her support and maintainence, undiminished by Federal estate taxes. Presently, if the deceased spouse's adjusted gross estate exceeds $425,625, the surviving spouse will receive the estate diminished by Federal taxes.

### SECTION 5. INCREASE IN THE ANNUAL GIFT TAX EXCLUSION

The gift tax law presently provides an annual $3,000 per donee exclusion for gifts made by any donor.[15] This exclusion was introduced along with the permanent gift tax law in 1932.[16] It was originally set at $5,000, but it was reduced to $3,000 in 1942, at which level it has remained.[17]

S. 395 would increase the annual exclusion to $10,000, with respect to all gifts after December 31, 1981.

### SECTION 6. VALUATION OF CERTAIN FARM AND CLOSELY-HELD BUSINESS REAL ESTATE

Property is included in a decedent's gross estate at its "fair market value" on the date of the decedent's death, or the date six months after the date of death, if the executor so chooses.[18] The fair market value of an asset is its value at its highest and best use, even if this is not the asset's present use.[19] In order to alleviate some of the hardship that this rule caused the estates of individuals who own farms and closely-held businesses, the Tax Reform Act of 1976 added section 2032A to the Internal Revenue Code, which allows real estate used in such businesses to be valued at its present use, rather than its highest and best use, in certain circumstances and subject to certain conditions.[20] Section 6 of S. 395 would substantially revise section 2032A, partially in light of the interpretation given that section by the final Treasury Department in regulations issued on July 31, 1980.[21]

*Subsection (a). Qualification for Special Use Valuation*

Subsection 6(a) of of S. 395 changes several of the basic qualifications for special use valuation of farm and business real estate.

The Code presently requires that specially valued property be "used for a qualified use" on the date of death. It is unclear whether special use valuation is available when, on the date of the decedent's death, the real property is used by a member of the decedent's family, rather than by the decedent, in conjunction with a farm or closely held business.

Subsection 6(a) of S. 395 would make it clear that special use valuation is available for property included in the decedent's gross estate, even if it is used in a farm or business by other members of the decedent's family, rather than by the decedent

[15] Int. Rev. Code § 2503(b).
[16] Revenue Act of 1932, Act of June 6, 1932, 47 Stat. 169.
[17] Revenue Act of 1942, Act of October 21, 1942, 56 Stat. 798.
[18] Int. Rev. Code §§ 2031, 2032.
[19] Treas. Regs. § 20.2031-1(b).
[20] Pub. L. 94-455 § 2003, 94th Cong., 2d Sess. (1976).
[21] T.D. 7710, 45 Federal Register 50737 (July 31, 1980).

himself or herself, on the date of death. The drafting of this provision, however, is not perfectly clear. The bill proposes to add "by the decedent or a member of the decedent's family" after "qualified use" each place that it appears in paragraph 2032A(b)(1). This is appropriate where the phrase "qualified use" appears at subparagraph 2032A(b)(1)(A)(i), but it is redundant where it appears in subparagraph 2032A(b)(1)(C)(i).

Special valuation is available only to estates of decedents who materially participated (or whose families materially participate) in the conduct of the farm or business for five of the eight years prior to the date of death.[22]

However, because the present statute refers to material participation during an eight year period ending on the date of death, special use valuation is not unavailable for the estate of a decedent who may have materially participated in the farm or business for five or more years, but who ceased such participation more than three years prior to the date of death. Therefore, if a decedent who retires or becomes disabled more than three years before his or her death and begins to rent the farm or business to others, section 2032A would not now apply.

Subsection 6(a) of S. 395 provides for the continued availability of special use valuation for a decedent who ceases to participate materially in the conduct of the farm or business because of retirement or disability. Under subsection 6(a), an estate could utilize special use valuation if it met all of the requirements except for material participation by the decedent, if the decedent was either eligible to receive old-age benefits under title II of the Social Security Act or was disabled (as defined in the bill) for a continuous period ending on that date. The estate would still have to establish that the decedent or the decedent's family materially participated in the business or farm for five of the eight years ending on the date the decedent qualified for old-age benefits or the date on which the decedent became disabled.

The specific wording of the present statute can present problems when both spouses participate in the operation of a farm or business. Subsection 2032A(b)(1)(C) requires that the decedent in whose estate the specially valued property is included, or his or her family have materially participated in the operation of the farm or business for five of the eight years preceding the date of death. Often a surviving spouse who did not also materially participate during the lifetime of the decedent will become involved in the operation of the farm or business after the decedent's death, but may not actually "materially participate" in the business. Special use valuation will be unavailable for the estate of a surviving spouse who does not materially participate in the business for a period of three years after the decedent's death.

Subsection 6(a) of S. 395 provides that special use valuation is available for the estate of a surviving spouse who was "engaged in the active management" of the business at all times during either the period between the death of the original decedent and that of the surviving spouse, or the ten-year period ending on the surviving spouse's death. The bill contains no definition of "engaged in the active management" of a farm or business, but it appears that a standard of personal participation below that of "material participation" is intended. This may be clarified in future committee reports.

S. 395 also proposes to make special use valuation available for certain woodlands on terms more favorable than those upon which it is available to other farm and business real estate. With respect to property which is used for planting, cultivating, caring for, or cutting of trees or the preparation (other than milling) of trees for market,[23] special use valuation will be allowed if the property was owned by the decedent or a member of the decedent's family for the ten years ending on the decedent's death and used for farming purposes, even if the property otherwise is not a sufficiently substantial portion of the decedent's estate and the decedent did not materially participate in its operation.

*Subsection (b). Post Mortem Dispositions of Special Use Property*

Subsection 6(b) of S. 395 relates to the rules governing post mortem dispositions of and changes in the use of special use property. Under present law, if the use of specially valued property is changed to something other than a closely held business or farm, or if the property is sold or otherwise disposed of to someone other than a

[22] Int. Rev. Code § 2032A(b)(1)(C).
[23] Int. Rev. Code § 2032A(e)(5)(C).

"qualified heir,"[24] the tax savings from the special use valuation are entirely or partially recaptured by the imposition of an additional estate tax.[25]

Under present law, the additional tax is imposed only if the disposition or change in use occurs within the 15 year period beginning on the date of death.[26] If the disposition or change in use occurs in the first ten years, the entire tax savings is recaptured. If it occurs in after the tenth year but before the expiration of 15 years, a ratable share of the tax savings is recaptured.[27]

Subsection (b)(1) of S. 395 would eliminate all recapture for changes in use and dispositions after the tenth year following the date of death. Conforming technical amendments are also made throughout section 2032A. This change should reduce the administrative burdens attendant in maintaining qualification under section 2032A, since it shortens the period within which recapture can occur.

As has been noted above, one of the events which triggers recapture of the tax savings of special use valuation is a "cessation of qualified use" of all or a part of the specially valued property.[28] The statute provides that a cessation of qualified use occurs when the use to which the property is put is changed to one which does not qualify, or the decedent and his or her family cease to participate materially in the operation of the farm or business for periods aggregating at least 3 of the 8 years ending after the date of death.[29]

Subsection (b)(1) of S. 395 first makes a technical change in this definition to permit the decedent's family to cease material participation upon qualification for old-age Social Security benefits or upon becoming disabled. Second, certain qualified heirs will be allowed to elect not to apply the normal cessation of use rules. Such individuals will not be treated as ceasing the qualified use merely because of a lack of material participation as long as the heir or a member of his or her family was engaged in the "active management of the farm or other business" until the earlier of the expiration of ten years from the date of the decedent's death, or the date of the death of the qualified heir. This rule will apply only with respect to the decedent's surviving spouse, qualified heirs who are under 21 years of age, students, or disabled. Third, the lack of material participation by a qualified heir will not constitute a cessation of use rules if the property continued to be used as woodlands (as defined earlier).

This amendment appears designed to alleviate perceived problems of surviving spouses and minor or disabled relatives (and relatives of the decedent who are students). Such persons might desire to maintain ownership of the business or farm and continue active management, but not "materially participate" in the operations of the business. Again, however, some consideration could be given to a specific definition of active management.

*Subsection (c). Limitation on Total Benefits*

Subsection 2032A(a)(2) presently limits the reduction in a decedent's gross estate attributable to special use valuation to $500,000. Subsection 6(c) of S. 395 repeals this limitation, to apply more completely the concept of special use valuation.

*Subsection (d). Like-Kind Exchange of Qualified Real Property*

As has been discussed above, if qualified real property is disposed of within the 15 year period beginning with the date of death, the qualified heirs are subject to an additional estate tax. If specially valued real property is exchanged for real property of a like-kind in a tax-free exchange[30] within this period, the qualified heirs are deemed to have disposed of their interests in the property and will be subject to the additional estate tax.

Subsection 6(d) of S. 395 would amend section 2032A to permit a tax-free like-kind exchange of qualified real property for other real property without the imposition of an additional estate tax. If the exchange was not solely for property of a like-kind, only a ratable share of the property transferred would generate additional estate tax. For example, if a qualified heir exchanged $500,000 worth of qualified real estate for $400,000 worth of like-kind real estate and $100,000 cash, the heir would

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[24] Int. Rev. Code § 2032A(e)(1) defines a "qualified heir" as "a member of the decedent's family who acquired such property (or to whom such property passed) from the decedent." Int. Rev. Code § 2032A(e)(2) defines "member of the decedent's family" as including only "such individual's ancestor or lineal descendant, a lineal descendant of a grandparent of such individual, the spouse of such individual, or the spouse of any such descendant."

[25] Int. Rev. Code § 2032A(c).

[26] Int. Rev. Code § 2032A(c)(1).

[27] Int. Rev. Code § 2032A(c)(3).

[28] Int. Rev. Code § 2032A(c)(7).

[29] Int. Rev. Code § 2032A(c)(7)(B).

[30] Int. Rev. Code § 1031.

be treated as having disposed of $100,000 worth of the qualified real estate and would be subject to the additional estate tax accordingly.

A substantial argument could be made in support of this proposed amendment based on the character of a like-kind exchange. The exchange is only tax-free if the property received by the transferor is of a "like-kind" to the property transferred. The transferor's holding period in property received in a like-kind exchange includes the holding period in the transferred property,[31] and the transferor's basis in the property received is a modified version of the transferor's basis in the transferred property.[32]

Furthermore, the Code presently provides an exception to the disposition rules on specially valued property for property which is purchased with the proceeds of an involuntary conversion (the destruction of property or its condemnation).[33] The income tax attributes of a transfer of property in an involuntary conversion followed by the purchase of replacement property which is "similar or related in use or service"[34] are substantially identical to those of a like-kind exchange. Consequently, sound arguments could be made for providing treatment for like-kind exchanges of specially valued real property similar to that afforded property acquired with the proceeds of an involuntary conversion.

Subsection 6(d) of S. 395 does not appear to address another problem raised in the Treasury's final regulations with respect to like-kind exchanges occurring before the date of death. Under the regulations, property received in a like-kind exchange is not treated as a continuation of the property transferred in the exchange, but as new property. Therefore, the decedent and his or her family must begin anew to satisify the requirement of material participation in five of eight years.[35] For example, the I.R.S. has ruled that section 2032A did not apply when a decedent exchanged a tract of farm land owned and operated for 30 years for another tract of like-kind farm land only two years before his death. On the date of death, the I.R.S. ruled privately, the decedent's farm land had been owned for only two years and was not eligible for special use valuation.[36] Since the provisions of subsection 6(d) of S. 395 relate entirely to the post mortem disposition of qualified real property by like-kind exchange, this problem would not appear to be resolved.

*Subsection 6(e). Involuntary Conversions of Specially Valued Realty*

As was noted above, the present estate tax law provides that if specially valued real estate is involuntarily converted and the qualified heir makes an affirmative election to subject the replacement property to the rules on qualified real property received from a decedent, the additional estate tax will not be imposed.[37] Subsection 6(e) of S. 395 makes this rule automatic, thus avoiding the possibility that a qualified heir might be subjected to the additional estate tax because he or she was unaware that an affirmative election was required to avoid that result.

*Subsection (f). Method of Valuing Farms*

If the real estate used by the decedent in a family farm meets the requirements for special use valuation, it is valued either according to an objective formula or by enumerated subjective criteria. The objective formula for valuation is: average annual gross cash rental for comparable land used for farming purposes and located in the same locality—minus average annual state and local real estate taxes on such comparable land/average annual effective interest rate for all new Federal Land Bank loans.

The regulations issued by the Treasury under section 2032A note that the objective formula requires the existence of a "cash" rental. Therefore, they take the position that if all of the comparable land in the same locality is rented on a crop share basis, the objective formula may not be used.[38]

The regulations also provide detailed standards for determining what constitutes "comparable" land, requiring an examination of ten distinct factors, including (i) the similarity of soil, as determined by any objective means, including an official soil survey reflected in a soil productivity index, (ii) whether the crops grown are

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[31] Int. Rev. Code § 1223(1).
[32] Int. Rev. Code § 1031(d).
[33] Int. Rev. Code §§ 2032A(h) and 1033.
[34] Int. Rev. Code § 1033(a)(2)(A); on some of the difficulties in applying this test for replacement property under section 1033, see also Froikin, "Involuntary Conversions and the Question of Qualified Replacement Property," 38 Ohio State L. J. 331 (1977); and Robinson, "Improvements Can Qualify as Replacement Property under Section 1033, says New Decision," 52 J. Taxation 340 (1980).
[35] Tres. Regs. § 20.2032A-(d).
[36] Letter Ruling 8006013.
[37] Int. Rev. Code § 2032A(h).
[38] Treas. Regs. § 20.2032A-4(b)(2)(iii).

such as would deplete the soil in a similar manner, (iii) the types of soil conservation techniques that have been practiced, (iv) whether the properties are subject to similar flooding, (v) the slope of the land, (vi) the carrying capacity of the land (in the case of livestock farming), (vii) whether any timber on the land is comparable with that of the subject property, (vii) whether the property as a whole is unified or whether it is segmented and, when segmented the availability of the means necessary for movement among the different segments, (ix) the number, types, and conditions of all buildings and other fixed improvements on the property and their location, and (x) the availability and type of transportation facilities in terms of cost and proximity to local markets.[39] Obviously, having to detail these factors can place a substantial burden of time and expense upon the executor of an estate containing specially valued property.

Subsection 6(f) of S. 395 eliminates the requirement of a cash rental and would allow valuation under the objective method even when the land was rented on a crop share basis. Furthermore, this same subsection changes the focus of the valuation formula from the rental on "comparable" land in the same "locality" to the gross rental value of the qualified real property itself. Thus, executors would no longer have to prove that there was comparable land located in the same general area, nor would they be required to establish what constitutes the same "locality." However, this change would require the executor to establish the "average gross rental value" of the qualified real property itself, shifting this standard to a more subjective one, and probably requiring greater reliance upon expert appraisal.

*Subsection 6(g). Basis Upon Recapture*

The income tax basis of property received from a decedent is normally its fair market value on the date of death or, if elected by the executor, the alternate valuation date six months after the date of death.[40] The basis of qualified real property received from a decedent to which Code section 2032A applied is its value under section 2032A, since this is the value used for estate tax purposes.[41]

If, however, there is a disposition of the qualified real property within the 15 year period beginning with the date of death and an additional estate tax is imposed, the present statutory law does not adjust the qualified heir's basis in the real property.

Subsection 6(g) of S. 395 appears designed to grant a qualified heir a basis increase to the extent that the estate tax benefits of section 2032A were lost because of an early disposition of the property or cessation of qualified use. In actuality, a problem may exist in the drafting of this provision.

The proposed amendment would give the qualified heir a basis in such real property equal to: its value determined under such section [2032A] (increased by the value of any interest in such property (determined for purposes of this chapter without regard to this section) with respect to which an additional estate tax is imposed under section 2032A(c)(1)).

The qualified heir starts with a basis equal to the value of the entire real estate interest, as specially determined at its present use. If the entire property is disposed of within the ten year period beginning with the date of death, the amendment would seem to increase the basis by the value of the interest disposed of, rather than by the difference between its fair market value and its special use value. For example, assume that a qualified heir receives from a decedent farm real property with a fair market value of $1 million and a special use value of $500,000. The heir's basis begins at $500,000. The heir changes the use to which the property was put from a farm to a shopping-center. Under the proposed amendment, the heir's basis is "increased by the value" of the interest the use of which was converted. It would appear from this language that the heir would now have a basis of $1.5 million—$500,000 increased by the $1 million value of the property.

*Subsection (h). Effective Date*

All of the changes in section 2032A would be effective for estates of decedents dying after 1981.

SECTION 7. ESTATE TAX TREATMENT OF TRANSFERS MADE WITHIN 3 YEARS OF DECEDENT'S DEATH

Present law includes in a decedent's gross estate the value of all property given by the decedent to another person within three years of the date of the decedent's death, unless no gift tax return was required because the value of the property

[39] Treas Regs. § 20.2032A-4(d).
[40] Int. Rev. Code § 1014(a).
[41] Int. Rev. Code § 1014(a)(3).

(other than a life insurance policy) was not more than $3,000.[42] If property is included in a decedent's gross estate under section 2035, its estate tax value is the value of the property on the date of death, rather than its value at the time of the gift.[43]

Section 7 of S. 395 would, with respect to gifts made after 1980, include in a deceased donor's gross estate any gift made within three years of the donor's death, but at the value of the property at the time the gift was made, rather than its value on the date of the donor's death. The executor would no longer be required to trace the value of assets which have been subsequently sold or otherwise disposed of by the donee. This rule would not apply if the property was includible in the deceased donor's gross estate because the donor retained a life estate in the property, the gift took effect on the donor's death, the donor retained a power to alter the beneficial enjoyment of the gift, the donor retained a general power of appointment over the property, or because the gift was one of a life insurance policy on the donor's life over which the donor retained an incident of ownership.

One may question the continued need for section 2035 in light of the unification of the estate and gift taxes by the Tax Reform Act of 1976. Before the 1976 legislation, the estate tax was computed on one set of rates and the gift tax on a lower set of rates, and the amount of a decedent's lifetime transfers had no effect upon his or her estate tax liability. Under the 1976 Act, however, the two taxes are unified and the amount of lifetime gifts is "grossed-up" in the donor's estate to determine the rate of tax on such transfers. Therefore, if a donor has made $500,000 of lifetime taxable gifts and has a taxable estate of $1 million, the tax imposed will be determined as if the donor had a taxable estate of $1.5 million, and a credit for the gift tax paid on the first $500,000. The net effect is to tax the deceased donor's taxable estate at higher marginal rates because of the lifetime taxable gifts.

Present section 2035 may be justified because it treats deathbed gifts as if the donor had died owning them. The appreciation in the value of the gifts occurring after the date of the gift is returned to the donor's gross estate for tax purposes. If this appreciation is eliminated, as is proposed in S. 395, there appears to be no further purpose in section 2035.

SECTION 8. ELECTION TO PAY GIFT TAX

One problem which has been raised concerning the present unified credit relates to its mandatory character. The former $30,000 lifetime gift tax exemption was elective and a taxpayer could elect to use only a part of the available exemption to offset the tax liability on a particular gift.[44] The specific language of the present unified credit provisions is mandatory and taxpayers must offset against their gift or estate tax liability any unused unified credit.[45]

The impact of the mandatory character of the unified credit creates two separate problems. First, it prevents a taxpayer from relying upon the limitation period of section 2504(c) with respect to a gift which requires no tax payment because of the unified credit. The gift tax is cumulative and the tax on each additional taxable gift is determined by computing the tax as if the taxpayer had made one large taxable gift equal to all of the taxpayer's lifetime taxable gifts, with a credit for the tax which was due on the previous transfers.[46] While the I.R.S. is bound by a three year statute of limitations on assessing additional tax with respect to a gift for which a tax return was filed,[47] only section 2504(c) prevents the I.R.S. from redetermining the valuation of a gift made many years earlier for purposes of determining the proper amount of tax on present transfers.

For example, if a donor made a gift of real estate with a perceived value of $153,000 in 1979, a gift tax return would have to be filed but no tax would have to

[42] Int. Rev. Code § 2035. Prior to the Tax Reform Act of 1976, the law included such gifts in the decedent's gross estate only if they were made "in contemplation of death" and not out of lifetime motives. See generally Peat, "The Constitutionality of New Section 2035: Is There Any Room for Doubt?" 33 Tax Law Review 287 (1978); with respect to the application of the "contemplation of death" rule, see *City Bank Farmers Trust Co.* v. *McGowan*, 323 U.S. 594 (1945); and *United States* v. *Wells*, 283 U.S. 102 (1931).

[43] See e.g., Rev. Rul. 81-14, IRB 1981-2, p. 26 (donor gave away a life insurance policy on the life of A within three years of the donor's death. In the interval between the gift and the date of donor's death, A died and the I.R.S. ruled that the entire proceeds were includible in the donor's gross estate); and Rev. Rul. 80-336, IRB 1980-49, p. 18 (a donor gave away 500 shares of publicly traded stock which, thereafter, declared a one-for-two stock dividend, and the I.R.S. ruled that all 750 shares were included in the donor's gross estate).

[44] See Treas. Regs. § 25.2521-1(a).

[45] Rev. Rul. 79-398, 1979-2 C.B. 338.

[46] Int. Rev. Code § 2502(a).

[47] Int. Rev. Code § 6501.

be paid because the donor's unified credit would offset the entire tax liability. After three years had passed, the I.R.S. could not assert a deficiency based upon a claim that the real estate was actually worth $300,000. However, assume that in 1984 the donor made another taxable gift of $103,000 in cash. The donor computed the gift tax liability on the basis of having made a prior $153,000 gift, and paid the $23,800 additional tax presumed to be due. The I.R.S., however, could argue that the value of the land given away in 1979 was actually $300,000, and that the gift tax due on the present gift was not $23,800, but $74,800.

Section 2504(c) prevents this type of revaluation after the expiration of the regular period of limitations, as long as the taxpayer has "paid" a tax on the prior taxable gift. Since the mandatory application of the unified credit precludes the taxpayer "paying" any gift tax, the protection afforded by section 2504(c) is unavailable.[48]

The mandatory character of the unified credit also prevents donors from making so-called "net gifts," transfers in which the donee agrees to pay the gift tax, before they have exhausted their unified credits.[49] As noted in Revenue Ruling 79-398,[50] the language of sections 2502 and 2505 requires the exhaustion of the donor's unified credit, rather than that of the donee, regardless of the agreement of the parties. While elimination of net gifts may be desirable, consideration should be given to whether it should be accomplished through the mandatory character of the unified credit or through more explicit legislation.

Section eight of S. 395 would permit donors of gifts after 1980 to elect to waive the unified credit, preserving the availability both of the net gift technique and the protection of section 2504(c).

SECTION 9. COORDINATION OF EXTENSIONS OF TIME FOR PAYMENT OF ESTATE TAX WHERE ESTATE CONSISTS LARGELY OF INTERESTS IN CLOSELY HELD BUSINESS

The Tax Reform Act of 1976 [51] added section 6166 to the Internal Revenue Code, enabling an estate composed primarily of an interest in a closely held business to pay the estate tax attributable to that business interest in up to ten equal annual installments, with no tax payment due until five years from the date of death, and with interest on the unpaid taxes attributable to the first $1 million in value of such business interests computed at the rate of four percent per annum. This provision is in addition to an existing section, now numbered section 6166A, which permitted an estate composed primarily of an interest in a closely held business to pay the estate tax attributable to that business interest in up to ten equal annual installments but without the five year moratorium and without the lower interest rate on the taxes attributable to the first $1 million in value. The requirements for qualifying under section 6166 and 6166A are different in many respects.

With respect to estate of decedents dying after 1980, section nine of S. 395 merges these two sections and provides uniform requirements for qualification. Generally, the least difficult standards with which to comply from each section have been adopted, and the rules of these two sections have been correlated with those of Internal Revenue Code section 303, which assures capital gains treatment on certain post mortem redemptions of closely held stock.

The proposed revision retains an estate's right to pay the estate taxes attributable to an interest in a closely-held business in up to ten equal annual installments with the same five year moratorium and four percent interest rate, but it reduces the portion of the estate which must be composed of such an interest. Presently, section 6166 requires that the business interest must constitute at least 65 percent of the adjusted gross estate (the gross estate, less deductible debts, taxes, and losses of the estate).[52] S. 395 would require that the business constitute either 35 percent of the gross estate or 50 percent of the taxable estate (the gross estate, less all deductions). The same percentages would be adopted for purposes of section 303, which provides capital gains treatment on redemptions of closely held stock in order to pay estate taxes and expenses.

S. 395 would also introduce with respect to section 303 redemptions, the present rules of section 6166 which allow an estate to aggregate interests in two or more

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[48] See also A.B.A. Legislative Recommendation No. 1980-5, 33 Tax Lawyer 1531 (1980); and S. 2797 § 7, 96th Cong., 2d Sess. (1980).

[49] See e.g., Crumbley & Orbach, "How to Shift the Gift Tax to the Donee," 117 Trusts & Estates 350 (1978); [illegible]er, "Gift Tax Planning: The New Valuation Tables; Net Gifts; Political Gifts, and other Problems," N.Y.U. 31st Inst. on Fed. Tax. 367 (1974); Grier, "Recent Litigation Upholds Treatment of the Net Gift Technique," 48 J. Taxation 214 (1978); and Pearle, "Net Gifts—Recent Developments," 1978-15 T.M. Memorandum 3 (1978).

[50] Rev. Rul. 79-398, 1979-2 C.B. 338.

[51] Pub. L. 94-455 § 2004, 94th Cong., 2d Sess. (1976).

[52] Int. Rev. Code § 6166(a).

closely held corporations for purposes of qualification for estate tax extension, if the decedent owned at least 20 percent of the stock of those corporations, or if that stock was held jointly with the decedent's spouse.

S. 395 would also adopt the less restrictive rules of section 6166A with respect to accelerating the deferred and unpaid estate taxes in case of a disposition of part of the business interest or assets. Section 6166 presently accelerates the deferred taxes if one-third or more of the business or its assets are disposed of, while section 6166A adopts a 50 percent rule.[53] S. 395 would apply a 50 percent rule with respect to section 6166.

Section 6166 presently provides that the unpaid installments become due and payable if the estate fails to pay one or more installments within the agreed upon time.[54] Under the present law, however, failure to pay one installment on time results in acceleration of the entire tax and provision is not made for a lesser penalty.

S. 395 would avoid acceleration of the entire unpaid tax if a late installment is paid within 6 months of the Secretary's notice and demand for payment. However, the taxpayer would forfeit the four percent interest rate on the estate taxes attributable to the first $1 million of value of the business interest, and a penalty of five percent per month in which the payment was late will be imposed.

These amendments will facilitate an estate's initial qualification for the substantial benefits of deferred payment of estate taxes attributable to interests in closely held businesses, as well as the retention of such benefits by an estate which has already qualified for them. The merger of sections 6166 and 6166A removes a major complication from the tax laws, since these two sections were at once very similar and very different.[55] Furthermore, the coordination of sections 6166 and 303 will greatly facilitate estate planning for owners of interests in closely held corporations, since it will enable the estate to use one set of standards for qualification both for the capital gain treatment on a post mortem redemption to pay death taxes and expenses, and for the estate tax deferral, where presently divergent requirements exist.

SECTION 10. DISCLAIMERS

A disclaimer is an individual's renunciation of a gift or bequest. If a disclaimer is properly made and is effective for tax purposes, the subsequent transfer of the property from the disclaimant to the next taker will not be a taxable transfer with respect to the disclaimant. If the disclaimer is not valid for Federal tax purposes, it will constitute a taxable gift. The Tax Reform Act of 1976 added a provision to the Internal Revenue Code to provide a Federal rule on disclaimers.[56]

The Treasury Department proposed regulations on the Federal disclaimer statute on July 22, 1980.[57] These regulations take the position that if a disclaimer is ineffective under applicable state law, it is not effective for Federal estate and gift tax purposes, either.[58] This result is not necessarily avoidable, since a disclaimer which is invalid under applicable state law will not result in the transfer of the property from the disclaimant.

If a disclaimer which met the requirements of the Federal statute but not of applicable state law were recognized for Federal purposes, the tax law could be treating one person as the owner of property which was actually owned by another.

S. 395 would change this result with respect to disclaimers made after 1980, recognizing a diclaimer for Federal tax purposes if it otherwise met the requirement of the Federal statute but did not qualify under applicable state law, if the disclaimant actually transferred the property to the person who would take the property were the disclaimer effective under state law.

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STATEMENT OF SENATOR HOWELL HEFLIN

Mr. Chairman, I am here to voice my strong support for the Estate and Gift Tax Amendments of 1981, of which I am a cosponsor. This legislation would provide significant tax relief for all estates, and it is especially helpful and will provide

[53] Compare Int. Rev. Code §§ 6166(g)(1) and 6166A(h)(1).
[54] Int. Rev. Code § 6166(g)(3).
[55] See e.g., Bush and Zaritsky, "Planning and Tax Considerations in the Use of Revocable Trusts (part IV)," 12 Tax Adviser 86-87 (1981).
[56] Int. Rev. Code § 2518, added by Public Law 94-455 § 2009, 94th Cong., 2d Sess. (1976); see also Newman and Kalter, "The Need for Disclaimer Legislation—An Analysis of the Background and Current Law," 28 Tax Lawyer 571 (1975).
[57] 45 Federal Register 48922 (July 22, 1980)
[58] Prop. Treas. Regs. § 25.2518-1(c).

assistance for family-owned farms and small businesses that are being ravaged by the combined effects of estate taxes and inflation. The major features of this bill, as I understand it, are:

First, it increases from $175,000 to $600,000 the amount of property that may pass free of Federal estate and gift taxes;

Second, it reduces the rates and widens the brackets used in calculating Federal estate taxes;

Third, it repeals the so-called widows' tax by exempting from estate and gift taxes all property bequeathed or transferred to a spouse;

Fourth, it provides for an increase in the amount of property which an individual may give tax-free annually to another individual from $3,000 to $10,000—which, incidentally, Mr. Chairman, despite the inflationary spiral which ahs plagued this country has not been changed in the last 35 years;

Fifth, it simplifies the so-called special use valuation rules for family farms and closely held businesses to take into consideration the problems of those who are disabled or receiving old-age benefits; and addressed unique problems faced by this country's timberland owners.

Mr Chairman, inflation has pushed many modest estates that were once too small to worry about estate taxes into extremely high estate tax brackets. The result has created many inequities in the estate tax laws, particularly as they affect family-owned farms and businesses. All too often, Mr. Chairman, family-owned farms, ranches, and small businesses have been forced out of business by the financial burdens created by the estate taxes. Often a substantial portion of the property or business must be sold just to provide the money to pay the estate taxes. This legislation will help many liquidity problems faced by many estates and will give our farmers new incentive to keep agricultural lands in production.

Existing law, specifically section 2032 (A) of the Internal Revenue Code, specifically included in the definition of a "farm," operations such as orchards and woodlands. Unfortunately, the regulations as issued by the Internal Revenue Service did not mention either orchards or woodlands, that is our timber industry, is perhaps the most obvious area in which the material participation test simply does not work. Because of long rotation periods which include intervals of management inactivity and a need for perfessional advice and sevice, material participation rules as written for other crop farming do not speak to timberland owners or tree farmers.

Mr. Chairman, in contrast to other agricultural farming, the crop period for timber growing often spans 30 to 60 years. Many timber owners make only one timber sale in their lifetime, and for the timber stand, that one sale may be only a thinning, improvement, or other intermediate cut. Tree farming and the management of timber do not require frequent of substantial work each year, or even at 5- or 10-year intervals; and thus they cannot comply with the regulations although the industry was clearly and specifically intended to benefit from this provision. This legislation would eliminate the requiremant of material participation but would provide other safeguards to eliminate casual investors or Wall Street cowboys from gaining a special treatment under the provision.

Mr. Chairman, the bill as drafted is certainly a good one and I give it my wholehearted support. However, I think that there are a couple of improvements that could be made to the bill which would again restore a bit of equity to the estate and gift tax system. I received a letter from an old friend of mine from Alabama who is now practicing law here in Washington, Mr. Don Cronin, who was formerly on the staff of Senator Lister Hill for many years. Don points out in his letter that increasing the annual gift tax exclusion from $3,000 to $10,000 per donee per year is a step in the right direction but he notes two serious problems that would continue to exist which resulted from revisions to the estate and gift tax laws in the Tax Reform act of 1976.

Mr. Chairman, I am sure the Committee remembers that before the 1976 Act gifts made by a decedent within 3 years of his death were pulled back into his estate if they were made in contemplation of death. There was presumption in the law that such gifts were made in contemplation in death but it could be rebutted by evidence showing to the contrary. The 1976 Act made this presumption an absolute rule with regard to gifts in excess of $3,000 made within three years of death of the donor. This absolute rule in itself is certainly unfair but it is doubly damaging in that if the gift is $1.00 more than $3,000, then the entire gift is pulled back into the estate not just the excess over the $3,000. Thus, in effect, the $3,000 exemption is taken away retroactively for these kinds of gifts. Clearly this is not fair. I am attaching to my testimony a copy of Mr. Cronin's letter which explains these issues in a little more detail but I think that the inequity is so obvious as to require little elabora-

tion. I request that Mr. Cronin's letter be made a part of the record along with my testimony.

In conclusion, Mr. Chairman, I just want to say that I think that this legislation is long overdue. I hope that the Committee will give it favorable consideration and report it quickly and I hope the Committee will consider clearing up some of the other inequities which have been written into the law, such as pointed out by Mr. Cronin. I think on the whole when this bill is understood by the members of the Senate, the majority will conclude as I did that it is certainly an idea whose time has come and which should be made into law as quickly as possible.

CORCORAN, YOUNGMAN & ROWE,
*Washington, D.C., March 26, 1981.*

Senator HOWELL HEFLIN,
*Dirksen Senate Office Building,*
*Washington, D.C.*

DEAR SENATOR: I was pleased to note in the Congressional Record of February 24, 1981 your remarks in support of the Estate and Gift Tax Amendments of 1981, which you cosponsored with Senator Wallop. As one whose practice includes estates and gift tax, I wholeheartedly agree that "the legislation would provide significant (and may I add 'badly needed') relief for all estates."

In your remarks you refer to certain inequities in the estate and tax laws resulting from the inflationary spiral of recent years and you attempt to correct one of those inequities by increasing the annual gift tax exclusion from $3,000 to $10,000. This is certainly a step in the right direction, for the $3,000 amount has remained unchanged for nearly four decades. In terms of today's dollar, the current $3,000 exclusion is equivalent to nearly $13,000. May I suggest, however, that this increase does not totally correct the inequities in that area of gift tax laws. Two other serious inequities exist. Both result from the revisions to the estate and gift tax laws in the Tax Reform Act of 1976.

First, the 1976 Act changed the presumption in contemplation of death to an absolute rule with regards to gifts in excess of $3,000 made within 3 years of death of the donor. Secondly, if the gift within that 3 years is $3,001 the entire gift is added back into the estate—not the $1. The $3,000 exclusion is lost.

The legislative history suggests that the change from presumption to absolute was for the convenience of institutional trustees and executors. Such a so-called convenience should not be allowed to override the basic intent of the gift tax and the charity or generosity of the donor.

Who at any age boarding the DC10 in Chicago a couple of years ago could contemplate it would crash when planning their estate and gift programs. Who at any age when boarding their automobiles for a vacation trip can contemplate that before returning home, they may add to the list of the largest single killer in America today—highway fatalities. These clearly point up the illogic of the absolute rule and the law should be changed to allow circumstances to determine whether or not a gift is in fact made in contemplation of death.

Even more illogical is the 1976 change which provides that if a donor exceeds the $3,000 annual gift tax exclusion by as little as one dollar, the entire amount of the gift is added back into the estate for tax purposes if the donor dies within 3 years of the gift. This concept totally disregards the concept of the $3,000 exclusion and, again, was purportedly adopted as a convenience to the Treasury Department in valuating appreciated gifts. This should not be the basis for depriving any donor of the annual gift tax exclusion, whatever the amount or value of the gift may be.

I hope you will consider these proposed changes in the gift tax exclusion and discuss them with Senator Wallop as possible amendments to your bill when it is before the Committee or the Senate. If I can be of any help in this regard, I will be available to you at any time.

Sincerely,

DONALD J. CRONIN.

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## STATEMENT OF HON. DONALD W. RIEGLE, JR.

Thank you, Mr. Chairman and Members of the Subcommittee, for the opportunity to comment on the need for reform of Federal estate and gift taxation.

Family farms and closely held small businesses are an integral and vital segment of our economy. Indeed, these enterprises provide strength to the American economic system. I am deeply troubled, therefore, that federal estate taxes have created an environment detrimental to the continuation of these independent enterprises.

I believe that it is imperative that Congress take immediate action to reform the existing federal estate and gift tax laws. I am pleased to note that many of my

colleagues share my concerns in this area and appear ready to support meaningful reform.

In recognition of this need, and the increased burden that federal estate taxes place on family farms and small businesses, I introduced S. 392, the "Family Enterprise Estate and Gift Tax Equity Act". The reform embodied in this legislation will bring much needed relief to thousands of farms and closely-held businesses which all-too-frequently have been forced to sell their assets in order to pay estate taxes. This bill is an important first step toward insuring the continued existence of the family farm and independent business. In addition, this proposal recognizes the importance of a working spouse in a family enterprise by allowing the exemption from estate and gift taxes on all property inherited or transferred to a spouse.

In 1976, when Congress adopted the Tax Reform Act, it was reasonable to exclude from estate taxes those estates with less than an estimated value of $175,000. Today this figure is grossly inadequate. S. 392 would increase the estate tax exemption from the current $175,000 to $800,000, which in my view is much more realistic. S. 392 also contains a provision to widen and reduce the estate tax brackets.

Currently the annual exclusion for gifts which may be given to relatives tax free is $3,000. This figure has not been revised in over three decades. I have proposed an increase in the annual gift tax exclusion to $6,000.

S. 392 also addresses another important provision of the Tax Reform Act of 1976 which has not held up to the original legislative intentions. The "valuation according to use" provision for family farms and businesses should be clarified and amended so as to be more beneficial to the elderly, the disabled, and minors. My bill would simplify the special valuation rules, thereby eliminating the all too often occurrence of the dissolution of a family enterprise because of the death of the principal wage earner.

Finally, S. 392 would repeal the "widows tax", limitations which have been especially burdensome to those who wish to transfer property at the time of death.

I am confident that the 97th Congress will find a consensus on the basic criteria for changes in estate and gift tax laws. I feel strongly that estate tax reform is needed. Adopting the proposals embodied in S. 392 will help stop the needless dissolution of small family enterprises and improve our nation's general economic outlook. I believe that these tax reform measures should be included in any tax reduction plan considered by the Congress.

Again, I thank my colleagues for their efforts in this area, and I remain hopeful that meaningful reforms will be enacted in the near future.

Senator SYMMS. Senator Nancy Kassebaum from Kansas is with us, as well as Senator Jepsen another sponsor of our legislation here this morning.

Senator Kassebaum, we have—why don't you both go down to the witness table and testify together.

Because chivalry is not dead on the Finance Committee; it will be ladies first.

Senator KASSEBAUM. It is just because I am brief, Mr. Chairman.

## STATEMENT OF HON. NANCY KASSEBAUM, A U.S. SENATOR FROM THE STATE OF KANSAS

Senator KASSEBAUM. I just have a few brief comments I want to make, because I don't want to take the time from the excellent panels that are here to testify on this important issue.

I wish to commend you for the direction you are giving to an issue that is of immediate concern to us all, recognizing the tragedy that is resulting from inflated values and the particular burden it is causing on farming enterprises and small business enterprise.

I think that we all recognize that this is indeed a detriment that can't be carried much further.

I would also like to say, as the junior Senator from Kansas, I am very appreciative of the fact that the senior Senator from Kansas is the chairman of the Finance Committee. He has a very sensitive understanding of the importance of this issue.

I have introduced legislation which is a modified version to a certain extent. Senate bill 574 would provide a family deduction, not just the current marital deduction to allow children or other designated members of the family a deduction of $750,000 or half of the value of the estate.

It would be the same for, of course, the small business enterprise.

I would be very supportive of a total elimination of the estate tax, because I do believe this is the way we should go, not only for farming and small business, but a recognition that the death tax poses a great hardship on any family.

But I think what we need to address specifically is how to help provide the family farm operation with every chance it can have at this time to maintain its strength in our society.

Thank you very much, Mr. Chairman.

I want to say again, that I would be supportive of any efforts that the committee will recommend and any legislation that the committee will approve.

Senator SYMMS. Thank you very much, Senator Kassebaum.

I might just note for the record that your bill was incorrectly printed, but in your statement that will be submitted to the record, it will be corrected.

Thank you for your support and for your appearance here this morning.

[The prepared statement of Senator Kassebaum follows:]

PREPARED STATEMENT BY SENATOR NANCY KASSEBAUM

I would like to begin by expressing my appreciation to the distinguished Chair of the Subcommittee on Estate and Gift Taxation, Senator Symms, for this opportunity to comment on a subject of special interest to me and to many others as well.

The impact of estate taxation on family farms and family-owned businesses is subject of longstanding concern to me. Earlier this year, on February 4, I chaired a hearing of the Senate Special Committee on Aging, exploring the impact of federal estate tax policies on rural women. On February 26, I introduced S. 574, legislation which would allow a marital deduction up to $750,000 or one half the estate and provide a similar deduction for heirs other than a spouse in cases where most of the estate is comprised of a family farm or a family-owned business. This provision is simple and direct because, unlike other tax-saving provisions, it would apply automatically and would not have to be elected. In this way, it could never be unavailable due to faulty estate planning. Hopefully, it could even eliminate some of the need for complex, costly estate planning.

I would like to give you a brief example of how my bill would work. Though the example pertains to a farm. I could have just as easily used a family business example. A "family farm" as I use the term is one that requires about 2,600 hours of labor per year, contributed by a husband, wife, two children, and no hired labor. In Kansas, the typical family farm is approximately 640 acres. It value in 1979 dollars is approximately $938,000. If this farm passed between generations, say between a parent and child, $114,000 in liquid assets would be required to pay the estate tax. It is critical to note that this example assumes that maximum tax savings have been achieved through the unified estate and gift tax credit and that $500,000 of special use valuation has been used.

If my bill were applied to the transfer of this typical family farm from parent to child, the estate tax bill would be reduced from $114,000 to approximately $25,000. Since the average ratio of earnings to farm value is about 5%, it would be much easier to meet an estate tax bill of the lower amount, especially with installment payment of taxes. Thus, intergenerational transfer is assured.

If this same family farm valued at $938,000 passed from a husband to a wife, under the most advantageous tax scenario, using the marital deduction, the unified estate and gift tax credit, and special use valuation up to $500,000, it is possible that the husband's estate would pay no tax. This would be true for estates up to about $1.5 million in value. It must be noted that this example does not mean that the "widow's tax" no longer exists. Rather, this example assumes that the estate has been able to take maximum advantage of all tax saving provisions, and obviously,

this is not always the case. My bill would come to the rescue in cases in which the maximum savings have not been achieved, and when there was a danger of losing the farm or business property. On the whole, my bill would provide a supportive estate tax environment for family enterprises and minimize revenue loss at the same time.

It is important to note that in recent years some significant changes have been made in estate tax policies. These recognize at least to a degree the special relationship of family effort to the success of the farm or small business and the vital contribution of farm and small business women. However, many of these changes, such as the "credit-for-services rule" of Section 2040(c) and "special use valuation" of Section 2032A, are highly complex and difficult to take advantage of due to burdensome recordkeeping requirements. I think we need to do more than just liberalize present provisions. We need to simplify them.

Under present estate tax law, when the unified estate and gift tax credit is combined with the marital deduction, an estate of $425,625 left to a surviving spouse will not be taxed on the federal level. This figure may sound high, but inflation continues to push land values upward, the estate tax rates are steeply graduated, and many people simply do not have an estate tax plan, all of which combine to make present credits and deductions inadequate.

On the whole, the present estate tax system, with its complexities, inadequate deductions and credits, and high tax rates, may have extremely harsh effects on family farms and family-owned businesses due to inflation and illiquidity of assets in these types of businesses. In seeking reform, we need to consider the important goals of maintaining the family farm and business structure, recognizing the contribution that women make to that structure, and facilitating the transfer of these enterprises to the next generation of farmers and entrepreneurs.

In exploring major estate tax issues today, I am pleased to be a part of a wider effort to develop solutions to issues of taxation fundamental to our family farms and family-owned businesses. I am looking forward to examining the problems under present law and the proposals to be discussed today. I hope the efforts of the subcommittee today will go a long way toward gaining estate tax equity for family farms and businesses.

Senator Symms. Senator Jepsen.

Senator Dole. Mr. Chairman.

Senator Symms. Senator Dole.

Senator Dole. I just want to thank Senator Kassebaum for her statement. Her interest has been continuing. I do think, Nancy, we can figure out something before the year is up. I appreciate your help.

Senator Symms. Senator Jepsen.

## STATEMENT OF HON. ROGER JEPSEN, A U.S. SENATOR FROM THE STATE OF IOWA

Senator Jepsen. Mr. Chairman, it is a very special pleasure to appear here today before you and the Subcommittee on Estate and Gift Taxation.

While you were still on the other side of the Hill, you and I introduced companion bills to repeal this unfair and confiscatory tax. We joined together this year in reintroducing similar legislation here in the Senate. Senator Boren has made a comment that he is sure the President will come around and support us. I want to state for the record that we have already had that assurance. It is in our party platform. The President has made a very definite statement on it. I'm very optimistic about passage this year.

This morning we have a distinguished panel of experts to testify on the effects present law has on various groups and the economy as a whole.

To avoid duplication, I will make my remarks very brief and address two specific issues, arguments for repeal and actual incidence of the tax.

Any argument for repeal should take into consideration that the estate gift tax was introduced in 1916 for two reasons. One, to raise revenues for the First World War.

Two, to prevent entrenched wealth from threatening the democratic principles of American society.

Let's consider the first claim; has revenue, in fact, been produced? According to the figures released by the Joint Committee on Taxation, on April 30, revenues from estate and gift tax in 1981 will amount to $7.2 billion, which is approximately 1 percent of the total IRS collections.

Furthermore, a review of historical data shows that the estate tax share of aggregate revenues has decreased almost every year since 1961. This trend is not expected to reverse.

Clearly, estate and gift tax revenues play an insignificant role in Federal expenditures.

The social equity argument, is just as unsupported by available evidence. The most instructive literature on this subject is George Cooper's "A Voluntary Tax." The author and the Brookings Institute which published the monograph, can scarcely be accused of reactionary thinking.

Yet the conclusion arrived is that the wealthy pay estate taxes only if they want to. It is the family farmer and small businessman who carry the overwhelming burden of this harsh and unnecessary law. They do not have access to the expensive, long-term legal advice of the rich.

I have been in the estate planning and tax planning business professionally for 25 years, Mr. Chairman. I have always said to people there are two sets of tax laws. One for those who plan and one for those who don't. Unless Uncle Sam is your favorite charity, you better do some planning.

But, unfortunately, the advice of specialists in both the legal field and the tax field is very expensive.

The estate tax effectively, does the opposite of its original intention rather than guaranteeing equity, it aggravates inequity. The rich get richer and the poor pay taxes.

My original floor statement, this February, addressed both revenue and equity questions in greater detail. I ask it be inserted in the record at this point.

Senator SYMMS. Without objection, so ordered.

[The statement follows:]

[From the Congressional Record, Thursday, Feb. 5, 1981]

Mr. JEPSEN. Mr. President, today I join with my distinguished colleague from Idaho, Mr. Symms, in reintroducing a bill to repeal the estate and gift tax.

During the 96th Congress, Mr. Symms led the fight for this measure on the House side while I pushed for action in the Senate.

I welcome the opportunity to work with him on this side of the aisle. With the support of President Reagan, we anticipate a favorable reception to our proposal. Both social and economic considerations urge the immediate abolition of the estate and gift tax.

The estate and gift tax became a permanent part of the Federal tax system in 1916. A powerful argument for its acceptance at that time involved the question of social justice. It was felt that large concentrations of entrenched wealth ran contrary to the spirit of a free society and that this tax could correct the threat, by breaking up substantial fortunes after one generation and redistributing wealth to the middle and lower rungs of the economic ladder. But, in 1981 we must ask the question: Have the original purposes of the legislation been fulfilled? Emphatically, the answer is no.

In fact, data from the Internal Revenue Service indicates that the estate and gift tax directly contradicts its historical mandate. The tax has not only failed to accomplish what it set out to do; in effect, it has aggravated the gap between the haves and have nots. The wealthy have been able to avoid the tax by careful estate planning while moderate-income families—independent farmers and small businessmen—bear the brunt. In fact, in 1979, more than 76 percent of inheritance tax returns processed by the IRS represented gross estates of less than $300,000.

Mr. President, I have been in the estate and business planning business for nearly a quarter of a century. I can attest to the fact that there are indeed two sets of tax laws in this country. There is one for those who plan and one for those who do not plan. Now they are one in the same and you cannot evade taxes, but you can avoid them. The sum result of the way the tax laws are constructed today, especially with regard to gift and estate tax laws, is the rich get rich and the poor get kids.

The estate tax affects all Americans and interferes with the efficient operation of the open market by discouraging work long-term savings and capital formation. Nobody gains. Everybody loses.

Why is the middle class particularly hard hit? Because the unified gift and estate tax imposes a fixed dollar amount and its rates are steeply graduated. This means that inflation increases the burden of the estate tax in the same way it increases the burden of the income tax. Consequently, in 1981, many people with relatively modest estates are assessed at levels that drive them out of a home or a business.

Presently, farmland in Iowa sells for $3,000 or more per acre, meaning that a modest 200-acre farm is worth $600,000. To pay estate tax, the inheritors often sell all or part of the farm even though the farmer who owned it may never have made more than $10,000 in his best year. Such a person can hardly be called rich.

Ironically, the very rich, who presumably should be hit the hardest by the tax, are generally able to avoid it. What we really have, in effect, are two estate taxes: A relatively light one for those who plan their estates carefully—generally the wealthiest members of society—and and extremely harsh estate tax for those who do not, generally those with modest incomes who are unaware that they even have a taxable estate. This is why almost ever study on the subject concludes that estate tax has done nothing to alter the underlying distribution of wealth in the United States.

We have already seen a bill in this Congress to amend the estate tax by liberalizing brackets, special-use valuations and exemptions. It is argued that these changes suitably address all the problems I have just outlined.

That is not the case.

Anything short of repeal is a short term and superficial cure, an effective little bandaid. Whether rates are indexed or not, whether limits are increased or not, whether exemptions are comprehensive and equitable or not, is beside the point. Abolition is the only real answer.

Historically, poor people have lifted themselves out of poverty by building up capital within the family unit, so that each generation starts off in a better position than its predecessor. A father may work all his life to build a small business, hoping that his sons and daughters will be able to turn it into a large one. It is this kind of mettle and fortitude that made America great.

Today high taxes on capital gains income and estates make it difficult to leave ones' descendant any inheritance at all. In my view, that is contrary to all that America stands for, and must be abolished.

AVERAGE AGRICULTURAL ACREAGE, LAND PRICES, ASSETS, AND INCOME BY STATE (1980) [1]

| State | Average acreage | Price per acre | Assets | Aggregate land worth | Aggregate farm worth | Income |
|---|---|---|---|---|---|---|
| California | 423 | $1,073 | $144,304 | $453,873 | $598,177 | $43,090 |
| Florida | 344 | 1,130 | 106,672 | 388,720 | 495,392 | 37,313 |
| Idaho | 639 | 557 | 135,367 | 35,923 | 511,290 | 14,613 |
| Illinois | 274 | 1,915 | 131,992 | 524,984 | 656,976 | 15,085 |
| Indiana | 193 | 1,733 | 97,110 | 334,469 | 431,579 | 9,992 |
| Iowa | 284 | 1,716 | 156,329 | 487,344 | 643,673 | 9,461 |
| Kansas | 644 | 497 | 131,701 | 320,068 | 451,769 | 16,053 |
| Minnesota | 286 | 1,018 | 133,579 | 291,148 | 424,727 | 13,469 |
| Missouri | 265 | 837 | 83,169 | 221,805 | 304,974 | 10,523 |
| Montana | 2,609 | 218 | 170,292 | 568,762 | 739,054 | 7,833 |
| Nebraska | 732 | 538 | 170,618 | 393,816 | 564,434 | 11,452 |
| North Dakota | 1,043 | 352 | 171,480 | 367,136 | 538,616 | 12,323 |
| Ohio | 173 | 1,702 | 86,849 | 294,446 | 381,295 | 7,711 |

AVERAGE AGRICULTURAL ACREAGE, LAND PRICES, ASSETS, AND INCOME BY STATE (1980) [1]—Continued

| State | Average acreage | Price per acre | Assets | Aggregate land worth | Aggregate farm worth | Income |
|---|---|---|---|---|---|---|
| Oklahoma | 481 | 520 | 88,217 | 250,120 | 338,337 | 10,007 |
| South Dakota | 1,169 | 295 | 166,916 | 344,855 | 311,771 | 12,455 |
| Texas | 746 | 410 | 84,742 | 305,860 | 390,602 | 10,195 |
| Wisconsin | 200 | 928 | 116,561 | 185,600 | 302,161 | 14,744 |
| Wyoming | 3,804 | 127 | 175,611 | 483,108 | 658,719 | 10,111 |

[1] U.S.D.A. (Economics and Statistics Service), "Economic Indicators of the Farm Sector," Washington, D.C.: 1981 provided raw data for these figures.

Senator JEPSEN. In conclusion, Mr. Chairman, the original justification for estate taxation no longer applies. The revenue effect is almost nonexistent. The wealthy can and do shelter their capital through a variety of legal maneuvers. To get to the second point I want to address today, what is the actual incidence of the tax?

Who pays most of it?

What are the implications of these data?

The Joint Committee on Taxation estimates that 55,672 taxable returns will be filed in 1981. Of those returns, 90 percent will be under $1 million.

In Iowa, that turns out to be a moderate figure for a farm's net worth. An acre of prime agricultural land in Iowa sells for a little over $3,000. An average property covers just under 300 acres.

Equipment, livestock, property inventories, and personal assets add another $160,000 to the bill.

That means a small farmer's gross estate in Iowa is very quickly worth something in the high six figures.

Initially, this might seem like a lot of money, but it isn't. In a good year that same farmer will earn just over $9,000, and there aren't too many good years.

Furthermore, $9,000 is actually a negative tax or net loss on capital of 30 percent.

I have prepared a table showing the average price size assets, and annual income for agricultural properties in 18 major farm States. The data is based on the most recent statistics available from the Department of Agriculture. Because the figures include nonprime land, actual aggregates are underestimated by 50 percent.

Nevertheless, the data show national results consistent with Iowa's. What it does show is that the average farmer owns substantial assets, but earns less than $10,000 annually.

The people who feed America get a negative real return on capital.

Mr. Chairman, I am not playing with numbers here. I know I am not the only Senator hearing from his constituents on this issue. When working Americans pay most of the taxes instead of the well-to-do, something is wrong.

We have two choices. Either we raise exemptions or we repeal the tax outright.

Mr. Chairman, in Iowa we have 119,000 family farms demanding relief. These people work 12 hours a day, 7 days a week, 52 weeks a year. Few ever take a vacation. They earn less than the median

American income. They are constantly vulnerable to shifting patterns of politics and the weather.

I don't think it is asking too much to let them pass on their farms to their families.

As I have said before, we have a real problem. I believe the simplest way to solve it is to repeal this tax. We owe that, at least, to the American farmer and the small businessman.

I thank you for letting me appear and testify this morning.

Senator SYMMS. Well, thank you very much for a very excellent statement. I was on the floor of the Senate when you delivered a statement which is also going to be a part of our record here. It was very excellent on the subject. I am very happy that you are a sponsor of S. 404. I know that Senator, I agree with you, we do have a President who is dedicated to us philosophically, to what we are trying to do.

I think the potential for passage of this legislation or at least part of it and the rest of it in the following year looks very good as far as I am concerned.

Senator Dole.

Senator DOLE. Well, I appreciate very much your statement.

I think the record should reflect not every one in the Senate will agree with those of us who are here this morning.

I recall our efforts, a modest effort we made in 1976, were vigorously opposed by a number of Senators, led by Senator Kennedy, who indicated it was nothing but a ripoff to the rich.

So, I wouldn't want to suggest that those who have an interest, that everyone in the Senate will endorse this legislation, but I also know that the climate is better now in the Senate. Everything is better now in the Senate than it was in 1976. [Laughter.]

So, I think there is a friendlier attitude and more recognition that this is a problem, as pointed out by the Senator from Iowa and others who will follow the Senator from Iowa.

Senator SYMMS. Senator Byrd.

Senator BYRD. If what is sought is accomplished here, I think there will be a tremendous fight in opposition to what Senator Jepsen recommends and what members of this committee favor.

I think the fight is important and one that should be pressed. I think in the end commonsense will prevail. Certainly it is necessary that commonsense prevails in this issue or we are going to find ourselves with further concentration of big business and less and less small farms and small businesses in our Nation.

You made a fine statement, Senator Jepsen.

Senator JEPSEN. Thank you, Senator Byrd.

There is a very real sense of urgency here in this thing. The keystone of what has really made America great throughout the years is the opportunity for men and women, regardless of race, color, creed, and so on, to have a piece of the action, to own something.

The American dream of being able to work hard and save and maybe do a little bit better by your children than you had it. That has always been a part of this American dream. We have managed to hold on to it.

As the President has said, it is still here. It is still savable and we still have it. We are turning this country around.

This is very, very key. At this state of the game we are making it impossible for Mr. and Mrs. Mainstreet America to have a piece of the action. And that is not acceptable. It is not acceptable at all.

Senator SYMMS. Thank you very much, Senator.

[The prepared statement of Senator Jepsen follows:]

PREPARED STATEMENT OF SENATOR ROGER W. JEPSEN

Mr. Chairman, it is a very special pleasure to appear here today before you and the Subcommittee on Estate and Gift Taxation. While you were still on the other side of the Hill, you and I introduced companion bills to repeal this unfair and confiscatory tax. Recently, we jointly reintroduced similar legislation here in the Senate. Considering our mutual interest, I am confident that we will see meaningful action on this issue in this Congress.

This morning, a distinguished panel of experts will testify on the disastrous effects of present law on various groups and the economy as a whole. To avoid duplication, I will restrict my remarks to two specific issues: arguments for repeal; and actual incidence of the tax.

Any argument for repeal should take into consideration that the estate and gift tax was introduced in 1916 for two reasons: (a) To raise revenues for the First World War; and (b) to prevent entrenched wealth from threatening the democratic principles of American society.

Let's consider the first claim about revenue that has been produced. According to figures released by the Joint Committee on Taxation on April 30, revenues from estate and gift taxation in 1981 will amount to $7.2 billion, or a mere 1 percent of total IRS collections.

Furthermore, a review of the historical data shows that the inheritance tax share of aggregate revenues has decreased almost every year since 1961. This trend is not expected to reverse.

Clearly, estate and gift tax revenues play an insignificant role in federal expenditures.

The second, the social equity argument, is just as unsupported by available evidence. The most instructive literature on this subject is George Cooper's "A Voluntary Tax". Neither the author nor the Brookings Institute, which published the monograph, can be accused of reactionary thinking. Yet the conclusion arrived at is that the wealthy pay estate taxes—only if they want to. The family farmer and small businessman carry the burden of this harsh and unnecessary law. They do not have access to the expensive long-term legal advice of the rich. In other words, the estate tax effectively does the opposite of its original intention: rather than guaranteeing equity, it aggravates inequity. The rich get richer and the poor pay taxes.

My original floor statement this February addressed both the revenue and the equity questions in greater detail. I ask that it be inserted in the record at this point.

In conclusion, the original justifications for estate taxation no longer apply. The revenue effect is almost nonexistent; the wealthy can and do shelter their capital through a variety of legal maneuvers. Since the tax has outlived its usefulness, it makes good sense to get rid of it.

The second point I want to address today is the actual incidence of the tax. Who pays most of it? What are the implications of the data?

The Joint Committee on Taxation estimates that 55,672 taxable returns will be filed in 1981. Of those returns 90 percent will be under $1 million. In Iowa that turns out to be a moderate figure for a farm's net worth. An acre of prime agricultural land in Iowa sells for a little over $3,000 and an average property covers just under 300 acres. Equipment, livestock, crop inventories and personal assets add another $160,000 to the bill. That means a small farmer's gross estate in Iowa is worth about $1.1 million. Initially, that might seem like a lot of money. But it isn't. In a good year, that same farmer will earn just over $9,000. And, there aren't too many good years. Furthermore, $9,000 is actually a negative tax on capital of 30 percent. Can you call this Iowan rich? Hardly.

I have prepared a table showing average price, size, assets and annual income for agricultural peoperties in 20 major farm States. The data is based on the most recent statistics available from the Department of Agriculture. Because the figures include nonprime land, actual aggregates are understated by 50 percent. Nevertheless, the data show national results consistent with Iowa's. The average farmer owns assets of almost $1 million but earns less than $10,000 annually. The people who feed America get a negative real return on capital. I ask that the table be inserted in the record at this point.

I'm not playing with numbers here. I know I'm not the only Senator hearing from his consitituents on this issue. When working Americans pay most of the taxes instead of the well-to-do, something is wrong. We have two choices. Either we raise the exemptions, or we repeal the tax outright.

The question is: If we do the first option, how high should the exemption be? If we adjust the 1926 level for inflation, the number is $600,000. But that's the rub: Inflation. If the cost of living continues to rise at current rates, in 6 years we'll have to double that figure. In any case, if we want to protect family farms and small businesses, the original exemption will need to be much higher—about $2 million. But at that level it doesn't make sense anymore to have a tax. The number of returns would be insignificant.

In Iowa, 119,000 family farms are demanding relief. These people work 12 hours a day, 7 days a week, 52 weeks a year. Few ever take a vacation, and they earn less than the median American income. They are constantly vunerable to the shifting patterns of politics and the weather. Is it asking so much to let them pass on their farm to their offspring?

Senator SYMMS. I note that Senator Pressler will be delayed and will be here later.

Senator SYMMS. The next witness we will call up, James Heinhold, who will be accompanied by the Honorable Wilbur D. Mills, who both Chairman Dole and myself had the privilege of serving with in the House of Representatives.

We welcome you both here before our committee this morning.

Senator DOLE. I might add that Jim knows this committee very well, having been a staff member of the committee. He did outstanding work for the committee.

## STATEMENT OF JAMES C. HEINHOLD, SHEA & GOULD, WASHINGTON, D.C., ACCOMPANIED BY HON. WILBUR D. MILLS

Mr. HEINHOLD. Good morning, Senators.

My name is Jim Heinhold. I am with the law firm of Shea & Gould, Washington, D.C.

With me is the Honorable Wilbur D. Mills, also of our firm.

I would ask that the full text of my remarks be included in the record.

Senator SYMMS. Without objection.

Mr. HEINHOLD. Thank you. First, I would like to thank you, Senator Symms, and the members of your subcommittee, for inviting me to testify on these estate tax bills. It is particularly significant for me because it has been exactly 1 year to the day that I left the Finance Committee staff, and I cannot think of a better way to mark that milestone than testifying before this committee.

My primary reason for being here today is actually to testify on a problem relating to disclaimers which is a relatively small part of the estate tax picture.

Before I get to that, I would like to say a few words in support of your efforts to alleviate the problems in general caused by the estate and gift tax laws.

For several years, I audited estate tax returns for the IRS. In doing so, I was particularly troubled by the way the law, as it was before 1976, impacted on the widow in a small estate, and the severe impact on a small family business.

I think we took a step forward in 1976, in raising the exemptions for estates. But, inflation has since pushed us back to where we were before the Tax Reform Act.

I also think we took a giant step forward in 1976, in introducing the special use valuation provision for farms and small businesses.

But the special use provision has not worked to anyone's satisfaction since its inception. The underlying reason for that provision is sound, but it does need some fine tuning.

Therefore, I am pleased that Senator Wallop, Senator Boren, and Senator Byrd of this committee has introduced S. 395, to again lift the burden of estate tax from the inflated values of medium size estates, and to make some adjustment to the special use provision, in order to allow it to operate more equitably.

Gentlemen, I would like to talk about disclaimers.

Generally speaking, a disclaimer is a renounciation or a refusal to accept a gift or an inheritance.

If a disclaimer is properly made and is deemed effective for gift tax purposes, the person making the disclaimer is not considered to have made a gift to the person who eventually takes the property.

If the disclaimer is not treated as valid, for Federal gift tax purposes, the person making the disclaimer will be deemed to have made a taxable gift.

For instance, a husband may pass property to his wife, for her use during her life, and then to their daughter and then to their grandchildren.

Now, it may happen by the time the mother dies and the daughter has a right to take possession of the property, that her own circumstances are such that she does not wish to have the property. So, she refuses to accept it.

She disclaims any right to it, refuses any benefit from it, and the property passes to the grandchildren, if there are any.

The question is: When must the daughter disclaim in order for it to be considered a valid disclaimer and not a gift?

Prior to 1976, there was no Federal law on whether a disclaimer was subject to a gift tax. The gift tax consequences of a disclaimer were largely dependent upon its effectiveness under local law.

The underlying principle of all local law was that if a person absolutely refused to accept the property, then he would not be considered to have received it, and thus, could not give it away.

You can't give what you don't have.

Even though there was no Federal law governing these disclaimers, the IRS, on its own in 1958, decided to establish some standards for the making of a valid disclaimer.

One standard was that a disclaimer had to be made within a reasonable time after knowledge of the existence of the transfer.

This requirement did not immediately cause any alarm, because making a disclaimer within a reasonable time after the transfer was not a new concept. Tax practitioners for many years uniformly agreed that the proper time to make a disclaimer was shortly after the life beneficiary died. Most local law agreed.

However, what the tax bar did not know was that the IRS was about to introduce a new concept by interpreting the word "transfer" to mean that point in time when the trust was created and not when the life beneficiary had died.

Now for many years, tax practitioners uniformly have been of the view and local law agreed, that the proper time to disclaim was when the life beneficiary had died and the next beneficiary was entitled to possession of the interest.

This contrary position of the IRS caused mass confusion and led to a number of contradictory court decisions.

In 1976, section 2518 was added to the Internal Revenue Code, and essentially adopted the IRS position. But only for disclaimers of property interests created after 1976.

This section specifically stated that it was not to change prior law. Nevertheless, the IRS has persisted in applying the standards of section 2518 retroactively.

Ironically, the 1976 act gives the holders of remainder interests created after 1976, a 9-month period in which to disclaim.

Yet, the IRS maintains those interests created before the law was enacted are to be denied any time within which to conform to the new standards. This could not have been the intent of Congress.

The inequity of the IRS position is greatest with regard to those interests created prior to the publication of the IRS regulations in 1958.

Prior to that date, the law was clear that a disclaimer did not constitute a taxable gift so long as it was effective under applicable local law. Because local law generally did not require that a disclaimer be made until after the interest became possessory, many interests created in 1920, 1940, and even 1950, and not reduced to possession by the time of the IRS regulations, never had the opportunity to disclaim subsequent to the announcement of the new policy.

What we are suggesting is an amendment to S. 395 which would permit those interests created before 1958, to have a period of 9 months after the enactment of the bill within which to disclaim their interests and be treated as a qualified disclaimer under section 2518.

In other words, we are asking for the same treatment accorded those trusts created after 1976, which had full knowledge of the new law.

We are asking that the suggested amendment which has already been introduced in the House, by Congressman Conable and others, as H.R. 2583, be made a part of S. 395.

Senators, I am sorry that my time did not allow me to go into your bills, because I am absolutely delighted by them because having worked in the area for the past 12 years the changes you suggest are overdue.

But your witness list shows there are experts who are very qualified to testify on them.

Thank you for your time.

Senator SYMMS. Well, I thank you very much for a very excellent statement.

Senator Grassley, did you have any questions or comments you wish to make?

Senator GRASSLEY. Only this observation. Some of the things that obviously need to be changed by law and are part of these various pieces of legislation, are also the subject of ongoing hearings that I

have had and will be having on the IRS Oversight Subcommittee of this full committee. We will be wanting to work very closely with all of you, even though you haven't testified before our committee on any of these things, we can do just through getting the administration to make some changes by regulation, in lieu of law.

Mr. HEINHOLD. Senator, I appreciate that very, very much. Even though I spent 5 years in the IRS, in Washington, writing regulations, they can at times lose sight of the intentions of Congress. I would appreciate any help from your subcommittee.

Senator GRASSLEY. Well, we did bring out in our meeting on Monday, at least two major, and maybe if you include a couple minor points, some changes in regulation that we thought were going to be very difficult to get changed. They surprised us by making these announcements public, on Monday.

Mr. HEINHOLD. Maybe there is just too much of an antitaxpayer attitude in the IRS.

Senator GRASSLEY. There is lots of that in every department of Government.

Mr. HEINHOLD. Thank you very much, Senator.

Senator SYMMS. Senator Boren.

Senator BOREN. Thank you, Mr. Chairman.

Jim, I appreciate your testimony very much. I am certainly pleased to have you and Chairman Mills lending your support for our efforts. That support carries great weight and great authority. We are very appreciative for both of you taking the time to appear this morning.

Does your written statement also encompass the special use value problem?

Have you addressed that any?

Mr. HEINHOLD. Senator, I have worked on the special use value problem for the past 5 years. My statement does not, simply because I realize you had the Cattleman's Association here and the farm groups which do an excellent job of presenting that view.

Let me just relate to you the policy when I was an estate examiner for the IRS in 1970. In applying the law, what we did was go out and take a look at a farm that was in an estate and not see a farm but see a shopping center or see a subdivision, and then sit down and divide up that farm down on paper into various building lots and parking lots and so forth, and then assess a value for estate tax purposes based on that hypothetical use.

In 1976, when I was with the IRS, I worked very hard in drafting the special use valuation based on my experience and the horrors of applying that pre-1976 law.

The only thing I had reservations about was calling it special use valuation. There is nothing special about it at all.

What we simply want the IRS to do is look at a farm and see a farm, that is all.

Senator BOREN. That is very well put.

Mr. HEINHOLD. But, there is a great deal of work to be done in the area to make it work.

Senator BOREN. Well, I would appreciate any additional suggestions you might have as you examine S. 395, if you see any additional changes that should be made and what we suggested there.

I appreciate your remarks about the disclaimer problem. I certainly would be very amenable to including an accountable type provision that has been introduced in the House side, in Senate legislation.

I appreciate your comments.

Mr. HEINHOLD. Thank you very much, Senator.

Senator SYMMS. Thank you very much, Jim, and Chairman Mills.

Mr. MILLS. Thank you.

Senator SYMMS. We will be able to call on you. So, we will let you go now. Thanks again for your excellent testimony.

Mr. HEINHOLD. Thank you.

Senator SYMMS. Thank you.

[Mr. Heinhold's prepared statement follows:]

PREPARED STATEMENT OF JAMES C. HEINHOLD, ESQ., WASHINGTON, D.C.

Good morning Senators. My name is Jim Heinhold, and I am with the law firm of Shea & Gould in Washington. With me is the Honorable Wilbur D. Mills, also of our firm.

First, I would like to thank you, Senator Symms, and the members of your subcommittee for inviting me to testify on these estate tax bills. It is particularly significant for me because it has been exactly one year to the day that I left the Finance Committee staff, and I cannot think of a better way to mark that milestone than testifying before this Committee.

My primary reason for being here today is actually to testify on a problem relating to disclaimers, which is a relatively small part of the estate tax pictue, But before I get to that I would like to say a few words in support of your efforts to alleviate the problems in general caused by the estate and gift tax laws.

For several years, I audited estate tax returns for the I.R.S. In doing so, I was particularly troubled by the way the law, as it was before 1976, impacted on the widow in a small estate and the severe impact on the small family business. I think we took a step forward in 1976 in raising the exemptions for estates, but inflation has since pushed us back to where were before Tax Reform Act. I also think we took a giant step forward in 1976 in introducing the Special Use Valuation Provision for farms and small businesses.

But the Special Use Provision has not worked to anyone's satisfaction since its inception. The underlying reason for the provision, is sound, but it does need some fine tuning. Therefore, I am pleased that Senator Wallop has introduced S. 395 to again lift the burden of estate tax from the inflated values of medium-sized estates and to make some adjustments to the Special Use Provision on order to allow it to operate more equitably.

Gentleman, I would like to talk about disclaimers. Generally speaking, a disclaimer is a renunciation or a refusal to accept a gift or an inheritance. If a disclaimer is properly made and is deemed effective for gift tax purposes, the person making the disclaimer is not considered to have made a gift to the person who eventually takes the property. If the disclaimer is not treated as valid for federal gift tax purposes, the person making the disclaimer will be deemed to have made a taxable gift. For instance, a husband may pass property to his wife for her to use during her life, and then to their daughter and then to their grandchildren. It may happen that by the time the mother dies and the daughter has right to take possession of the property, that her own circumstances are such that she does not wish to have the property and so she refuses to accept it. She disclaims any right to it and the property will pass to the grandchildren if there are any. The question is when must the daughter disclaim in order for it to be considered a valid disclaimer and not a gift?

Prior to 1976, there was no federal law on whether a disclaimer was subject to a gift tax. The gift tax consequences of a disclaimer were largely dependent upon its effectiveness under local law. The underlying principle of all local law was that if a person absolutely refused to accept the property, then he would not be considered to have received it and thus could not give it away. You can't give what you don't have.

Even though there was no federal law governing these disclaimers, the I.R.S., in 1958, decided to establish some standards for the making of a valid disclaimer. One standard was that a disclaimer had to be made within a "reasonable time after knowledge of the existence of the transfer." This requirement did not immediately cause any alarm because making a disclaimer within a "reasonable time after the

transfer" was not a new concept. However, what the tax bar did not know was that the I.R.S. was about to introduce a new concept by interpreting the word "transfer" to mean that point in time when the trust was created. Now for many years, tax practitioners uniformly have been of the view and local law agreed, that the proper time to disclaim was when the life beneficiary had died and the next beneficiary was entitled to possession of the interest, rather than when the trust was created. This contrary position by the I.R.S. caused mass confusion and led to a number of contradictory court decisions. In 1976, Section 2518 was added to the Internal Revenue Code and essentially adopted the I.R.S. position but only for disclaimers of property interests created *after* 1976, This section specifically stated that it was not to change prior law. Nevertheless, the I.R.S. has persisted in applying the standards of Section 2518 retroactively.

Ironically, the 1976 Act gives the holders of remainder interests created after 1976 a nine-month period in which to disclaim, yet the IRS maintains those interests created before the law was enacted are to be denied any time within which to conform to the new standards. This could not have been the intent of Congress.

The inequity of the IRS position is greatest with regard to those interests created prior to the publication of the IRS regulations in 1958. Prior to that date, the law was clear that a disclaimer did not constitute a taxable gift so long as it was effective under applicable local law. Because local law generally did not require that a disclaimer be made until after the interest became possessory, many interests created in 1920 or 1940 or even 1950 and not reduced to possession by the time of the IRS regulations, never had the opportunity to disclaim subsequent to the announcment of the new policy.

What we are suggesting, is an amendment to S. 395 which would permit those interests created before 1958 to have a period of nine months after the enactment of the bill within which to disclaim their interests and be treated as a qualified disclaimer under Section 2518. In other words, the same treatment as those who created trusts after 1976 with full knowledge of the new law.

We are asking that the suggested amendment, which has already been introduced in the House of Representatives by Representative Conable and others as H.R. 2583, be made a part of S. 395.

Senator SYMMS. The Chair would like to announce that the first panel we will call up is Mr. Donald Thurmond, Mr. Richard McGuire, Ms. Helen Timmermann, and Mrs. Ruth Kobell.

Then, when this panel is completed, the next panel we will call up will be Mr. Tom Field, Mr. Larson, and Mr. Goldy.

So, would panel No. 1 please come and be seated at the witness table.

STATEMENTS OF DONALD W. THURMOND, CHAIRMAN, TRUST TAXATION COMMITTEE, AMERICAN BANKERS ASSOCIATION, WASHINGTON, D.C.; RICHARD McGUIRE, PRESIDENT, NEW YORK FARM BUREAU, AMERICAN FARM BUREAU FEDERATION, WASHINGTON, D.C.; HELEN TIMMERMANN, CHAIRMAN, COMMITTEE ON TAXATION, NATIONAL ASSOCIATION OF WHEAT GROWERS, WASHINGTON, D.C.; AND RUTH KOBELL, LEGISLATIVE ASSISTANT, NATIONAL FARMERS UNION, WASHINGTON, D.C.

Senator SYMMS. Do you have a preference of order, panel?

Mrs. Kobell, would you like to commence, please?

Mrs. KOBELL. Yes.

Senator SYMMS. Do you all have prepared statements?

Mrs. KOBELL. I have a prepared statement. I recognize the length of your witness list and the time involved. I would like to have our statement entered into the record. I will try to be very brief because you have already had a wide review of the issue.

Senator SYMMS. The text of all of your complete statements shall be part of our record.

Please go ahead.

Mrs. KOBELL. The National Farmers Union views the subject of estate taxes not only from the impact on individual farm families, but as part of the maintenance of the structure of family farms in America.

We have an ample record that the family farm has been the superior choice of food and fiber production in this country, to assure abundance, efficient production, care of land and water resources, and to support the quality of life in rural communities.

Farming still represents the largest industry in our country. Farmers are major consumers which impact on and support the economy.

So, we believe that estate tax legislation must focus on the problems of transferring land from one generation to the next.

We recognize that the inflation in land values has brought this issue to the fore, and you have had excellent testimony this morning as to figures in this field.

Inflation has also increased cost of farm production. We recognize that farmers have faced relatively low farm price in recent years. Parity now stands at 63 percent, I think. Energy costs have increased. Interest rates have increased.

This means that farmers have their assets tied up in the land. Quite often inflation has simply meant they could borrow more money to try and stay in business a little longer.

Our delegates met in convention in March and passed a rather comprehensive statement relating to economic policy. I have attached that to our testimony, but I would like to review the points of that policy statement in relation to some of your bills that you are considering here today.

The Farmers Union policy statement advocates a somewhat higher exclusion, recognizing that we never quite seem to catch up with inflation.

Farmers Union delegates called for a unified tax credit equivalent to $1 million exemption in their policy statement. I was interested in the comments of Senator Jepsen which pointed out that $1 million is probably not far wrong for an Iowa farm. Also pointing out that net income may average about $9,000 or $10,000.

The Farmers Union recommends an annual gift tax exclusion be raised to $12,000, while S. 395 would raise the limit to $10,000. S. 858 and S. 360 would raise it to $6,000.

As regards special use valuation rule, in section 203(2)(a), of the Internal Revenue Code, we consider this an extremely important provision.

We would suggest that in typical circumstances, we believe that the use of this rule would result in a tax valuation of only 35 or 40 percent of the figure which would apply under our market value criteria.

We concur in the recommendations of S. 395 and S. 360 and S. 858 which would lift the present $500,000 cap on the special use valuation.

However, we urge that extreme care be taken in amending the eligibility and material participation provisions so that nothing is done that would open up use of that provision by persons who are not bona fide family farm operators.

With the adoption of the above provision, we believe the principal problems of family farm operators, with Federal estate and gift taxes will be taken care of for the immediate future.

We do not believe that family farm agriculture would be advantaged by proposals which would terminate the Federal estate and gift tax entirely.

Adoption of S. 404 would serve to narrow the Federal tax base, throwing an additional burden on other levies.

For fiscal year 1982, it is estimated the Federal estate and gift taxes will raise $7.6 billion in revenues.

While other bills before the committee today will reduce that potential somewhat, and your staff certainly has a broader understanding of the implications of that, we see no justification at this time for eliminating the tax altogether.

Finally, I want to note that we have appended to our statement a letter from Mr. Cy Carpenter, chairman of the Executive Committee of National Farmers Union and president of our Minnesota Farmers Union, supporting the estate and gift tax sections of Senator Durenberger's bill, S. 360.

We appreciate the opportunity for the Minnesota Farmers Union to make a statement for the record.

Recognizing the pressures of time, I would close my comments with these brief remarks.

Senator SYMMS. Thank you very much.

Mr. McGuire.

Mr. McGUIRE. Thank you very much, Mr. Chairman, and Senator Boren.

I am Richard McGuire, president of the New York Farm Bureau, member of the AFBF board of directors. I own and operate a 550 acre dairy farm in New York State. I am a third generation on that family farm. The ultimate conclusion of the problem of estate taxes is going to have a direct bearing on whether a fourth generation family farm takes place or not.

I was also here in 1976, and testified before this committee, on this same subject. I am happy to have the opportunity to return again and on behalf of the American Farm Bureau Federation and testify on the estate and gift tax laws, as well as legislation designed to repeal or modify current statutes.

The Farm Bureau has appeared before the Senate Finance Committee and its subcommittees on many occasions to discuss our position on estate taxes.

Our most recent testimony was presented earlier this week to the subcommittee on the oversight of the Internal Revenue Service concerning in part, problems associated with the special use valuation regulations under section 2032A, of the Internal Revenue Code.

The Farm Bureau has had a longtime interest in involvement in the Federal estate gift tax area, because the effect that these taxes have upon the well-being of the Nation's farm and ranch families.

The Farm Bureau actively supported estate tax relief in the Tax Reform Act of 1976 and the Revenue Act of 1978. I already mentioned I testified at that time.

Repeal of the Federal estate tax is a legislative priority for the Farm Bureau during the 97th Congress.

Estate tax reform in 1976 and 1978 debatedly eased the economic and administrative burdens associated with the estate tax.

However, such reform provided no permanent remedy for the increasingly heavy taxation of farm estates whose major asset, land, is highly inflated.

An effect out of inflation has been to subject many small and moderate sized estates to the estate tax.

The $47,000 unified credit, enacted in 1976, is now of little benefit to most farm and ranch estates.

Special use evaluation which is hailed as an answer to estate tax problems for agriculture has become as entangled in the regulatory efforts of the Internal Revenue Service as some estates have forgone its application entirely.

Material participation requirements and evaluation procedures are restricted to the point of negating a law that was intended to benefit farms and other small businesses.

It has been suggested by some that the repeal of the estate taxes could cause an influx of nonfarm investors because the absence of estate taxes would make farm land an attractive investment opportunity.

In a business where the historic return on investment has averaged 4 percent annually, and where farmers themselves must necessarily expand their production base to cover ever-increasing costs of production, it is ironic to suggest that estate tax repeal would be a boon to nonfarm investors.

On the contrary, the presence of the estate tax has caused many farm heirs in the past to sell a portion of the estate to pay the estate tax.

The estate taxes are distinctive to savings, investment, and productivity. It is a tool of those who adhere to the philosophy of using tax policy to accomplish social goals; that is, the redistribution of wealth. The farming operation size often increases in order to maintain a semblance of profitability in agriculture.

We cannot pass our costs to consumers through increased commodity prices.

As previously mentioned, our only alternative is to increase our production base. To penalize heirs for efforts of the decedents to establish profitable businesses is fundamentally wrong in America's capitalistic private enterprise system.

At the least such a notion is inconsistent with the emphasis on capital formation.

The Farm Bureau supports repeal of the estate tax. We will work toward the accomplishment of this goal through the endorsement of S. 404, introduced by Senator Symms, Senator Jepsen and Senator Boren to repeal Federal estate and gift taxes.

The Farm Bureau policy also addresses provisions contained in other legislation pending before the subcommittee: S. 395, by Senators Wallop and Boren; S. 574, by Senator Kassebaum; and S. 585 by Senator Durenberger.

While none of these bills provide for elimination of the Federal estate tax, they do allow a greater measure of estate tax relief for farm families.

We commend the sponsor of these bills and offer our support as part of an overall package of steps in phasing out the estate tax over a period of time.

Our general comments with regard to these bills are directed in several areas: Unified credit, rate reduction, and family deductions. They have already been addressed by this hearing.

At hearings before the Subcommittee on Taxation and Debt Management on August 4, 1980, and the Subcommittee on Oversight of the Internal Revenue Service of April 27, 1981, the Farm Bureau reemphasized that the benefits of special use valuation can be realized by farm families only if reasonable guidelines for methods of evaluation are presented.

To date, the Internal Revenue Service has not offered workable guidelines.

Therefore, the Farm Bureau supports amendments to the Internal Revenue Code such as those contained in S. 395 and S. 878 that will provide realistic requirements.

Senator SYMMS. Can you kind of wrap up your statement?

Mr. MCGUIRE. Yes, I can.

This is not in my statement, but I would like to comment, Senator. I hear a great deal of oratory on the preservation of family farms. I hear a great deal of concern for the continued reduction in agricultural land and our land base and our ability to feed ourselves in the year 2000 and on.

I am involved in a lot of meetings around the country with consumers in New York State on the possibility of starvation and so on.

Government and political leaders continually talk about this and their concern for foreign investment in agricultural land. And yet, at the same time, they refuse to address one of the leading issues that causes the land to move out of agriculture to some other use.

I think this is one of those very great opportunities we have to preserve agricultural land and to insure the ability of this country to feed itself in the future. I hope we repeal the bill.

Senator SYMMS. Thank you very much for a very excellent statement.

Ms. Helen Timmermann, chairman of the Committee on Taxation, National Association of Wheat Growers.

Ms. TIMMERMANN. Mr. Chairman, and members of the committee, my husband and I farm a fourth generation farm near Pendleton, Oreg.

I would ask that my testimony also be entered in total in the record.

Senator SYMMS. Without objection, it shall be.

Ms. TIMMERMANN. Estate taxation was designed to prevent accumulation of great wealth and not as a revenue raising measure.

However, it will become a major source of revenue unless drastic estate tax reform measures are adopted now.

The rate of inflation we have been experiencing since the Tax Reform Act of 1976 is increasing the number of estates subject to estate taxation.

The inflation factor is pushing modest estates, as well as sole proprietors, closely held small businesses and farms into higher and higher estate tax brackets.

The impact of current estate taxation in the next 10 years will be detrimental to the continuation of small businesses and farms.

The following is an example of the acceleration in this trend to tax more and more estates at higher and higher rates due only to the effects of inflation.

An estate of $250,000 on January 1, 1977, would incur an estate tax assessment of $23,800.

Assuming a 10-percent inflation rate, the estate will be worth $500,000 in 7 years, and incur an estate tax of $108,000 by 1984.

In exhibit A, another example shows the effect of inflation on a farm estate of $975,000. You can see that the value increases to approximately $2.5 million in 10 years, at a 10-percent inflation rate.

Figure 3 shows the increasing estate tax burden relative to the current value of this estate.

In 1981, the tax liability is $257,250, or 26 percent of the current value.

This increases to $471,515, or 48 percent of current value in 5 years, and further increases to $853,000, or 87 percent of the current value in just 10 years.

Even the debt due to the estate tax liability in 1981 would be very difficult to service from the income of the farm land.

It will not take very many years under the current estate taxation levels to produce this shift in idealogy from the prevention of accumulation of great wealth to a revenue raising measure.

As deaths occur over the next 10 to 20 years, we will end up with a very different economic and social structure as fewer individual and family farms or businesses are able to survive.

We believe this would be a very undesirable course to choose.

In reference to the issue of special valuation procedures, since the intent of Congress is to have a special farm use valuation to reflect the actual earning capacity of the land, we must have a valuation procedure treating all farm lands equally.

Special farm use valuation is essential for farm continuity. The prevailing market price of farm land can be artificially inflated because of heavy investment interest, and not because of earning capacity.

Current IRS regulations on farm use valuation are drawn so narrowly so as to permit the rent capitalization formula in section 2032(e)(7) to be used for only some farm lands—those based on a pure cash rent.

The regulations permit the net return from cash lease land to be capitalized in the formula, but exclude all others by definition.

In many major agricultural areas of the country, few if any leases are written for cash rental, but all leases are convertible to cash.

The in-kind crop share rent can be converted to its cash equivalent to reflect the actual earning capacity of the land, just as the cash lease can.

In exhibit B, when we look at four farms identical except for type of lease we can see the extreme discrimination in valuation resulting from current regulations.

The proposed IRS regulations of July 19, 1978, recognize the need for converting crop share to cash and outlined a method for determining its cash equivalent.

In April 27 hearings, conducted by the Senate Finance Subcommittee on Oversight of the Internal Revenue Service, Assistant Secretary of Tax Policy John Chapoton told Senator Lloyd Bentsen that he would work with him legislatively on the matter of crop share rent and commented that in some parts of the country it can be objectively determined.

I might mention the State of Oregon has developed a farm use appraisal method that determines annual net rent for all agricultural land, regardless of leases.

Oregon uses the annual net rental return to owner capitalized over a Federal Land Bank interest rate to determine the farm use valuation. This provides a valuation method based on rent capitalization that is fair and equitable to all farm lands.

This concludes my remarks on estate tax reform and special use valuation, Mr. Chairman, and I would be happy to respond to any questions you and the other members of the subcommittee may wish to ask.

Thank you.

Senator SYMMS. Thank you all.

Your appearing here is appreciated very much.

Mr. THURMOND. Thank you.

Mr. MCGUIRE. Thank you.

Ms. TIMMERMANN. Thank you, Senator Symms.

Ms. KOBELL. Thank you, Senator.

[The statements of the preceding panel follow:]

SUMMARY OF TESTIMONY

OF

DONALD W. THURMOND

ON BEHALF OF

AMERICAN BANKERS ASSOCIATION

ON

ESTATE AND GIFT TAX REFORM

BEFORE THE

SUBCOMMITTEE ON ESTATE AND GIFT TAXATION

COMMITTEE ON FINANCE

UNITED STATES SENATE

May 1, 1981

ABA's recommendations for changes in the estate and gift tax are made within the framework of two overriding association policies. The program of tax and spending cuts urged by the President are of the highest priority and should be promptly adopted. Any further tax reductions should be offset by corresponding reductions in revenue to avoid increasing the Federal deficit.

ABA urges repeal of the complex generation skipping transfer tax. The IRS has been unable, although nearly five years have elapsed since enactment of this tax, to develop regulations or reasonable forms. The generation skipping tax produces no significant revenue and is very costly to administer. It should be repealed.

To the extent that a tax cut is available for estate and gift taxes, ABA believes across the board rate reduction is the most equitable and appropriate manner to provide relief. Rate reduction has the added effect of increasing the unified credit.

ABA supports an unlimited estate and gift tax marital deduction only if transfers of a current beneficial interest in property will qualify for the deduction. Without this change the tax incentive to make full use of the deduction is likely to unduly influence the manner in which an individual disposes of property.

The special use valuation provision (Section 2032A) is in need of improvement. In addition to the changes advanced by the bills before the Committee, ABA believes the unduly strict rules relating to the consent agreements should be liberalized.

Simplification and clarity are needed in the provisions covering all closely-held businesses. The special use valuation is of no real use to non-farm closely-held businesses. We ask the Committee to address simplification in the payment deferral provisions as discussed in our attached memorandum, "Sections 6166 and 6166A and Related Matters - Proposals for Change."

TESTIMONY

OF DONALD W. THURMOND

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ESTATE AND GIFT TAX REFORM

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COMMITTEE ON FINANCE

UNITED STATES SENATE

May 1, 1981

Mr. Chairman and Members of the Committee: My name is Donald W. Thurmond. I am Chairman of the Taxation Committee of the Trust Division of the American Bankers Association and Group Vice President of the Trust Company Bank, Atlanta, Georgia.

The American Bankers Association (ABA) is a trade association composed of more than 13,100 banks - over 90% of the nation's full service banks. Approximately 4,000 of these banks are authorized to serve their customers as trustees and executors. The Association has a long involvement in the federal estate and gift tax area because of our members' experience in the planning and administration of customer's estates. We appreciate the opportunity to present our views on suggested reform of the estate and gift tax.

Before we begin to discuss the particular issues of estate and gift tax, we must make one point very clear. The American Bankers Association has thrown its full support behind the goals expressed in the President's economic package of tax and spending cuts. Our nation must bring inflation under

control, that is, and will be our highest priority. Measures to reform the estate and gift tax, or other proposals no matter how meritorious they may be, should not interfere with the prompt enactment of the President's economic package.

There is a need to reexamine the estate and gift tax laws in terms of the level of taxation, the effects of inflation and the liquidity problems and capital formation requirements of family-owned and closely-held businesses. Although official revenue estimates on the various proposals under consideration by the Subcommittee are not yet available, it is apparent a substantial tax reduction would result. As a general proposition, the ABA strongly believes that any tax cut should be matched by a reduction in federal expenditures sufficient to prevent an increase in the Federal deficit. The reduction should be designed to encourage savings, investments, technological advances and innovative activity rather than consumption. We urge the Subcommittee to consider a reduction in estate tax and gift tax within these guidelines.

The bills pending before the Subcommittee today - S. 404, S. 395, S. 858 and S. 574 - focus on the general need to revise the estate and gift tax. We appreciate the foresight of the Subcommittee in scheduling hearings on "major estate tax issues." Comprehensive tax legislation requires the benefit of extensive review. The ABA believes, in light of the broad nature of the issues and the need to provide across the board transfer tax relief, that the problems of a comprehensive law should not be approached in a piecemeal fashion. As requested by the Subcommittee, our testimony today will address the major issues raised by the pending legislation.

REPEAL OF ESTATE AND GIFT TAX AND THE GENERATION-SKIPPING TAX

The American Bankers Association, at this time, neither endorses nor opposes that portion of S. 404 which deals with the repeal of the estate and gift tax. However, we do urge repeal of the tax on generation-skipping transfers which is included in S. 404. This tax, embodied in Chapter 13 of the Code, was enacted as a part of the Tax Reform Act of 1976. The extreme complexity of the statute renders it incomprehensible to all but a few. Witness the fact that the IRS, nearly five years after enactment, has failed to publish final forms or final regulations except for some transitional rules.

Until 1976, property could be placed in a trust benefitting several generations without a transfer tax (estate or gift tax) being paid until the property was ultimately included in a beneficiary's estate. Congress was persuaded in 1976 that this was a tax loophole and that a tax similar to the estate tax should be imposed on any transfers from a trust or trust equivalent to a younger generation beneficiary if there were beneficiaries in two or more younger generations. Excluded from the tax are certain transfers for a grantor's grandchildren in an amount of $250,000 per child of the grantor. There is also an exclusion for transfers of current income. The timing of the tax depends on the last of a generation or their ancestors to die and the tax is determined by reference to a "deemed transferor." The existence of beneficiaries is determined by powers and interests.

The law is a model of complexity presenting as it does fundamental administrative difficulties. For example, in many cases it is a challenge of immeasurable proportion to determine who the "deemed transferor" is, and in many cases to determine even if there is a "generation-skipping transfer."

The efforts of the Internal Revenue Service to develop regulations and forms demonstrate the extraordinary complexity of the law. Although the law applies to generation-skipping transfers which occurred as early as June 11, 1976, no regulations even in proposed form were published until December, 1978. The following schedule shows the extent of IRS efforts, and lack of progress even today nearly five years after enactment, in developing regulations and return forms.

Transitional rules
- proposed...December 21, 1978
- final...July 31, 1980

Return requirements
- temporary (proposed)...July 18, 1980
- modified...January 30, 1981
- final...

Definitional rules
- proposed...December 30, 1980
- final...

Remaining provisions
- proposed...
- final...

Forms

- proposed...February 17, 1981
- revised (proposed)...April 21, 1981
- final...

What that schedule fails to show is the lack of quality of the work done thus far. The proposed definitional rules are simply inadequate. They fail to provide needed guidance on a number of issues the answers to which are required to draft properly even common types of trusts. The forms proposed by the Service are far more complicated and detailed than needed in all but a few cases. The "Information Return by Trustee for Taxable Distribution or Termination From a Generation-Skipping Trust" (Form 706-B(1)) runs to four pages and includes 61 questions. Twenty-three pages of instructions in their

present format accompany the forms. The 706-B(1) form calls for the trustee to determine market value of property that has been distributed. This is a determination that should properly be made by the taxpayer and the IRS on a return dealing with the payment of the tax. (Copies of the 706B(1) and B(2) information return forms and instructions are attached).

The problems we have encountered with respect to the generation-skipping forms are not reserved to the content of the documents. The unworkability of the tax and the accompanying forms is illustrated by the fact that the forms are still being circulated within Treasury and OMB for comment, despite a June 30, 1981 deadline for the filing of the information returns. If our previous experience with the Service concerning the issuance of these forms repeats itself we may expect publication of the final forms in mid-June for filing of information returns by June 30th. The return requirement regulations, proposed in July 1980, initially provided for a February 5, 1981 filing date for the return forms. On February 2, 1981, only three days before the forms were due, the IRS announced the postponement of the due dates for the filing of the generation-skipping forms. And not until February 17th were the forms actually published for comment. If the Internal Revenue Service cannot draft a simple, relevant and timely set of forms to implement the law then we question how trustees and taxpayers may be expected to understand and comply with the requirements of the generation-skipping provisions.

Under the statute it is anticipated that the IRS will become a national clearinghouse for transfer tax information to collect and store, in quickly retrievable form, all estate, gift and generation-skipping transfer tax returns. The Service is expected to retrieve and transmit such information on a timely basis on the request of those entitled to such information. To fulfill this function IRS will have to develop extremely sophisticated automated systems.

To the best of our knowledge these systems have not been developed, nor are they even in the planning stage. However, without them administration and enforcement of Chapter 13 will be impossible.

The revenue effect of this tax is negligible. In 1976 the Joint Committee on Taxation estimated that by the early 1980's the generation-skipping tax would raise less than $1 million per year. In the long run (18 to 20 years) by 1996, the Committee estimated that the net revenue gain would be approximately $280 million per year. The costs to the government together with the expense to trustees and taxpayers to monitor and identify generation-skipping transfers, file information returns, compute and pay the tax will certainly in the early years far exceed revenues.

Because they are so technical, the generation-skipping provisions will not likely be understood by the typical estate planning professional much less the attorney in general practice who writes wills only occasionally. The untimely death of a trust beneficiary can convert an ordinary nongeneration-skipping testamentary family trust into a generation-skipping trust subject to tax when that result was neither intended nor could it have been reasonably anticipated at the time the trust was created. At the same time the very wealthy who can afford to establish separate trusts for each generation level may avoid the tax altogether.

The generation-skipping tax is impossibly complex, a trap for the unwary. It is extrememly costly to administer yet raises little revenue. It is yet another tax on capital. It makes no sense. ABA urges its immediate repeal.

INCREASED UNIFIED CREDIT

The Family Enterprise Estate and Gift Tax Equity Act, S. 395, and the Family Farm Protection Act of 1981, S. 858, provide for an increase in the unified

credit for gift and estate taxes to exempt from these taxes transfers by individuals of up to $600,000. In August of 1980, the Senate Subcommittee on Taxation and Debt Management held hearings on a bill (S. 2967) which was the predecessor to S. 395. S. 2967 would have increased the unified credit to $500,000 by 1985. The estimated revenue loss from S. 2967 was projected to be $3.3 billion, of which $3 billion was attributable to the $500,000 estate tax exemption. The revenue loss from the $600,000 exemption, as proposed in S. 395 and S. 858, would obviously exceed $3½ billion.

While an increase in the unified credit may be warranted, the ABA firmly believes that the estate tax rate structure is too severe and that a reduction at all levels is more desirable. In addition to the increase in the unified credit S. 395 contains a provision which would reduce the estate tax on the average of 10% per bracket. The Association feels that the Subcommittee should give serious consideration to whether the revenue loss that would result from the enactment of these two provisions can be absorbed by the government. In other words, will this increase the federal deficit? If a decision is made to reduce the level of revenue, there should be a corresponding decrease in government expenditures. Then, we believe the question must be asked how we can best achieve estate tax relief that is both affordable and beneficial to all estates.

If a tax reduction is available for estate and gift taxes, the Association is of the opinion that a general reduction in the estate tax rate would be the most appropriate and equitable manner to fashion estate tax relief. We would like to bring the Subcommittee's attention to the fact that the approximate 10% across-the-board rate reduction as contained in S. 395 would have the effect of raising the unified credit to approximately $260,000 from its

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present level of $175,000. A reduction in the estate tax rates would therefore accomplish the dual purpose of increasing the estate tax exemption and providing all estates with the opportunity of benefitting from tax reduction.

MARITAL DEDUCTION

S. 395 provides a change in the marital deduction which would permit the passage of an entire estate to a surviving spouse free of transfer tax. The ABA supports a quantitative change in the marital deduction which would permit an unlimited deduction for the value of property passing to a spouse only if a qualitative change is also made so that a current beneficial interest in property would qualify for the deduction. In other words, a trust income interest or a legal life estate in a surviving spouse would so qualify.

This represents a change from the position taken by the Association as recently as last year. At that time we expressed concern that the unlimited marital deduction would create an undeniable tax incentive to leave one's entire estate to a surviving spouse, to the total exclusion even, for example, of children of an earlier marriage of the decedent. We believe the current beneficial test solves that problem. It recognizes that spouses in today's society by and large consider property as belonging to both of them and at the same time permits a decedent to provide for children of that earlier marriage.

Section 4 of S. 395 contains an unlimited marital deduction, but does not change the nature of the interests that qualify for the deduction. As a result, the deduction would continue to be available only if the spouse is given the right to control the disposition of the property by means of a general power of appointment. In many cases a donor or decedent would prefer not to give his or her spouse such control. The point becomes more significant

as divorce and remarriage increase, which has occurred. The property owner would like to be sure that upon the death of his spouse his children by prior marriages share in his property, including the marital deduction property. Under current law, this objective is attainable, at least in part, through the disposition of that part of the estate which does not qualify for the deduction.

If the marital deduction were made unlimited, the "tax pull" would be substantial to make full use of the deduction. The property owner would be put to a most difficult choice between paying no immediate tax but giving up control over the affected property or paying an "early" tax but keeping such control. A shift to a qualification test based only upon current beneficial enjoyment in property would eliminate the necessity for such a choice to be made.

The ABA believes a current beneficial enjoyment test could most simply be effectuated by modifying sections 2056(b)(5) and 2523(e) to eliminate the power of appointment requirement. Each of these sections now also requires a current beneficial interest in the affected property. Under these provisions, the current beneficial interest would have to continue until the death of the surviving spouse in order to qualify for the deduction. This requirement would prevent the "forcing" of a transfer on the spouse during life by terminating the current beneficial interest and thereby increasing the transfer tax rates under section 2001 on later gifts or the spouse's estate. Upon the termination of the spouse's interest at death, the property subject to the current beneficial interest would be taxed "on top of" that spouse's own transfers, in other words, at the incremental estate tax bracket of the spouse. As a result, the spouse's own transfers would not be adversely affected by the transfer occurring

as a result of the termination of the interest qualifying for the marital deduction.

A complexity created by a current beneficial interest test is that an income interest of a spouse may be neither taxable and non-taxable at the spouse's death depending upon whether a marital deduction was allowed. The donor or decedent spouse would be given the right to elect to have the property in which the other spouse is given a current beneficial interest treated as a taxable transfer. Thus an election "out" of the marital deduction would be permitted. The beneficiary spouse would not be given any right to change an election of the other spouse.

ANNUAL GIFT TAX EXCLUSION

S. 395 includes a section that would increase the gift tax annual exclusion for gifts from $3,000 to $10,000 per person. The need to increase the annual gift tax exclusion has been apparent for the past several years and we are pleased to add our support for this proposal.

SPECIAL USE VALUATION - SECTION 2032A

Section 2032A was enacted as a part of the Tax Reform Act of 1976 and permits a special valuation method to be used in valuing farms for estate tax purposes if certain requirements are met. The section is in our judgment defective in many aspects. S. 395 and S. 858 would make substantial changes in Section 2032A and improve its effectiveness. S. 574 also addresses itself to the problem of the impact of the estate tax on farm estates.

Changes in section 2032A, some of which should be noncontroversial, have been opposed by the Treasury in the past. We note that Treasury has announced its intent to modify some aspects of the regulations under this section. However, Treasury has not altered its position to permit crop share rentals to be used in

the section 2032A(e)(7) formula when no cash rentals for comparable land are available. As a result, many farm estates will continue to be denied the benefit of the use of the section 2032A(e)(7) formula because when the cash rentals are not available for comparable land the farm must be valued at fair market value. The ABA supports this change as contained in S. 395 and S. 858.

We also believe the modification of the stringent material participation requirement proposed by S. 395 and S. 858 to permit farms held by elderly disabled or retired farmers or their spouses is desirable and support the other technical changes in section 2032A that are contained in both bills. We suggest that a further change be made in the section. Under current law, every person who has or may have an interest in section 2032A property must sign a consent agreement electing special use valuation. The final regulations interpret this requirement in a literal manner and require that the agreement be filed with the estate tax return. Treas. Reg. § 20.2032A-8(a)(3) and (c). The regulations do not contain a "good faith" rule to cover the case where the consent of one or more persons is not obtained before the return is due to be filed. A "mistake" in ascertaining the necessary parties apparently means the use of section 2032A is invalidated. This problem would be solved by permitting consents to be filed after the estate tax return is filed, provided a reasonable cause test is satisfied. The ABA also believes that a decedent should be permitted to waive the consent agreement requirement. We recognize that these proposals present some technical problems if section 2032A(c) becomes applicable and an additional estate tax is imposed and would be pleased to work with staff members in their resolution.

In the course of discussions with numerous bankers across the country it has become apparent that the special use valuation provisions are not being administered uniformly. There does not appear to be agreement within the

district offices of the Internal Revenue Service as to what constitutes "material participation" or what is meant by the term "comparable land." We are pleased to see that both S. 395 and S. 858 contain sections that would substantially "clean-up" section 2032A. However, we question whether a legislative clean-up can cure this uneven-handed administration of the special use valuation provisions.

Our major concern with section 2032A has been and continues to be the valuation distinction that it creates between farms and other closely-held businesses. We believe such a distinction is unwarranted. The distinction would be broadened rather than narrowed through the removal of the $500,000 limitation on the decrease in value resulting from section 2032A. In 1976 and in 1980 we suggested a means of creating the same type of estate tax relief for farms and other closely-held businesses. This would be done by granting a partial forgiveness for estate tax deferred under section 6166. We continue to believe that such an approach is desirable.

MERGER OF SECTIONS 6166 and 6166A

There is a need to provide simplification and clarity in the provisions covering closely-held businesses. The special use valuation provision is of no real use to a non-farm closely-held business.

During the past year, sections 6166 and 6166A, relating to the deferral of the payment of estate tax attributable to an interest in a closely-held business, have been the subject of much discussion. The ABA believes that reform of this aspect of the estate tax law is essential. The existence of two deferral provisions with differing requirements creates confusion and uncertainty. Considerable simplification would be achieved by "merging"

the two sections and using as a point of departure the deferral provisions of section 6166.

S. 395 includes a provision which would merge sections 6166 and 6166A by (i) using the lower threshold percentage qualification requirements of section 6166A and (ii) all other provisions of section 6166. We support the merger concept, but urge that other changes be made to make the deferral provisions more useful. We are attaching to this statement the latest version of an ABA memorandum captioned "Sections 6166 and 6166A and Related Matters - Proposals for Change" dated August 27, 1980 which contains a number of suggestions for increasing the utility of the deferral provisions.

GIFT TAX ELECTION

Under current law, use of the unified credit is mandatory for gifts. As a result, a taxpayer cannot obtain a binding determination of value for gift tax purposes until the credit has been used up and gift tax is paid. See Section 2504(c). This is not troublesome when the gift is cash or marketable securities because no valuation problem exists. However, if closely-held stock or real property is involved, the valuation of such property is necessarily uncertain or imprecise and therefore gifts of such property present a problem that is not present with other gifts because of the lack of valuation finality until a gift is paid.

S. 395 would make the use of the unified credit elective. The ABA supports this provision which has insignificant revenue consequences. The ABA also recommends that a related problem be eliminated. Section 2504(c) provides in essence that if a gift tax has been paid for a calendar quarter and the statute of limitations has expired, then the valuations reported on the return (as adjusted in audit or in litigation) are final for later application of the gift tax to subsequent gifts. As a result of the Tax Reform

Act of 1976, the estate tax and the Chapter 13 tax on certain generation skipping transfers are computed "on top of" an individual's taxable gifts. Section 2504(c) should therefore be revised to accord finality for any valuation in computing a prior gift or estate tax where a later gift, estate or Chapter 13 tax is computed "on top of" the prior tax.

ANNUAL REPORTING OF GIFT TAX

Senator Harry F. Byrd, Jr. and Senator Bob Packwood recently introduced a bill, S. 955, to permit the reporting of gift tax on an annual basis rather than on a quarterly system as is now required. Although this issue is not presently under consideration by the Subcommittee we would like to take this opportunity to express our support for such a proposal.

The elimination of the quarterly gift tax return requirement as proposed in S. 955 represents much needed simplification in our tax law. The current quarterly requirement is burdensome on the taxpayer and the Internal Revenue Service. Furthermore, it frequently amounts to a trap for the unwary since many taxpayers rely on a tax return professional to handle their return requirements on an annual basis - at the time for filing the income tax return. It is possible the rationale that supported going to a quarterly return in 1971 no longer exists since the addition of the unified credit and the $100,000 gift to spouse provisions by the Tax Reform Act of 1976.

It has been clear since 1971 that the quarterly return has increased complexity and added expense for the taxpayer and the Internal Revenue Service. The 1979 change that coordinated the fourth quarter gift tax return filing with the income tax return was a step in the right direction to reduce this complexity but did not go far enough. The current proposal that substitutes an annual filing requirement for a quarterly filing requirement will complete the needed simplification.

Last year's version of S. 955 was favorably reported by the Senate Finance Committee and subsequently passed by the Senate. However, because the House of Representatives was unable to hold hearings on the proposal it was deleted in a conference between the House and the Senate. The ABA urges the Subcommittee to give serious consideration to this proposal in its future deliberations.

The ABA appreciates having had this opportunity to comment on the issues pending before the Subcommittee today. We would be pleased to answer any questions the Subcommittee or staff may have.

April 21, 1981

Form **706-B(1)** (Rev. April, 1981) Department of the Treasury Internal Revenue Service

# Information Return by Trustee for Taxable Distribution or Termination From a Generation-Skipping Trust

Tax year beginning ........, 19 .., ending ........, 19 ..

Date to: ______ Expires: ______

| | |
|---|---|
| 1 Name of deemed transferor | 2 Social security number |
| 3 Name of person filing this return | 4 Name of trust |
| 5 Address of person filing this return (number and street, city, State, and ZIP code) | 6 Employer identification number of trust |

7 Check whether this return is filed for: (check as many blocks as apply).

- ☐ (a) Taxable Termination (complete Part I)
- ☐ (b) Taxable Distributions where all the trusts current year's distributions are cash (complete Part II)
- ☐ (c) Distributions of property and cash distributed in the current year (complete Part III)
- ☐ (d) Distributions of cash or property before the current tax year and within three years before the deemed transferor's death (complete Part IV)
- ☐ (e) Transfers that are not subject to generation skipping transfer taxes because they were subject to estate or gift taxes (complete Part V)
- ☐ (f) Terminations that are postponed by operation of Code section 2613(b)(2) (complete Part V)

## Part I Terminations (see the instructions for which parts of this schedule must be completed)

8 If the deemed transferor was not alive at the end of the current tax year, enter the date of the deemed transferor's death .........., 19 .... and complete lines 9 through 14 and/or lines 15 through 20 below. Do not complete lines 21 through 26. If the transferor was alive at the end of the current tax year, skip to line 21.

9 For terminations that occurred within 3 years before the date of death, enter the date of the termination and the fair market value of the transferred property on the date of death or the alternate valuation date if applicable (see instructions)

| Date of termination: Month | Day | Year | Value (see instructions) |
|---|---|---|---|
| | | | |
| | | | |
| | | | |
| | | Total 9 | |

10 Debts, expenses, taxes and losses to be applied against the terminations on line 9 . . . . . 10

11 Charitable deductions from the terminations on line 9 . . . . . 11

12 Grandchild exclusions applied to the terminations on line 9 . . . . . 12

13 Add lines 10, 11, and 12 . . . . . 13

14 Net terminations
Subtract line 13 from line 9. If line 13 is more than line 9, enter zero . . . . . 14

15 For terminations caused by reason of the deemed transferor's death, enter the date of death and the fair market value of the transferred property on the date of death or on the alternate valuation date (if elected) (see instructions)

| Date of termination: Month | Day | Year | Value |
|---|---|---|---|
| | | | |
| | | | |
| | | | |
| | | Total 15 | |

16 Debts, expenses, taxes and losses to be applied against the terminations on line 15 . . . . . 16

17 Charitable deductions from the terminations on line 15 . . . . . 17

18 Grandchild exclusions applied to the terminations on line 15 . . . . . 18

19 Add lines 16, 17, and 18 . . . . . 19

20 Net terminations
Subtract line 19 from line 15. If line 19 is more than line 15 enter zero . . . . . 20

21 Do not complete this line if you completed lines 9 or 15. If the deemed transferor was alive at the end of the current tax year, enter the date of each termination and the fair market value of the transferred property on the date of the termination (or alternate evaluation date, if applicable, see instructions)

| Date of termination: Month | Day | Year | Value |
|---|---|---|---|
| | | | |
| | | | |
| | | | |
| | | Total 21 | |

For Paperwork Reduction Act Notice see page 1 of separate instructions

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22 Debts, expenses, taxes, and losses to be applied against the above terminations . . . . . 22
23 Charitable deductions from the above terminations . . . . . 23
24 Grandchild exclusions applied to the above terminations . . . . . 24
25 Add lines 22, 23, and 24 . . . . . 25
26 Net terminations
Subtract line 25 from line 21. If line 25 is more than line 21 enter zero . . . . . 26
27 Summary of the grandchild exclusions that will be applied to the terminations listed above

| Grandchild's name | Date of ~~birth~~ termination | Social security number | Amount of exclusion |
|---|---|---|---|
| | | | |
| | | | |
| | | | |
| | | | |
| Total . . . . . | | ▶ 27 | |

**Part II Distributions where all the trust's distributions were cash**

If all the trust's distributions to all recipients attributed to the current tax year were made in cash you must enter these distributions on Part II, below. If any distribution from the trust to any recipient attributed to the current year was made in property other than cash, you must enter all distributions (including cash distributions) on Part III, below.

28 Recipients of transfers that ~~are attributable to~~ were made during the current tax year and that have the deemed transferor named on line 1 of this form

| (a) Code | (b) Recipient's name | (c) Social security number | (d) Relationship to grantor | (e) Amount |
|---|---|---|---|---|
| A | | | | |
| B | | | | |
| C | | | | |
| D | | | | |

Attach a separate schedule showing how the trusts section 643(b) income for the year was computed.

29 Is the deemed transferor who is listed on line 1 of this form the only deemed transferor with respect to whom the trust made distributions attributable to the current tax year? . . . . . ☐ Yes ☐ No

If you checked "Yes," complete lines 30 through 37 and lines 32 through 46 (if applicable) and enter the total taxable distributions on line 47. If you checked "No," you must allocate section 643(b) income on an attached sheet and complete only lines 30, 31, 37, 46, and 47 as explained in the instructions. If there was a termination during the tax year, figure section 643 income and taxable distributions for two short periods as explained in the instructions. Complete lines 30 through 38 for the first short period and lines 39 through 46 for the second short period. If there was no termination during the tax year, complete lines 30 through 37 for the entire tax year and do not complete lines 38 through 46

39, 40, (4)

30 Period for which lines 32 through 37 are completed:
☐ Full year ☐ Short period beginning . . . . . , 19 . . , and ending . . . . . , 19 . . . .

31 List the code letters from column a, line 28 of the recipients for whom you are completing lines 32 through 36. . . . . .
32 Total section 643(b) income for full tax year (or first short period) . . . . . 32
33 Distributions to charities during full tax year (or first short period) . . . 33
34 Distributions to beneficiaries assigned to generations older than that of the recipients listed on line 31 . . . . . 34
35 Add lines 33 and 34 . . . . . 35
36 Subtract line 35 from line 32 (but not less than zero) . . . . . 36
37 Share of taxable distribution allocable to beneficiaries who are listed on line 28

| (a) Code | (b) Date of distribution: Month | Day | Year | (c) Amount distributed | (d) Percent | (e) Share of income | (f) Share of taxable distribution |
|---|---|---|---|---|---|---|---|
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| Total . . . . . | | | | 37(c) | | | 37(f) |

Do not complete lines 38 through 46 if you completed lines 32 through 37 for the full year. Instead, skip to line 47 and enter the total of line 37, column (f)

38 Excess section 643 income to be applied to the second short period (see instructions) . . . . . 38
39 Period for which lines 41 through 46 are completed
beginning , 19 , and ending , 19
40 List the code letters from column a, line 28 of the recipients for whom you are completing lines 32 through 36 . . . . .

41 Total of section 643(b) income for this short period and amount on line 38 . . . . . . . . . . 41

42 Distributions to charities during this short period . . . . . . . . . . 42

43 Distributions to beneficiaries assigned to generations older than that of the recipients listed on line 40 . . . . . . . . . . 43

44 Add lines 42 and 43 . . . . . . . . . . 44

45 Subtract line 44 from line 41 (but not less than zero) . . . . . . . . . . 45

46 Share of taxable distribution allocable to beneficiaries who are listed on line 28

| (a) Code | (b) Date of distribution | | | (c) Amount distributed | (d) Percent | (e) Share of income | (f) Share of taxable distribution |
|---|---|---|---|---|---|---|---|
| | Month | Day | Year | | | | |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| Total . . . . . . . . . | | | | 46(c) | | | 46(f) |

47 Add line 37, column (f) and line 46, column (f) and enter here. If this amount is greater than zero you must file a Form 706-B(2) for each distributee who received a taxable distribution . . . . 47

## Part III Distributions where the trust distributed property other than cash

If the trust made any distribution attributable to the current year, to any recipient, of property other than cash, then all distributions (including cash distributions) attributable to the current year and to the deemed transferor named on line 1 of this form must be listed on Part III. Do not complete Part II, if you completed Part III.

48 Recipients of transfers that have the deemed transferor named on line 1 of this form and are attributed to the current tax year

| (a) Code | (b) Recipient's name | (c) Social security number | (d) Relationship to grantor |
|---|---|---|---|
| A | | | |
| B | | | |
| C | | | |
| D | | | |

49 Transfers to the recipients listed on line 48 above

| (a) Code | (b) Description of transferred property | Date of transfer | | |
|---|---|---|---|---|
| | | Month | Day | Year |
| | | | | |
| | | | | |
| | | | | |
| | | | | |

50 Is the deemed transferor who is listed on line 1 of this form the only deemed transferor with respect to whom the trust made distributions attributable to the current year? . . . . . . . . . . ☐ Yes ☐ No

Attach a separate schedule showing how the trust's section 643(b) income was computed.

51 If there were no terminations during the current tax year, enter the trust's section 643(b) income for the entire year . . . . . . . . . .

52 If there was a termination during the current tax year, you must figure section 643(b) income using 2 short periods as explained in the instructions to line 30.

(a) enter the dates of the first short period: beginning ............, 19 .. ending ............, 19 ..

(b) section 643(b) income for the first short period . . . . . . . . . . 52(b)

(c) enter the dates of the second short period: beginning ............, 19 .. ending ............, 19 ..

(d) section 643(b) income for the second short period . . . . . . . . . . 52(d)

53 Distributions to Charities

| (a) Charitable Recipient's name | (b) Date of transfer | | | (c) Description of property | Value (see instructions) |
|---|---|---|---|---|---|
| | Month | Day | Year | | |
| | | | | | |
| | | | | | |
| | | | | | |
| | | | | | |
| | | | | | |

If you completed Part III of this form, you must complete Form 706-B(2) for each distributee

**Part IV Distributions made before the current tax year but within three years of the deemed transferor's death**

54 Recipients of distributions (of cash or other property) that were made before the current tax year but within three years of the deemed transferor's death

| (a) Code | (b) Recipient's name | (c) Social security number | (d) Relationship to grantor |
|---|---|---|---|
| | | | |
| A | | | |
| B | | | |
| C | | | |
| D | | | |

55 Distributions to the recipients listed on line 54 above.

| (a) Code | (b) Description of transferred property | Date of transfer | | |
|---|---|---|---|---|
| | | Month | Day | Year |
| | | | | |
| | | | | |
| | | | | |
| | | | | |

56 Enter the date of the deemed transferor's death . . . . . , 19 .
You must complete a Form 706-B(2) for each recipient listed on line 54 above

**Part V Other transfers**

57 Transfers that are not subject to generation-skipping transfer taxes because they are subject to estate or gift taxes (section 2613 (a)(4)(B) and 2613(b)(5)(B) of the Code and transfers that are not taxable by reason of section 2613(b)(7)(B) of the Code see instructions. List these transfers for the deemed transferor named on line 1 of this form on the schedule below.

| Date of transfer Month Day Year | Recipient | Type of transfer (Termination or Distribution) | Description of transferred property or interest | Reason transfer is nontaxable (see instructions) |
|---|---|---|---|---|
| | | | | |
| | | | | |
| | | | | |
| | | | | |

58 Terminations that are postponed by operation of section 2613(b)(2) of the code. List these terminations for the current year on the schedule below

| Code | Date of termination Month Day Year | Description of terminated interest |
|---|---|---|
| | | |
| | | |
| | | |
| | | |

For each termination listed above, attach a separate sheet describing why the termination was postponed and listing the unexpired powers or interests of the other younger generation beneficiaries that caused the termination to be postponed

**Part VI Other information**

| | Yes | No |
|---|---|---|
| 59 Has the trust ever loaned, after June 11, 1976, any of its assets to any person without reporting the loan previously on a Form 706-B(1)? If your answer is "Yes," attach a separate sheet describing for each loan, its amount, its interest rate, the security for the loan and the name of the person to whom the loan was made. | | |
| 60 Has there ever been a disclaimer, after June 11, 1976, relating to the trust that has not previously been reported on a Form 706-B(1)? If you answer "Yes," attach a copy of the written disclaimer required by section 2518 of the Internal Revenue Code. | | |
| 61 Has there been a change in the trust's grantors or in the relative contributions of the trust's grantors that has not previously been reported on a Form 706-B(1)? If you answer "Yes," attach a statement describing the change. | | |

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer other than trustee is based on all information of which preparer has any knowledge.

Signature of trustee ▶ . . . . . . . . . . Date ▶ . . . . . .

Signature of preparer other than trustee ▶ . . . . . . . . Date ▶ . . .

Address ▶

(If more space is needed, attach additional sheets of same size.)
343-304-1

Form 706-B(1) Instructions

Paperwork Reduction Act Notice - The Paperwork Reduction Act of 1980 says we must tell you why we are collecting this information, how we will use it, and whether you have to give it to us. We ask for the information to carry out the Internal Revenue laws of the United States. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax. You are required to give us this information.

Purpose of Form - Form 706-B(1) is an information return that is completed by the trustee of a generation - skipping trust for all distributions to younger generation beneficiaries and charities and for all terminations. The information provided on Form 706-B(1) enables the Service to provide other trustees and distributees whose transfers have the same deemed transferor with enough information to complete their returns.

Definitions - For purposes of these instructions:

Current tax year is the tax year you entered above line 1 of this Form 706-B(1).

Distributions made during the current tax year include distributions attributed to the current tax year under the 65 day rule of section 663(b) of the Code.

How to complete Form 706-B(1): You must complete a Form 706-B(1) for each deemed transferor.

Terminations

In Part I, you should enter all terminations that you will file for this tax year. If the trust has terminations that are not going to reported on a Form 706-B because of Code sections 2613(b)(5)(B), 2613 (b)(7)(B) or 2613(b)(2), report these terminations on Part V rather than Part I.

Distributions

Parts II and III are used to report distributions attributable to the current tax year.

Part II may only be used if all of the trust's distributions (to every recipient) made during the current tax year were made in cash. Part II enable you to reduce the distributions by the trust's section 643(b) income and to determine the taxable distribution made to each distributee. By completing Part II, you greatly reduce the distributee's difficulties in completing their Forms 706-B and you greatly increase the accuracy of the taxes they compute.

Part III must be used if the trust made any non cash distribution (to any recipient) during to the current year. In this case, Part II may not be used and all distributions, including cash distributions, should be listed on Part III.

Part IV should be completed if the trust had any distributions that were made before the current tax year but within three years before the deemed transferors death.

Part V should be used to report a distribution that is not taxable by reason of Code sections 2613(a)(4)(B) or 2613(b)(7)(B). These distributions should be listed only on Part V and not on Parts II, III, or IV.

Other Information

Part VI requires you to provide other information that aids the service in computing the generation-skipping transfer tax. If you do not have ~~to fill Form 706-B(1)~~ file, to complete one or more of Parts I-V, you do not need to ~~complete Part VI~~ file Form 706-B(1) even if one of the events described in ~~that~~ Part VI took place during the current tax year. However, if you are required to complete one or more of Parts I-V, you must answer the questions in Part VI and provide the information requested.

Who Must File - The trustee must file Form 706-B(1) for:

(1) All of the trust's terminations that took place during the current tax year and will be reported on Form 706-B for the current tax year.

(2) All distributions attributed to the current tax year for which there there is a deemed transferor; and

(3) All distributions before the current tax year but within three years of the deemed transferor's death if the distributions were reported (or should have been reported) on a Form 706-B(1) for the year in which they were considered made.

(4) All transfers attributed to the current tax year which are not subject to generation - skipping transfer taxes because they are described by sections 2613(a)(4)(B), 2613(b)(5)(B) or 2643(b)(7)(B) of the Code.

(5) All terminations attributed to the current tax year that are postponed by operation of section 2613(b)(2) of the Code.

When to File. - File the return by the fifteenth day of the third month following the end of the trust's tax year if the only transfers reported are distributions and terminations that occurred before the death of the deemed transferor. However, if you are reporting a distribution or termination that occurred in the tax year of the deemed transferor's death, file Form 706-B(1) by the later of the fifteenth day of the third month following the last day allowed for filing the estate tax return.

If the due date figured as explained in the previous paragraph falls before June 30, 1981, you may have an automatic extension of time to file until June 30, 1981.

81-288 O - 81 - 12

Where to File. - File Form 706-B(1) with the Internal Revenue Service Center where an estate or gift tax return of the deemed transferor would be filed. The service center addresses are listed below. File the Form 706-B(1) for a nonresident alien distributee with the Internal Revenue Service Center, 11601 Roosevelt Boulevard, Philadelphia, PA 19255.

| If your legal residence, principal place of business, office or agency is located in<br>* * * * * * * * * | Use this address<br>* * * * * * * * |
|---|---|
| New Jersey, NY City and counties of Nassau, Rockland, Suffolk, and Westchester | Internal Revenue Service Center<br>Holtsville, NY 00501 |
| New York (all other counties), Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont | Internal Revenue Service Center<br>Andover, MA 05501 |
| District of Columbia, Delaware, Maryland, Pennsylvania | Internal Revenue Service Center<br>Philadelphia, PA 19255 |
| Alabama, Florida, Georgia, Mississippi, South Carolina | Internal Revenue Service Center<br>Atlanta, GA 31101 |
| Michigan, Ohio | Internal Revenue Service Center<br>Cincinnati, OH 45999 |
| Arkansas, Kansas, Louisiana, New Mexico Oklahoma, Texas | Internal Revenue Service Center<br>Austin, TX 73301 |

| | |
|---|---|
| Alaska, Arizona, Colorado, Idaho, Minnesota, Montana, Nebraska, Nevada, North Dakota, Oregon, South Dakota, Utah, Washington, Wyoming | Internal Revenue Service Center<br>Ogden, UT 84201 |
| Illinois, Iowa, Missouri, Wisconsin | Internal Revenue Service Center<br>Kansas City, MO 64999 |
| California, Hawaii | Internal Revenue Service Center<br>Fresno, CA 53888 |
| Indiana, Kentucky, North Carolina, Tennessee, Virginia, West Virginia | Internal Revenue Service Center<br>Memphis, TN 37501 |

Form 706-B(2)

You need not complete Form 706-B(2) for Terminations listed in Part I or for any of the transfers listed in Parts V or VI. If you completed part II and line 47 is greater than zero you must complete a Form 706-B(2) for each recipient listed on line 28 who received a taxable distribution. If you completed Part III, you must complete a Form 706-B(2) for each recipient listed on line 48. If you completed Part IV, you must complete a Form 706-B(2) for each recipient listed on line 54.

You need complete only one Form 706-B(2) for each recipient and may list on it distributions from several parts of Form 706-B(1).

SPECIFIC INSTRUCTIONS

Line 1. - Form 706-B(1) is filed for the deemed transferor. Enter only one deemed transferor on line 1, and complete this Form 706-B(1) for all transfers that have the deemed transferor named on line 1. If the trust has more than one deemed transferor, file a separate Form 706-B(1) for each deemed transferor. In this situation you may have to allocate the trust's section 643(b) income among the deemed transferors as explained in the instructions to line 15.

Line 2 - Enter the deemed transferor's social security number.

Part 1 - Terminations

If the deemed transferor was alive at the end of the current tax year, complete lines 21-26, do not complete lines 9-20. If the deemed transferor was not alive at the end of the current tax year, complete lines 9-14 and/or 15-20 as described below. Do not complete lines 21-26.

You must enter the values of all the terminations shown on lines 9, 14, and 21. These values are used to help distributees and other trustees determine the proper tax brackets for their transfers.

Alternate valuation date - If any transfer listed on lines 9, 15, and 21 was caused by the death of any person (including the death of the deemed transferor), you may elect the appropriate alternate valuation date for the transferred property.

How to report postponed terminations

If a transfer would have been a termination in the year that it ocurred except that it was postponed under section 2613(b)(2) to the current tax year, enter the transfer on line 15 if the deemed transferor is not alive at the end of the current tax year and on line 21 if the deemed transferor is alive at the end of the current tax year.

Lines 22-24-See the instructions for Lines-10-12.

Line 27 - Make one entry per grandchild and total the grandchild exclusions that will be claimed on the Form 706-B filed for the terminations listed on lines 9, 15 and 21.

Line 9. —

If the deemed transferor died during the current tax year, enter in line 9 the terminations that ocurred within three years before the date of death. Include terminations that ocurred within the current tax year and before the deemed transferor's death. Note that the terminations that are to be entered on line 9 may not be postponed under section 2613(b)(2) of the Code. You should report these terminations on line 9 of a Form 706-B(1) filed for the tax year in which the deemed transferor died even if the terminations caused by reason of the deemed transferor's death are postponed under section 2613(b)(2).

If the deemed transferor died in a tax year before the current tax year and the terminations made three years before death were reported on line 9 of an earlier Form 706-B(1), you should not complete line 9 of this Form.

Line 10. —

You may list debts, expenses, taxes, and losses that are actually paid or awarded at the time you complete this form. You may also list those debts, etc., whose exact amount is not known at the time you file, provided that they are ascertainable with reasonable certainty and will be paid. List the total debts, etc., for the terminations listed on line 9. For more information on what debts, expenses, taxes, and losses are deductible, see Schedule B of Form 706-B.

Line 11. —

Figure the charitable deduction as you would for Schedule C, Form 706-B. List the total charitable deductions the termination listed on line 9.

Line 12. —

List the total grandchild exclusions that will be applied to the terminations on line 9.

Lines 16 - 20 - See the instructions for lines 10-12.

Lines 22 - 24 - See the instructions for lines 10-12.

per termination to a · grandchild the grandchild exclusion will be similar.

Lines 27 - Make one entry ~~per~~ grandchild ~~and total the grandchild exclusions for each grandchild.~~ Enter only the exclusions that will be claimed on the Form 706-B filed for the terminations listed on lines 9, 15, and 21.

If you need more entry blanks, attach a separate schedule using the format of line 27.

Part II - Distributions where all the trust's distributions were cash.

Who Should Use Part II.

You should complete Part II only if all the distributions from the trust made during this current tax year for all deemed transferors are in cash. Part II's section 643(b) income allocations only apply to the 643(b) income from the current tax year. Therefore, you should complete Part II if all the trust's distributions made during the current tax year were in cash even if you are also required to show noncash distributions made in prior tax years, but within three years of the deemed transferor's death, in Part IV.

If any distribution from the trust for this tax year from any deemed transferor to any beneficiary is in property other than cash, then you should not use Part II for any of the Forms 706-B(1) you file for the trust for this tax year. Instead, you should report all distributions from the trust, including cash distributions, on Part III of the appropriate deemed transferor's Form 706-B(1).

Attach a separate schedule showing how the trusts section 643(b) income was computed.

Line 28.

Enter on line 28 all of the recipients of trust distributions that were (1) made during the current year and (2) have the deemed transferor listed on line 1. Usually, these recipients will all have the same generation assignment, which will be one generation younger than the generation assignment of the deemed transferor listed on line 1. If the recipients are not all assigned to the same generation, list them on line 28 in order of generations assignments, listing those assigned to the oldest generation first.

If you need to list more than five recipients, list them on an attached sheet in the same format as line 28.

Enter each recipient once, regardless of how many distributions were made to the recipient during the tax year. In column (e) enter the total of the distrubutions that have the deemed transferor listed on line 1 that were made to each recipient for the year.

Line 29.—If you checked "yes", the amounts you enter on lines 32 and 41 will be the section 643(b) income of the entire trust for the full year or appropriate short period.

If you answer "no" to line 29, you must allocate the trust's section 643(b) income among all the trust's recipients on a separate detailed sheet.

First determine the generations assignment of each trust beneficiary who received a distribution made during the current tax year.

Second, complete line 30.

If you checked a short period on line 30, you must make two attached allocations, one for each short period. If you checked "full year" on line 30, make one allocation for the full year.

Third, subtract all charitable distributions the trust made during the current tax year from the section 643(b) income.

Fourth, allocate the remaining section 643(b) income to the oldest generation of beneficiaries who received distributions made during the current tax year. The allocation should be made pro rata among the beneficiaries according to the amount of distributions each received.

Fifth, if any section 643(b) income remains, allocate it among the next oldest generation of beneficiaries, and continue the allocations among successively younger generations of beneficiaries until either the 643(b) income is fully allocated or all of the trust's beneficiaries have had section 643(b) income allocated to them.

Line 30.- If there was no termination for the tax year, check the box marked "Full year." If, in addition to taxable distributions during the tax year of the trust, there is also a taxable termination, check the "Short period" box. You will need to first figure section 643(b) income and distributions for the short period before the termination and then for the short period after the termination.

If the termination was not the result of the deemed transferor's death, the first short period begins on the first day of the trust's tax year and ends on the day before the taxable termination occurs. The second short period begins the day the taxable termination occurs and ends on the last day of the tax year.

If the termination was the result of the death of a deemed transferor, the first short period ends immediately before the termination occurs and the second short period begins immediately after the termination occurs.

Do not complete lines 31-36 if you checked "no" to line 29 and allocated section 643(b) income on a separate attached sheet.

Line 31 - If all the recipients listed on line 28 are assigned to the same generation, enter all the Code letters you completed on line 28(a). If the recipients are assigned to more than one generation, list the Code letters of the members of the oldest generation listed on line 28.

Complete lines 32-35 only for the recipients listed on line 31. If you did not list all the recipients from line 28 on line 31, the instructions to line 37 will explain how to allocate any remaining section 643(b) income.

Lines 32 through 37. - Complete lines 32 through 37 only for distributions made in the short period (or full year) indicated on line 30. Do not include on lines 32 through 37 information pertaining to distributions made before the current tax year and reported on this form only because they were made during the 3 years before the deemed transferor's death.

Line 32 - Enter the section 643(b) income of the entire trust for the tax year (or period).

Line 33 - Enter all of the distributions to charities made by the trust during the tax year (or period).

Line 34 - Enter the total distributions made by the trust to beneficiaries who are assigned to generations older than the generation assignment of the beneficiaries listed on line 31. Usually, these are distributions to members of the deemed transferor's generation and older generations. The recipients of these distributions should not have been listed on line 28.

Line 37 - If you checked "yes" on line 29 and completed lines 31-35 for all the beneficiaries listed on line 28, complete line 37 according to the sample schedule below.

If you checked "yes" to line 29 and completed lines 31-35 for only some of the beneficiaries listed on line 28, you must first allocate the remaining section 643(b) income among the recipients who were listed on line 28, but not on line 31. Then you should complete line 37 according to the sample schedule below.

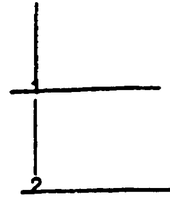
If you checked "no" to line 29, then you have already allocated all of the trust's section 643(b) income among the beneficiary's. You should complete line 37, columns (a), (b), (c), (e) and (f) using the information from your separate allocation. Leave column (d) blank.

How to allocate section 643(b) income if more than one generation is listed on line 28: This allocation must be done on an attached schedule.

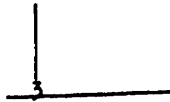
The attached schedule should follow the format below:

1. Amount of 643(b) income carried over (amount on line 36, Form 706-B(1)).

2. Total distributions to the recipients listed on line 31 of Form 706-B(1).

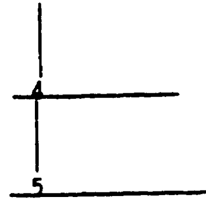


3. Subtract line 2 from line 1. This is the amount of section 643(b) income to be allocated among the next generation.



4. List the codes from line 28 of the recipients who are assigned to the next generation after the generation of the recipients listed on line 31 of Form 706-B(1): Line 28 codes __________ to __________.

5. Total distributions to the recipients listed on line 4.



6. Subtract line 5 from line 3. This is the section 643 income to be allocated among the next generation.

If the amount on line 6 of the schedule is zero or less, complete line 37 according to the instructions for that line. If the amount on line 6 of the schedule is more than zero, you must repeat the schedule's computations for the next younger generation listed on line 28. Repeat the computation for each generation until the computation is made for all the generations listed on line 28 or until the section 643(b) income is fully allocated.

Line 37 - Make a separate entry on line 37 for each distribution to each recipient shown on line 28, including distributions for which a grandchild exclusion may later be claimed. If you need more entry blanks, attach a separate schedule using the same format as line 37. Enter the total of the columns on the printed form and the separate schedule in the Total, line 37(c) and line 37(f) spaces.

Line 37, column (a). - Enter the recipient's code ~~number~~ letter from line 28, column (a).

Line 37, column (b). - Enter the date of the distribution.

Line 37, column (c) - Enter the amount distributed.

Line 37, column (d) - If you checked "no" ~~to~~ on line 29, leave column (d) blank.

If you checked "yes" ~~to~~ on line 29, and if all the recipients listed on line 28 were also listed on line 31, then for each distribution ~~to recipients~~ listed on line 37~~(b)~~, enter in column (d) the percentage obtained by dividing the amount on each line of column (c) by the total amount ~~of the distributions to all of the recipients listed on line 37 (b).~~ of column (c).

If there are some recipients listed on line 28 who were not listed on line 31, then to compute the percentage from the total of column (c) would result in an inaccurate allocation. Instead, you should compute the percentage by dividing the column (c) distribution, for each recipient by only the total of the column (c) distributions to all of the recipients who are assigned to the same generation as this recipient.

Line 22, column (e).

If you answered "no" to line 29, enter in column (e) the share of income for each recipient that you computed on the separate allocation.

If you checked "yes" to line 29 for all the distributions to recipients listed on line 28 who were also listed on line 31, multiply the amount on line 36 by the percentage in column (d) and enter the result on column (e).

For those distributions whose recipients are not listed on line 31, multiply the amount of section 643(b) income you allocated to the recipient's generation on a separate sheet (as explained in the instruction above) by the percentage in column (d) and enter the result in column (e).

Line 37, column (f). - Subtract the amounts in column (e) from the amounts in column (c). Enter the difference in column (f). If any column (e) amount is more that a column (c) amount, enter zero in column (f).

Line 38 - Complete line 38 only if you checked the "short period" box on line 30. If line 37 (f) is greater than zero always enter "__0__" on line 38. If line 37 (f) is zero, enter on line 38 the first periods section 643(b) income that was not allocated to charitable or other distributions made during the first short period. This excess section 643(b) income will be applied against distributions made in the second short period. Attach a schedule showing your computation of the amount you entered in

Line 38. If you checked "yes" to line 29 and all the recipients listed on line 28 are also listed on line 31, then you should subtract line 37(c) from line 36 and enter the result in line 38. You need not attach a schedule in this situation.

Line 40.- Enter only those recipients listed on line 28 who received distributions during the short period shown on line 34 and who are assigned to the oldest generation shown on line 28.

Lines 41 through 46. - On these lines list only distributions that occurred during the short period entered on line 39. Complete lines 41 through 46, as explained for lines 32 through 37.

Line 47 - If line 47 is zero, you must still complete and file this Form 706-B(1), but need not file any Forms 706-B(2).

Part III

Part III is for distributions attributed to the current tax year. Part IV is for distributions attributed to tax years before the current tax year and within 3 years of the deemed transferor's death. If the trust made any distribution of property other than cash the current tax year to any of its beneficiaries, regardless of their generation assignment or the deemed transferor of the distribution, then all of the distributions (including cash distributions) from the trust for the current year must be reported on Part III of the appropriate Forms 706-B(1). No distributions from the trust during this tax year may be reported on Part II of any Form 706-B(1).

Line 48 - Make one entry on line 48 for each recipient from the trust who has the deemed transferor listed on line 1. If you need more space, attach a separate sheet following the same format.

Line 49 - Make one entry on line 49 for each transfer attributed to the

current tax year from the trust to each recipient listed on line 48. On line 49, column (a), enter the recipient's code letter from line 48, column (a). In column (b), describe the transferred property. If you list cash, include the amount. In column (c), enter the date of the transfer. If you need more space, attach an additional sheet following the same format.

Line 52 - See the instructions for line 30 for a description of how to compute the short periods.

Line 53 - Complete line 53 for all the charitable distributions made by the trust.

Line 53, column (d) - If the distribution was cash, enter the amount in column (d). If the distribution was property other than cash and the trust reported the full value of the property on its Form 1041, enter the value reported on the Form 1041. Otherwise, leave column (d) blank. ~~Form 706-B(2): You must complete a Form 706-B(2) for each recipient listed on line 48.~~

[moved to line 48]

Part IV

If the deemed transferor died during the current tax year, you must complete Part IV if you previously reported (or should have reported) on a Form 706-B(1) any distributions for this deemed transferor that were made before the current tax year and within three years before the deemed transferor's death. Part IV is the only part of this Form 706-B(1) where these prior years' distributions are reported. ~~If you meet the requirements above,~~ If distributions were made for this deemed transferor, you should complete Part IV regardless of whether there were any current tax year's distributions, and regardless of whether you entered current tax year's distributions on Parts II or III of this form.

Line 54 - Make one entry for each younger generation beneficiary who received a distribution from ~~the~~ this deemed transferor ~~listed on line 1~~ in

years before the current tax year but within 3 years before the deemed transferor's death. If you need more space, attach a separate schedule using the same format as line 54. You must complete a Form 706-B(2) for each recipient listed on line 54.

Line 55 - Make one entry for each transfer to each of the recipients listed on line 54.

Line 55, column (b) - Describe the transferred property as shown on the previous Form 706-B(1) filed for the transfer.

Line 58, column (c) - Enter the date shown on the previous Form 706-B(1) filed for the transfer.

~~Form 706-B(2): You must complete a form 706-B(2) for each recipient listed on line 54.~~

Part V

Part V is used to report transfers that would be taxable generation-skipping transfers except that they are nontaxable because they are subject to estate or gift taxes (section 2613 (a)(4)(B) and 2613 (b)(5)(B)), or because the deemed transferor and the transferee of a prior transfer of the property meet the conditions of section 2613 (b)(7)(B). Part V is also used to report terminations that are postponed under section 2613(b)(2).

If the trust made any transfers described in these sections during the current tax year that were attributed to the deemed transferor listed on line 1 of this Form 1, complete Part V for those transfers and file Form 706-B(1) even if no transfers are reported in Parts I-IV.

Line 57 - Under reason not taxable, enter either "estate", "gift" or "2613 (b)(7)(B)" whichever applies.

Part VI.

You must answer the question in Part VI if you completed any of Parts I through V of this form. If you did not complete any of Parts I through V of this form, you need not complete Part VI (and need not file Form 706-B(1) for this deemed transferor).

**Page 1 of Form 706-B(2) (Page 2 is blank)**

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April 21, 1981

Form **706-B(2)** (April, 1981) Department of the Treasury Internal Revenue Service

# Beneficiary's Share of a Taxable Distribution From a Generation-Skipping Trust

Tax year beginning ........, 19 ..., ending ........, 19 ...

Copy A for Beneficiary to File With Form 706-B

OMB No. ........ Expires ........

| | |
|---|---|
| 1 Name of deemed transferor | 2 Social security number |
| 3 Name of trustee | 4 Employer identification number of trust |
| 5 Name of grantor | 6 Date trust created |
| 7 Name of beneficiary | 8 Social security number |

| 9a Date of transfer: Mo | Day | Yr | 9b Share of taxable distribution |
|---|---|---|---|
| | | | |
| Total . . . ▶ | | | 9b |

10 Total taxable distributions for the tax year for all beneficiaries who are transferees of this deemed transferor. Enter the amount from Form 706-B(1), Part II, line 47 . . . . . . . . . .

11 If you completed Form 706-B(1), Part I, line 14, (terminations within 3 years of death) enter the total from that line here. If you did not complete line 14 of Form 706-B(1), enter zero here .

12 Add lines 10 and 11 above . . . . . . . . . . . .

13 This beneficiary's share of generation-skipping transfers. Divide the total of line 9b on this form by the amount on line 12 above. Enter the result as a percentage on this line . . . . . . . %

14 Terminations caused by reason of the deemed transferor's death. Enter the amount from Form 706-B(1), line 20 . . . . $

*(If you need more space, attach additional sheets of same size.)*

If you completed Part III or Part IV of Form 706-B(1), complete lines 15 to 22 below.

15 Terminations within 3 years of death. Enter the total from Form 706-B(1), line 14 . . . . . . . . . .

16 Terminations during the current tax year where the deemed transferor was alive at the end of the current year. Enter the amount from Form 706-B(1), line 26 . . . . . . . . . . . . . . . . . . . .

17 Terminations caused by the deemed transferors death. Enter the amount from Form 706-B(1), line 20 . .

18 This beneficiary's share of distributions attributed to the current tax year. Enter the distributions to this beneficiary as they are shown on Form 706-B(1), line 49.

| Description of transferred property | Date of transfer: Month | Day | Year |
|---|---|---|---|
| | | | |
| | | | |

19 This beneficiary's share of distributions made before the current tax year and within 3 years before the deemed transferor's death. Enter the distributions to this beneficiary as they are shown on Form 706-B(1), line 55.

| Description of transferred property | Date of transfer: Month | Day | Year |
|---|---|---|---|
| | | | |
| | | | |

20 If you completed line 51 of Form 706-B(1), enter the trust's section 643(b) income for the full year . . . . . .

21 If you completed line 52 of Form 706-B(1), enter the trust's section 643(b) income and the applicable short periods

a First short period beginning ........, 19 .. and ending ........, 19 ..: 643(b) income ....

b Second short period beginning ........, 19 .. and ending ........, 19 ..: 643(b) income ....

22 Distributions to charities. Enter the information shown on line 53 of Form 706-B(1).

| (a) Charitable recipient's name | (b) Date of transfer: Month | Day | Year | (c) Description of property | (d) Value |
|---|---|---|---|---|---|
| | | | | | |
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For Paperwork Reduction Act Notice, see the Instructions to this form.

Form **706-B(2)** (12-80)

343-303-1

## Page 3 of Form 706-B(2)

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Form **706-B(2)** (April, 1981) Department of the Treasury Internal Revenue Service

# Beneficiary's Share of a Taxable Distribution From a Generation-Skipping Trust

Copy B for Beneficiary

OMB No. ________ Expires ________

Tax year beginning .........., 19 .., ending .........., 19

| | |
|---|---|
| 1 Name of deemed transferor | 2 Social security number |
| 3 Name of trustee | 4 Employer identification number of trust |
| 5 Name of grantor | 6 Date trust created |
| 7 Name of beneficiary | 8 Social security number |

| 9a Date of transfer Mo | Day | Yr | 9b Share of taxable distribution |
|---|---|---|---|
| | | | |
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| | | | |
| | | | |
| | | | |
| | | | |
| Total . . . ▶ | | | 9b |

10 Total taxable distributions for the tax year for all beneficiaries who are transferees of this deemed transferor. Enter the amount from Form 706-B(1), Part II, line 47 . . . . . . . . .

11 If you completed Form 706-B(1), Part I, line 14, (terminations within 3 years of death) enter the total from that line here. If you did not complete line 14 of Form 706-B(1), enter zero here .

12 Add lines 10 and 11 above . . . . . . . . . . . .

13 This beneficiary's share of generation-skipping transfers. Divide the total of line 9b on this form by the amount on line 12 above. Enter the result as a percentage on this line . . . . . . . %

14 Terminations caused by reason of the deemed transferor's death. Enter the amount from Form 706-B(1), line 20 . . . .

*(If you need more space, attach additional sheets of same size.)*

If you completed Part III or Part IV of Form 706-B(1), complete lines 15 to 22 below.

15 Terminations within 3 years of death. Enter the total from Form 706-B(1), line 14 . . . . . . . . . .

16 Terminations during the current tax year where the deemed transferor was alive at the end of the current year. Enter the amount from Form 706-B(1), line 26 . . . . . . . . . . . . . . . . . . . .

17 Terminations caused by the deemed transferors death. Enter the amount from Form 706-B(1), line 20 . .

18 This beneficiary's share of distributions attributed to the current tax year. Enter the distributions to this beneficiary as they are shown on Form 706-B(1), line 49

| Description of transferred property | Date of transfer Month | Day | Year |
|---|---|---|---|
| | | | |
| | | | |
| | | | |

19 This beneficiary's share of distributions made before the current tax year and within 3 years before the deemed transferor's death. Enter the distributions to this beneficiary as they are shown on Form 706-B(1), line 55.

| Description of transferred property | Date of transfer Month | Day | Year |
|---|---|---|---|
| | | | |
| | | | |
| | | | |

20 If you completed line 51 of Form 706-B(1), enter the trust's section 643(b) income for the full year . . . . . . . .

21 If you completed line 52 of Form 706-B(1), enter the trust's section 643(b) income and the applicable short periods

a First short period beginning .........., 19 .. and ending .........., 19 ......: 643(b) income ....

b Second short period beginning .........., 19 .. and ending .........., 19 ....: 643(b) income

22 Distributions to charities. Enter the information shown on line 53 of Form 706-B(1)

| (a) Charitable recipient's name | (b) Date of transfer Month | Day | Year | (c) Description of property | (d) Value |
|---|---|---|---|---|---|
| | | | | | |
| | | | | | |
| | | | | | |

For Paperwork Reduction Act Notice, see the instructions to this form.

Form **706-B(2)** (12-80)

843-303-1

**Page 4 of Form 706-B(2)**

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## Instructions

**Paperwork Reduction Act Notice.**—The Paperwork Reduction Act of 1980 says we must tell you why we are collecting this information, how we will use it, and whether you have to give it to us. We ask for the information to carry out the Internal Revenue Laws of the United States. We need it to ensure that you are complying with these laws. You are required to give us this information.

### Purpose of Form

Form 706-B(2) is used by trustees to notify beneficiaries that they must file Form 706-B, Generation-Skipping Transfer Tax Return, and to provide beneficiaries with some of the information they will need to prepare Form 706-B.

### Instructions for the Trustee

Complete a separate Form 706-B(2) for each distributee. For each Form 706-B(2) you may list only one distributee, and one deemed transferor. Give Form 706-B(2) to the beneficiary by the due date for filing Form 706-B(1) with the Internal Revenue Service.

**Line 1.**—If the trust has more than one deemed transferor who made distributions to this beneficiary, you must complete a Form 706-B(2) for each beneficiary.

**Line 2.**—Enter the deemed transferor's Social Security number.

**Line 8.**—Enter the beneficiary's Social Security number.

Complete lines 9a through 14 only if you completed Part II of Form 706-B(1). Otherwise, skip to line 15.

**Line 9a.**—For each distributee, enter on line 9a the applicable dates from Form 706-B(1), Part II, lines 37 and 46, column (b).

**Line 9b.**—Enter on line 9b the applicable amounts from Form 706-B(1), Part II, lines 37 and 46, column (f).

**Line 10.**—On line 10 enter the total amount from Form 706-B(1), Part II, line 47.

**Lines 11-14.**—The information you provide on lines 11 through 14 will be used to determine the tax bracket in which the distributions will be taxed on Form 706-B.

**Line 18.**—Complete line 18 only if you completed Part III of Form 706-B(1). Enter the date of each transfer and a description of the transferred property for each transfer made to this beneficiary that you reported on line 49 of Form 706-B(1).

**Line 19.**—Complete this line only if you completed Form 706-B(1), Part IV. Complete line 19 for all the distributions shown on line 55 of Form 706-B(1).

**Line 22.**—Enter the charitable distributions shown on Form 706-B(1), line 53. If you showed a value for a distribution on Form 706-B(1), line 53, enter that value on Form 706-B(2), line 22, column (d). Otherwise, leave column (d) blank.

### Instructions for the Beneficiary

The trustee will complete Form 706-B(2) and give it to you. If you receive a Form 706-B(2), you must complete a Form 706-B, Generation-Skipping Transfer Tax Return, using the information from Form 706-B(2).

Attach a copy of the Form 706-B(2) to the Form 706-B that you file.

☆ U.S. GOVERNMENT PRINTING OFFICE [illegible] 343-303-1

**Page 5 of Form 706-B(2)**

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Form **706-B(2)** (April, 1981) Department of the Treasury Internal Revenue Service

# Beneficiary's Share of a Taxable Distribution From a Generation-Skipping Trust

Copy C for Trustee

OMB No. ______ Expires ______

Tax year beginning ........, 19 ...., ending ........, 19

1 Name of deemed transferor | 2 Social security number

3 Name of trustee | 4 Employer identification number of trust

5 Name of grantor | 6 Date trust created

7 Name of beneficiary | 8 Social security number

| 9a Date of transfer Mo | Day | Yr | 9b Share of taxable distribution |
|---|---|---|---|
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| Total ▶ | | | 9b |

10 Total taxable distributions for the tax year for all beneficiaries who are transferees of this deemed transferor. Enter the amount from Form 706-B(1), Part II, line 47 . . . . . . . .

11 If you completed Form 706-B(1), Part I, line 14, (terminations within 3 years of death) enter the total from that line here. If you did not complete line 14 of Form 706-B(1), enter zero here .

12 Add lines 10 and 11 above . . . . . . . . . . . .

13 This beneficiary's share of generation-skipping transfers. Divide the total of line 9b on this form by the amount on line 12 above. Enter the result as a percentage on this line . . . . . . . %

14 Terminations caused by reason of the deemed transferor's death. Enter the amount from Form 706-B(1), line 20 . . . .

*(If you need more space, attach additional sheets of same size.)*

If you completed Part III or Part IV of Form 706-B(1), complete lines 15 to 22 below.

15 Terminations within 3 years of death. Enter the total from Form 706-B(1), line 14 . . . . . . . . .

16 Terminations during the current tax year where the deemed transferor was alive at the end of the current year. Enter the amount from Form 706-B(1), line 26 . . . . . . . . . . . . . . . . . .

17 Terminations caused by the deemed transferors death. Enter the amount from Form 706-B(1), line 20 . .

18 This beneficiary's share of distributions attributed to the current tax year. Enter the distributions to this beneficiary as they are shown on Form 706-B(1), line 49

| Description of transferred property | Date of transfer Month | Day | Year |
|---|---|---|---|
| | | | |
| | | | |
| | | | |

19 This beneficiary's share of distributions made before the current tax year and within 3 years before the deemed transferor's death. Enter the distributions to this beneficiary as they are shown on Form 706-B(1), line 55.

| Description of transferred property | Date of transfer Month | Day | Year |
|---|---|---|---|
| | | | |
| | | | |
| | | | |

20 If you completed line 51 of Form 706-B(1), enter the trust's section 643(b) income for the full year . . . . .

21 If you completed line 52 of Form 706-B(1), enter the trust's section 643(b) income and the applicable short periods.

a First short period beginning ........, 19...... and ending ........, 19......: 643(b) income . . ......

b Second short period beginning ........, 19...... and ending ........, 19 . : 643(b) income . . . .

22 Distributions to charities. Enter the information shown on line 53 of Form 706-B(1)

| (a) Charitable recipient's name | (b) Date of transfer Month | Day | Year | (c) Description of property | (d) Value |
|---|---|---|---|---|---|
| | | | | | |
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For Paperwork Reduction Act Notice, see the instructions to this form.

Form **706-B(2)** (12-80)

843-303-1

August 27, 1980

MEMORANDUM OF AMERICAN BANKERS ASSOCIATION

Re: Sections 6166 and 6166A and Related Matters - Proposals for Change

A. Introduction

The operation of §§6166 and 6166A, relating to the deferral of the payment of estate tax attributable to an interest in a closely held business, is troublesome in a number of respects. In addition, other statutory provisions add to the liquidity problems of, or create other problems for, a decedent's estate which consists of one or more interests in closely held businesses. The purpose of this memorandum is to discuss the sources of concern and make recommendations for change. In considering these recommendations, we would emphasize that the deferral provisions do not reduce taxes but only extend the period of payment. As a result, we believe the proper approach is to broaden the application of these provisions.

Each of these sections permits an executor to extend the time for payment of the estate tax attributable to closely held business interests, including farms. The amount of the tax that may be deferred in payment is the

net federal estate tax payable times a fraction having a numerator equal to the value of the closely held business interest and a denominator equal to the decedent's adjusted gross estate, viz., the gross estate reduced by "allowable" §2053 and 2054 deductions. Payments are made in equal annual installments over a ten year period. The term "interest in a closely held business" is defined differently in each section. Qualification requirements are imposed by each section.

B. Differences Between Sections 6166 and 6166A

Sections 6166 and 6166A contain significant differences which include the following:

1. Section 6166 has a higher percentage qualification requirement - 65 percent of the decedent's adjusted gross estate - than §6166A - 35 percent of the decedent's gross estate or 50 percent of his taxable estate.

2. Section 6166 provides for a five year moratorium on the payment of the estate tax attributable to the closely held business. Section 6166A contains no moratorium.

3. A four percent interest rate applicable to the estate tax attributable to the first $1,000,000 of value is available for deferrals under §6166 but not for deferrals under §6166A.

4. The definition of "interest in a closely held business" is more liberal in §6166. Compare §6166(b)(1)(B)(ii) and (C)(ii) with §6166A(c)(2)(B) and (3)(B).

5. Under §6166(b)(2)(B), stock or a partnership interest held by a husband and wife as community

property or as joint tenants, tenants by the entirety or tenants in common is treated as owned by one shareholder or partner. Section 6166A contains no provision dealing with this matter.

6. Section 6166(b)(2)(C) contains a constructive ownership rule where a corporation, partnership, estate or trust holds an interest in a closely held business. Section 6166A contains no such rule.

7. Section 6166(b)(3) provides that for purposes of the 65 percent requirement an interest in a closely held business which is in the business of farming includes an interest in residential buildings which are used by persons engaged in the farming operation. No similar provision is in §6166A.

8. The aggregation rules for interests in more than one closely held business are more liberal under §6166 than under §6166A. Compare §6166(c) with §6166A(d).

9. Under §6166(g)(1)(A), a disposition of one-third or more in value of the eligible interest will accelerate the payment of the deferred tax whereas the figure in §6166A(h)(1)(A) is one-half or more.

10. Under §6166(g)(1)(D) transfers of property from a trust created by the decedent are not considered as a disposition for purposes of accelerating the payment of the deferred tax. No such statement is made in §6166A(h)(1)(D) and the contrary result could occur.

11. The "undistributed net income" rule of §6166(g)(2)(A) refers to any taxable year of the estate ending on or after the due date of the first installment but the same rule in §6166A(h)(2)(A) refers to any taxable year after its fourth taxable year.

C. "Unifying" Sections 6166 and 6166A

The existence of two deferral provisions with differing requirements creates confusion and in some cases

requires an executor to make a choice when all facts necessary to make an informed decision are not available. Considerable simplification would be achieved by "merging" the two sections. This approach was contained in H.R. 4694, introduced by Representative Fisher in 1979 and captioned the "Carryover Basis Simplification Act of 1979." The consolidation would be achieved by using §6166 with the changes referred to in part D below.

D. Suggested Changes in Unified Approach

1. Post-Death Interest as an Administration Expense under Section 2053

The Service now recognizes that post-death interest (including estate tax interest) allowable as an administration expense under applicable state law is a proper estate tax deduction under §2053. Rev. Rul. 79-252, IRB 1979-34 at 11. When the interest is claimed as an estate tax deduction, the estate tax is reduced. Uncertainty exists as to the amount of the tax because it depends upon the amount of interest, which with deferral under §6166 or 6166A may not be finally determined until many years after the decedent's death.

In order to prevent an estate tax deduction for interest in excess of the amount actually paid, the Service has allowed the deduction only as interest is

paid. The procedure recommended by the Service is described in letter ruling 8022023 and requires the estate to file supplemental information on an estate tax return as interest is paid. When the total of the installment payments exceeds the estate tax, a refund claim may be filed. If the Service and the estate agree to the amount of the over-assessment as shown on the supplemental information return, the amount of the over-assessment will be abated, thus reducing the amount of unpaid tax upon which interest is computed. This procedure is contrary to the purpose of the deferral provisions - since future interest is not allowed in computing the estate tax the annual installments are overstated and are not in equal amounts as required by the statute.

The effect of the Service paying interest on the estate tax refunds attributable to the interest payments made by the estate is to give the estate an undiscounted deduction for future interest payments. Stated another way, although interest is not paid until several years after the decedent's death, the full amount is still allowed as an estate tax deduction, as are all expenses of administration. This result seems questionable.

The problem is more difficult and significant than indicated above. The threshold percentage

qualification requirement under §6166 is related to post-death interest that is paid because this section applies the percentage against an amount that is reduced by deductions that are "allowable" (not allowed) under §2053. The same result may occur under §6166A if the percentage qualification requirement relating to the taxable estate (rather than the gross estate) is used since, in arriving at the taxable estate, "allowed" §2053 deductions are subtracted. All post-death interest is "allowable" under §2053 although it may not be used (allowed) as an estate tax deduction. Thus, at the time an election must be made under §6166 or 6166A, the executor may not know whether the estate is eligible for deferral because the answer will depend upon how much interest will be paid in the future.

Also, in some cases a decedent may have a surviving spouse and make full use of the maximum marital deduction by a formula provision. When this occurs, the amount of the deduction (and the amount included in the surviving spouse's estate) will depend upon the amount of post-death interest claimed as an administration expense under §2053. How is the amount includible in the surviving spouse's gross estate determined when that spouse

dies during the estate tax deferral period used by the decedent's estate and interest after the spouse's death may be involved?

One approach to solving the post-death interest problem would be to deny post-death interest as an administration expense under §2053. This solution is unsatisfactory because it is unfair. In many cases, the interest paid cannot be used fully as an income tax deduction since it exceeds the gross income of the estate reduced by other deductions other than the distribution deduction. The likelihood of such a result is increased by a high interest rate. From February 1, 1980 through January 31, 1982 this rate will be 12%. Also, use of the interest as an income tax deduction may create distortion in the interests of different beneficiaries because the benefit of the income tax deduction reduces the taxable income of beneficiaries who do not bear the burden of the interest payment.

We believe a simple solution exists to the post-death interest problem. The denial of an estate tax deduction for the interest should be combined with a grant of forgiveness of the interest at a stated rate and with a lower threshold percentage qualification requirement to

reflect the "loss" of the interest deduction. The forgiveness rate would be the highest estate tax rate applicable to the estate, which would be the benefit to the estate if the interest were claimed as an estate tax deduction. Since the forgiveness does not occur until the interest becomes payable, the estate does not get the benefit of a current estate tax deduction for a future payment as occurs under current law. The estate would, of course, still be able to pay the "full" amount of all or any part of the interest and use that amount as an income tax deduction.

The forgiveness would be applicable to any interest on federal income, gift or estate tax of the decedent. This approach would not be applied to interest on a state tax of the decedent, whether income, gift or estate tax, or other interest that would qualify as an administration expense under applicable state law. Thus, the forgiveness would not be applicable to interest on a bank loan obtained to permit payment of the estate tax. Based upon the experience of our member banks, very few estates obtain bank loans to pay the estate tax. We are not bothered by creating a distinction which favors interest on a federal tax as compared with other interest when the application of the federal estate tax is involved.

An example may be helpful in indicating how the forgiveness approach would operate. Assume that an annual interest payment on the unpaid balance of the deferred tax was $15,000 and that the estate's marginal estate tax rate was 39%, applicable to taxable estates of between $750,000 and $1,000,000. The executor could secure a forgiveness of 39% of that part of the $15,000 which was not claimed as an income tax deduction. If the executor claimed $5,000 (of the $15,000) as an income tax deduction, the payment of interest would be $11,100 ($5,000 + 6,100).

As noted, the forgiveness would be based upon the rate schedule in §2001(c), which is applicable in determining the tax before the allowance of credits. Except for the state death tax credit, the credits are rarely applicable. With respect to the state death tax credit, we believe the correct result is that the forgiveness should be based upon the "gross" federal tax. If an estate tax refund were allowed for post-death interest, the refund would be computed using the rate schedule in §2001(c) except when the state death credit rate changes when the interest is subtracted in computing the taxable estate. The method of computing the forgiveness is the same as that contained in H.R. 4694 to determine the basis increase for death taxes attributable to appreciation.

When a marital bequest has been funded pursuant to a maximum marital deduction formula provision, use of the marginal estate tax rate to compute the forgiveness may be said to overstate this amount because, after making allowance for the marital deduction, the taxable estate is reduced by only one-half of the amount of the annual interest payment whereas the forgiveness percentage applies to the entire amount of this payment. However, such an analysis fails to take into account that the amount passing to the surviving spouse is "overstated" and will produce an "additional" estate tax at the spouse's death. These two factors offset each other and collectively are a fair result and certainly one that is preferable to current law.

The suggested approach does not interfere with applicable state law regarding whether estate tax interest is chargeable to income or principal and whether, if the interest is taken as an income tax deduction, an equitable adjustment must be made from income to principal.

2. Threshold Percentage Qualification Requirement

In combining §§6166 and 6166A, H.R. 4694 used the threshold percentage qualification requirements of both sections, thus creating a threefold test of (1) 65

percent of the adjusted gross estate, (2) 35 percent of the gross estate or (3) 50 percent of the taxable estate. The special 4 percent interest rate on the estate tax attributable to the first $1 million of value was available only if the estate met test (1).

Tests (1) and (3) are troublesome because, as noted in subpart 1 above, qualification may depend upon the amount of post-death interest "allowed" or "allowable". This problem is eliminated by excluding post-death interest from consideration. However, without more, such a change would or might increase the threshold requirement if (1) or (3) were used. To avoid this result, the percentages in (1) and (3) should be reduced. A reduction from 65 percent to 50 percent in (1) and from 50 percent to 40 percent in (3) seems appropriate. Use of a 50 percent requirement would achieve conformity with section 303. See discussion below of §303. If these changes are made, test (2) should be eliminated. The likelihood of an estate satisfying this test but not 40% of the taxable estate is remote.

3. Limitation on Amount of Deferred Payment

Section 6166(a)(2) limits the amount of estate tax that may be deferred which, as noted above, is

determined by multiplying the estate tax (after credits) by a fraction having a numerator equal to the value of the closely held business interest and a denominator equal to the adjusted gross estate as defined in §6166(b)(6). Thus, this limitation is uncertain whenever the amount of post-death interest is uncertain. The post-death interest allowable as an estate tax deduction reduces the denominator of the fraction and therefore increases the percentage of the tax deferred in payment.

As in the case of the threshold requirement, the solution is to remove the interest from consideration by modifying the definition of "adjusted gross estate" in §6166(b)(6) to exclude post-death interest.

4. Holding Company Qualification

The present position of the Service is that stock of a holding company cannot "qualify" under §6166 or 6166A unless this company operates a trade or business. Thus, the holding company's ownership of another company which does operate a trade or business is ignored, and form may prevail over substance. Such a result is unsound, particularly when no requirement exists that the trade or business of the holding company constitute a significant part of its assets. A holding company may be

required to maintain the differing equity interests of branches when shifting such interests from an older generation to a younger generation.

Section 6166(b)(1) should be modified to provide in effect that the indirect ownership rule of §6166(b)(2)-(C) applies for the purpose of determining whether the holding company operates a trade or business. If the holding company owns 20% or more of the voting stock of another company operating a trade or business, this trade or business should be attributed to the holding company for the purpose of determining whether the holding company is operating a trade or business.

5. Acceleration of Payment of Deferred Tax

a. Undistributed Net Income Rule

Sections 6166(g)(2) and 6166A(h)(2) contain rules applicable to a decedent's "estate" which requires that, for taxable years ending after a stated time, the executor must pay an amount equal to its undistributed net income in liquidation of the unpaid part of the deferred tax before the due date for the income tax return of the estate covering such year. If the executor fails to make the payment, the entire unpaid portion of the deferred tax may be accelerated by the Service under §6166(g)(3) or

6166A(h)(3). "Undistributed net income" is defined as the estate's distributable net income for the taxable year, as defined in section 643, reduced by the sum of (i) the distribution deductions under section 661(a)(1) and (2), (ii) the amount of the federal estate tax (plus interest) and federal income tax paid by the executor during or for such year.

These provisions create untenable distinctions depending upon what disposition is made of property included in a decedent's gross estate. The undistributed net income rule applies to income on property included in the probate estate but not to income on property included in a revocable trust created by the decedent or to income on property forming a part of a trust created by another person or an irrevocable trust created by the decedent. Thus, the rule is meaningless as to non-probate property.

Also, the rule is of limited significance for probate property. Interest on the deferred tax paid during a particular year reduces the "undistributed net income" at least once, or twice to the extent interest on the deferred tax is claimed as an income tax deduction and thereby reduces the estate's distributable net income. Why should the application of the rule vary depending upon

whether this interest is claimed as an income tax deduction or an estate tax deduction and why should "double dipping" be permitted?

Some states follow the federal lead and permit the state death tax attributable to a closely-held business to be deferred and paid in installments. See e.g., N.Y. Tax Law §962(f); Wis. Stat. Ann. §72.22(4)(a). In such situations, a distinction should not be made between the federal and state tax for purposes of the undistributed net income rule and, in addition, use of the income to pay the state income tax should not be "penalized."

To summarize, in its present form the undistributed net income rule is unsound. It should be modified to meet the points mentioned above or, preferably, be eliminated.

b. Section 6166(g)(1)(D) and Distributions from Trusts

Section 6166(g)(1)(D) should be amended to substitute the words "a trust included in the decedent's gross estate" for "a trust created by the decedent." A marital deduction trust may be included in a decedent's gross estate but will not be created by the decedent. No policy reason exists why in such a case a distribution of

trust property should accelerate the payment of the estate tax on the closely held business interest. Treas. Reg. §20.6166-3(e)(3), in referring to a distribution of an interest in a closely-held business which does not result in an acceleration of the deferred tax, encompasses an interest "which is included in the gross estate under sections 2035 through 2038, or section 2041."

c. Conformity with Section 303

Section 6166(g)(1)(B) states that where a §303 redemption occurs during the deferral period the redemption proceeds are not treated as a disposition of an interest in, or a withdrawal from, the closely held business, which may cause a loss of the deferral privilege, so long as payments of federal estate tax at least equal to these proceeds are made on or before next installment becomes payable. This is an all or nothing rule, with non-compliance causing the entire amount of the redemption proceeds to be treated as a disposition and a withdrawal. See Rev. Rul. 72-188, 1972-1 Cum. Bull. 383. The result should be changed so that only the amount in excess of the "permitted" §303 payments is treated as a disposition.

Sections 303 and 6166 are also "out of phase" because "protected" §303 redemptions may result in

acceleration under §6166. Section 6166(g)(1)(B) refers only to "an amount of tax imposed by Section 2001"* while §303 refers to the federal estate tax and state death taxes (including interest) and funeral and administration expenses. Section 6166(g)(1)(B) should be revised to protect all §303 redemptions. A "use of property" test is unnecessary in §6166(g)(1)(B) because a similar test is contained in §303(b)(4). It directs that in the case of amounts distributed more than four years after a decedent's death §303 applies only to the extent of the lesser of (i) the aggregate §303 unpaid amount immediately before the distribution and (ii) the aggregate §303 amounts paid during the one year period beginning on the date of the distribution.

d. Distribution of Indebtedness

A distribution of indebtedness by a corporation or a partnership in return for a "qualifying" stock or partnership interest is, under §§6166 and 6166A, treated as a distribution or withdrawal in determining whether payment of the deferred tax is accelerated. Section

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* A private letter ruling issued in 1976 holds that the tax imposed by section 2001 includes a state death tax that is allowed as a credit against the federal estate tax pursuant to section 2011.

6166(g) should be modified to eliminate this result as suggested in Recommendation No. 1979-6 of the Tax Section of the American Bar Association. See 32 Tax Lawyer 1464 (1979). This recommendation was approved by the House of Delegates of the Association earlier this year. With closely held business interests, distinctions between indebtedness and equity are inappropriate. Also, under some state laws governing professional partnerships and corporations the interest of the decedent-professional must be redeemed at death. As a result the distribution of indebtedness is to some extent involuntary and similar to a section 303 redemption which receives special treatment under §6166(g)(1)(B).

e. Coordinating Withdrawals and Dispositions

Acceleration of the deferred tax may be caused by a withdrawal from the business or as a result of a disposition of the estate's interest in the business. The withdrawal test is based upon the value of the business. See §§6166(g)(1)(A)(ii) and 6166A(h)(1)(A)(ii). The disposition test applies to the estate's interest in the business. See §§6166(g)(1)(A)(i) and 6166A(h)(1)(A)(i). In each case the percentage is the same, one-third (§6166) or one-half (§6166A). The differing treatment of

withdrawals and dispositions should be eliminated as suggested in Recommendation No. 1979-6 of the Tax Section of the American Bar Association and approved by the House of Delegates of the Association earlier this year. See 32 Tax Lawyer 1464 (1979). The report on the Recommendation states:

> "It is proposed to eliminate the disparate treatment which now exists between the withdrawal and disposition tests by eliminating the withdrawal test as an independent test and by making withdrawals subject to the same limitations as are applicable to dispositions. The disposition test would be further amended to prevent acceleration to the extent that the consideration received in the disposition consists of obligations of the closely held business, since such obligations are not likely to be marketable except at a substantial discount. It is proposed that such a transaction not be considered a disposition that would trigger acceleration. However, the obligations would then in effect take the place of the original interest in the business, so that a subsequent disposition of the specified percentage of the obligations would trigger acceleration."

f. Disposition of Interest or Withdrawal

Section 6166(g)(1) provides that if one-third or more in value of a qualifying closely-held business interest is "distributed, sold, exchanged or otherwise disposed of" payment of the deferred tax is accelerated. In certain cases this rule cannot be justified as a policy matter. To illustrate, let us assume that a decedent left one-third of his qualifying stock to his surviving spouse

in a marital deduction bequest which was not subject to estate tax and the other two-thirds in equal shares to his two children, with the estate taxes chargeable to his residuary estate which passes to his children. If the surviving spouse sells her stock, why should the payment of the deferred tax be accelerated? The children do not have the sales proceeds available to them for payment of the tax.

In theory, acceleration should occur only if the disposition is made by the person or persons charged with the responsibility for the payment of the tax. However, the preparation of an amendment to §6166(g)(1) to avoid the inequitable result in the case discussed in the preceding paragraph is not easy and presents many of the problems that exist in interpreting §303(b)(3). If a relatively simple solution cannot be devised, an approach which, while not ideal, would be preferable to current law is to increase the percentage from one-third or to one-half or more. A 50% figure is now used in §6166A for dispositions or withdrawals.

g. Certain Tax-Free Reorganizations

Acceleration of the deferred tax occurs under §6166(g)(1) if more than one-third of the value of the

closely held business interest is "distributed, sold, exchanged or otherwise disposed of". Section 6166(g)(1)(C) provides that an exchange of stock in some but not all tax-free reorganizations described in §368 is not subject to the acceleration rule. See Treas. Reg. §20.6166-3(e)(2). All reorganizations described in §368 should be exempted from this rule, provided the stock received in the reorganization satisfies the definition of "non-readily-tradeable stock" in §6166(b)(7)(B) or indebtedness is received in a company whose stock is so defined. Such a rule would be consistent with the result under §303 when a tax-free reorganization occurs. See §303(c).

6. Qualification as a Proprietor

Section 6166(b)(1)(A) defines an "interest in a closely held business" to include "an interest as a proprietorship." During the past year, Service personnel have asserted that the activities of a manager or agent will not be imputed to a decedent in determining whether the requirement of §6166(b)(1)(A) has been satisfied. In the self-employment tax area (qualification for social security coverage and liability for tax), courts have held that material participation may occur through agents and employees. Harper v. Flemming, 288 F.2d 61 (4th Cir.

1961); Henderson v. Flemming, 283 F.2d 282 (5th Cir. 1960); Foster v. Celebrezze, 313 F.2d 604 (8th Cir. 1963). See also Rev. Rul. 64-32, 1964-1 Cum. Bull. 319. Prior to the enactment of §6166 (now §6166A) in 1958 the Service acknowledged that material participation in farming could be accomplished through agents. Treas. Reg. §1.1402(a)-1(b)(2); Rev. Rul. 56-22, 1956-1 Cum. Bull. 588. Thus, a reasonable assumption is that Congress intended to permit agency relationships to be used in determining whether a trade or business was involved for purposes of §6166. The fact that in 1974 Congress changed the self-employment tax to exempt farm owners whose material participation in farming was attributable to activities of agents (PL 93-368) should not be interpreted as evidence of a Congressional intent to "read" this change into §6166. Further, such a position would create an undesirable distinction between a sole proprietorship and a partnership or corporation owning a farm. If a partnership or corporate holding is involved, the agency activities would be recognized because §§6166 and 6166A refer to the partnership or corporation carrying on a trade or business.

The legislative history of any changes in §6166 should state the intention of Congress that the activities

of agents and managers shall be taken into account in determining whether the test of §6166(b)(1)(A) is met.

7. Real Estate Holdings

Neither §6166(b)(1) nor the regulations promulgated thereunder contain a definition of the term "trade or business." In 1975, the Revenue Service issued Rev. Rul. 75-365, 1975-2 C.B. 471, which contained the following statement: "[S]ection 6166 was intended to apply only with regard to a business such as a manufacturing, mercantile, or service enterprise, as distinguished from management of rental property by an owner can never be considered the conduct of a trade or business." Such a restrictive interpretation finds no support in the legislative history accompanying the enactment of §6166, nor is it consistent with any other provision of the Revenue Code. In fact, for purposes of §§346(b) and 355, the management of rental property has been held to satisfy the more stringent "active" conduct of a trade or business test contained in such sections. See, for example, Rev. Rul. 57-334, 1957-2 C.B. 240.

The legislative history of any changes in §6166 should state the intention of Congress that there is no absolute prohibition against the management of rental

property qualifying as a trade or business for purposes of §6166(b)(1). The quality and quantity of activity which should be required in determining the existence of a trade or business in the case of real estate should be the same as for any other enterprise.

8. Husband and Wife Holdings

Section 6166(b)(2)(B) directs that stock or partnership interests which are community property of a husband and wife or are held by husband and wife as joint tenants, tenants by entirety or tenants in common shall be treated as owned by one shareholder or partner. This rule is not applicable to interests owned individually by a husband and wife or their estates. Thus, the form of ownership for a husband and wife may cause a difference in result under §6166. This seems inappropriate, particularly when the interest of one spouse was received from the other spouse through a transfer which is includible in the other spouse's gross estate under §2035. A single rule which treats individual holdings of a husband and wife or their estates as owned by one shareholder or one partner is desirable and consistent with the result for subchapter S corporations under §1371(c). In general we believe a single qualification requirement in terms of the number of

shareholders is desirable for §6166 and subchapter S corporations.

The last sentence of §6166(c), containing a special rule for interests in two or more closely held businesses being treated as an interest in a single closely held business, is the same as §6166(b)(2)(B) and should be modified in the same manner suggested in the preceding paragraph for §6166(b)(2)(B).

9. "Interest in Closely Held Business" Changes

We believe three changes should be made in the definition of an "interest in a closely held business" which would improve the operation of §6166.

a. "Small" Shareholders

Our members have often represented estates of shareholders in a company where no market exists for the shares but neither the voting stock nor shareholder requirement can be satisfied. For example, the decedent may own 3% of the outstanding stock of a company having 50 shareholders. When the value of the stock satisfies the threshold percentage requirement of §6166, deferral should be available. This may be done by expanding the definition of an "interest in a closely held business" to include any stock of a corporation which has no market on a

stock exchange or in an over-the-counter market at the decedent's death. See §6166(b)(7). This would in effect eliminate the requirement that the decedent own 20% of the voting stock of the company in any case where the shareholder number test cannot be satisfied.

b. Partnership Interests

In order for a partnership interest to qualify as an interest in a closely held business the decedent must have at least 20% of the total capital interest if the partnership has more than 15 partners. Partnership profits may be shared in a manner different from the partners' capital interests. Section 6166(b)(1)(B)(i) should be broadened to permit a 20% interest in partnership profits to qualify as an interest in a closely held business. Many provisions of the Code do not distinguish between an interest in capital or profits. See §§318-(a)(2) and (3), 544(a)(1) and (2), 554(a)(1) and (2), 707(6)(1) and (2) and 1563(e)(2).

c. Corporate or Partnership Indebtedness

Corporate or partnership indebtedness owed to a decedent whose stock or partnership interest meets the requirements of an interest in a closely held business is not considered a part of the business in applying §6166.

While a distinction between debt and equity interests may be appropriate for income tax purposes, we believe such a distinction is unwarranted for purposes of §6166 when the decedent has a substantial interest in the company. Further, in the case of a corporation, a distinction between indebtedness and preferred stock seems inappropriate. Indebtedness should be included as part of an interest in a closely held business when the "qualifying" stock or partnership interest (exclusive of the indebtedness) satisfies the threshold percentage qualification requirement.

10. Two or More Interests

A special rule is contained in §6166(c) and §6166A(d) which permits interests in two or more closely held businesses to be treated as a single interest. In order to satisfy this rule, each interest must have a value equal to a stated percentage of the total value of each such business. This percentage is 20 in the case of §6166 and 50 in the case of §6166A. In determining whether the test is met, interests held by members of the decedent's family as defined in section 6166(b)(1) are taken into account. The test is different from the threshold percentage requirement in §6166(b)(1)(B)(i) or

(b)(1)(C)(i) and the corresponding provisions in §6166A. This "dual" test for each interest may cause an interest which alone qualifies for deferral to lose this qualification when combined with another interest. Such a result is undesirable. Further, the 20% test introduces a valuation issue which may not be resolved in the federal estate tax proceeding. Unless the decedent owns 100% of the corporation or partnership, a determination of the value of the entire business will not be made. The special "combination" rule should be changed to use the same tests contained in §6166(b)(1)(B) and (b)(1)(C), namely, that each interest which satisfies the definition of an "interest in a closely held business" will qualify provided the value of all such interests exceed the threshold percentage qualification requirement.

11. "Contemplation of Death" Additions

Treas. Reg. §20.6166-2(c)(1) states

> "it is not necessary that all the assets of the partnership or the corporation be utilized in the carrying on of the trade or business"

Concern has been expressed that this regulation may permit the addition of liquid assets to a partnership or corporation for the purpose of securing a tax deferral with respect to such assets. This concern could be eliminated by

having the legislative history of the §6166 changes approve of a restriction on Treas. Reg. §20.6166-2(c)(1) which would be substantially the same as the limitation in §341(e)(7) stating that a contribution will be ignored "if it appears that there was not a bona fide business purpose for the transaction in respect of which such amount was received."

12. Chapter 13 Tax

Section 2621(b) states that §§6166 and 6166A shall not apply to the Chapter 13 tax imposed on certain generation-skipping transfers. We believe this policy decision is untenable. The Chapter 13 tax is a substitute for an estate tax. In almost all other respects, including the application of §303, the Chapter 13 tax is "conformed" to the estate tax. See §§2602(c) and (d) and 2614. No reason is given in the Chapter 13 legislative history for excluding the application of §§6166 and 6166A.

On the other hand, §303(d) contains a special rule for Chapter 13 transfers which is broad and difficult to justify as a policy matter. If a Chapter 13 transfer occurs at or after the death of the deemed transferor §303 will apply provided the value of the stock included in the transfer equals or exceeds 50% of the value of the

transfer. Thus, if the trustee has a discretionary power to distribute principal after the deemed transferor's death and the transfer does not occur at death, the trustee by selection of particular property to be distributed (the stock) may assure the application of §303(d) because the remaining trust property is not taken into account in applying the 50% qualification test.

The answer lies in applying §6166 to some Chapter 13 transfers and to restrict the application of §303(d) to the same transfers. The "protected" transfers should be taxable terminations occurring at or after the death of the deemed transferor, which is in general the test under §2602(d) for the application of the alternate valuation method to Chapter 13 transfers. Such terminations would include those occurring within three years before the death of the deemed transferor that are covered by §2602(e).

13. Attribution Rules

The Revenue Act of 1978 contained the so-called "Gallo Wine amendment" which applies the family attribution rules of §267(c)(4) in determining eligibility under §6166 in terms of the shareholder or partner number test or the percentage of capital interest or voting stock

requirement. These rules attribute ownership between brothers and sisters but not between spouses of brothers and sisters and descendants of deceased brothers and sisters. As a result, the order of deaths of brothers and sisters may be crucial and the last to die will not have the benefit of attribution which was available to the first to die. Such a result seems unwarranted. Attribution should be permitted from spouses of brothers and sisters and descendants of deceased brothers and sisters.

In addition, attribution should not be lost as a result of the death of a family member. Stated another way, estates of members of a decedent's family should be covered by §6166(b)(2)(D).

14. Section 2032A Property

This section permits certain real property, including farms, to be valued for estate tax purposes in accordance with a special valuation method that produces a value less than its fair market value. The lower value must be used in determining whether the estate qualifies for deferral under §6166 or 6166A. As a result, an estate may be forced to choose between using §2032A and §6166 or 6166A. We believe forcing such a choice is undesirable

and inconsistent with the purposes of these provisions. Section 6166 should be amended to permit all qualified real property, as defined in §2032A(b), to qualify under §6166.

15. Judicial Forum for Resolving Qualification Disputes

Neither §6166 nor §6166A deals with the issue of how a dispute between an estate and the Service concerning whether the estate satisfies the qualification requirements of the section. Revenue Procedure 79-55, IRB 1979-48 at 20, states that if such a dispute arises the estate may request technical advice from the National Office, but if the advice is negative, the estate appears to be without a forum to dispute the determination. A judicial forum should be available to an estate in such a case. We believe this may be accomplished by treating the additional amount of tax claimed by the Service as an asserted estate tax deficiency.

16. Unfunded Bequests

At death, a decedent may be entitled to receive property from an estate or trust which _may_ include an interest in a closely-held business. For example, a husband could die owning such an interest and leave his surviving spouse by will a pecuniary bequest in an amount equal to

the maximum marital deduction and the wife could die shortly after her husband and prior to the funding of the marital deduction bequest. In such a case, the determination of whether the wife's estate includes an interest in a closely-held business depends upon whether the executor of the husband's will distributes the interest in satisfaction of the marital bequest. The wife's estate should be entitled to treat such interest as included in the estate for purposes of applying §6166 to the extent that the interest is distributed to the estate. In determining the amount of the deferred tax, the interest would be valued as if it were included in the decedent's gross estate.

E. Suggested Changes in Related Provisions

1. Alternative Minimum Tax

If a taxpayer's adjusted itemized deductions, as defined in §57(b), exceed 60% of his adjusted gross income, the excess is treated as a tax preference and subject to the alternative minimum tax imposed by §55. Thus, to the extent that interest on deferred estate tax is claimed as an income tax deduction, an alternative minimum tax "problem" may exist. The application of this tax to interest on any death tax is inappropriate and inconsistent with the policy behind §§6166 and 6166A. The

alternative minimum tax should be modified to eliminate interest on any death tax as an adjusted itemized deduction. Consideration should also be given to eliminating interest on any tax as an adjusted itemized deduction. We have never heard or seen a satisfactory explanation as to why such interest should enter into the computation of the alternative minimum tax.

2. Section 303

This provision provides a safe haven from dividend treatment for the redemption of stock in an amount equal to the decedent's death taxes and interest thereon, funeral expenses and "allowable" administration expenses under §2053. A literal reading would permit "double dipping" in the sense that the interest on death taxes could be claimed twice, once as interest under §303(a)(1) and again as an administration expense under §303(a)(2). The section should be revised to prevent this result. The question then arises as to whether the §303 amount should reflect interest on death taxes and, if so, how the problem of the redemption occurring prior to the payment of future interest should be handled.

Under current law, §303 could apply when the decedent's estate is not eligible for deferral under §6166

or 6166A with respect to the estate tax attributable to the asset being redeemed. This could occur because (1) the threshold percentage requirement is higher under the deferral provisions than under §303 or (2) the asset does not qualify under §6166 or 6166A but does qualify under §303. As to (1), the threshold percentage requirement suggested in part D above would eliminate the disparity. As to (2), a policy decision is required concerning whether §303's broader coverage should be continued. We believe it should be. The redemption may occur before the §303 amount has been finally determined. If the redemption occurs and its amount plus all prior redemption amounts as to which §303 protection is asserted exceeds the protected amount already paid, the shareholder should be required to file the "final" figures with the Service and waive the application of the statute of limitations for a stated period after these figures are so supplied.

Another simplification could be achieved by modifying the aggregation rule of §303(b)(2)(B) to conform with the aggregation rule of §6166(c), which should be revised in the manner suggested above.

Finally, "conforming" changes to proposed §6166 should be made in §303(a)(2) and (b)(2)(A)(ii) to exclude

post-death interest in determining the amounts "allowable" as deductions under §2053.

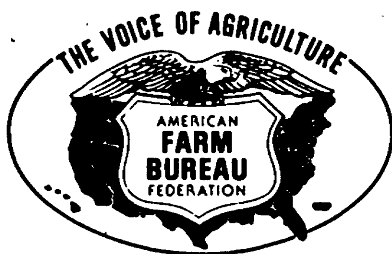
3. Sections 302 and 318

Closely-held stock included in a decedent's gross estate may fail to qualify under §303. In such a case, §302(b)(3) permits a redemption to be treated as an exchange (capital gain) if it is in "complete redemption of all the stock of the corporation owned by the shareholder." The constructive ownership rules of §318(a) are applicable in determining whether a complete redemption has occurred. Section 318(a)(3) provides that stock directly or indirectly owned by a beneficiary of an estate or trust is deemed owned by the estate or trust. The Tax Court has held in two cases that an estate or trust may file an agreement under §302(c)(2) waiving family attribution, with the result that a waiver by the estate or trust and a beneficiary prevents attribution to the estate or trust through the beneficiary. <u>Lillian M. Crawford</u>, 59 T.C. 830 (1973); <u>Rodgers P. Johnson Trust</u>, 71 T.C. 941 (1979). These decisions should be "codified" by amending §302(c)(2) to refer specifically to an estate or trust as a "distributee".

4. Section 2011 Credit

As previously noted, some states permit the

payment of a state death tax attributable to a closely-held business to be deferred and paid in installments. The usefulness of these statutes has been lessened by the Service's policy regarding allowance of the state death tax credit authorized by §2011. The Service has taken the position that a credit under this section will be allowed only to the extent a state death tax has been paid at the time of the allowance. See Gibbs, Emerging IRS Attitude Toward State Death Tax Credit and Its Impact on Installment Payment of Estate Taxes, U. Miami 14th Inst. on Est. Plan. ¶1800 (1980). §2011 credit should also be allowed for deferred tax provided the executor certifies that a state death tax in an amount at least equal to the credit will be paid.

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STATEMENT OF THE AMERICAN FARM BUREAU FEDERATION
BEFORE THE SUBCOMMITTEE ON ESTATE AND GIFT TAXATION
OF THE SENATE COMMITTEE ON FINANCE
WITH REGARD TO ESTATE AND GIFT TAX LAWS

Presented By
Richard McGuire, President of the New York Farm Bureau and Member
of the AFBF Board of Directors

May 1, 1981

--SUMMARY--

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May 1, 1981

1. Repeal of the federal estate tax is a legislative priority for Farm Bureau during the 97th Congress. We will work toward the accomplishment of this goal through the endorsement of S.404.

2. Estate tax reform in 1976 and 1978 eased the economic and administrative burdens associated with the estate tax, but provided no permanent remedy for the increasingly heavy taxation of farm estates.

3. It is true that repeal would mean a revenue loss; but it is also true that there are other opportunities to further reduce federal spending to offset this relatively small tax revenue loss.

4. The estate tax is a disincentive to savings, investment, and productivity. Such a position is inconsistent with the emphasis on capital formation.

5. Farm Bureau policy on estate tax also addresses provisions contained in other legislation pending before the Subcommittee: S. 395, S. 574, and S. 858. We offer our support to this legislation as part of an overall package to phase out the estate tax.

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May 1, 1981

The American Farm Bureau Federation appreciates the opportunity to testify on estate and gift tax laws as well as legislation designed to repeal or modify current statutes. Farm Bureau has appeared before the Senate Finance Committee and its Subcommittees on many occasions to discuss our position on estate taxes. Our most recent testimony was presented earlier this week to the Subcommittee on the Oversight of the Internal Revenue Service concerning, in part, problems associated with the special use valuation regulations under Section 2032A of the Internal Revenue Code.

Farm Bureau has had a longtime interest and involvement in the federal estate and gift tax area because of the effect that these taxes have upon the well-being of the nation's farm and ranch families. Farm Bureau actively supported estate tax relief in the Tax Reform Act of 1976 and the Revenue Act of 1978. The continuing interest of our three million member families is reflected in the following policy which was adopted by the voting delegates of the member State Farm Bureaus at the American Farm Bureau Federation's annual meeting in January 1981.

Federal Estate and Gift Taxes

"We favor a phase-out of the federal estate tax. Until this phase-out is accomplished, we will continue to support legislation to reduce the impact of the federal estate tax on the orderly transfer of property and an exemption for property on which an estate tax has been paid within 15 years prior to the death of the second decedent.

"We favor indexing of the federal estate tax to compensate for inflation.

"We favor recognition of the equal contribution of the spouse to a farming enterprise in estate settlements.

"We believe both crop share and cash rentals should qualify in determining the special use valuation of farmland under Section 2032A of the Internal Revenue Code.

"We favor special use valuation of agricultural land for gift tax purposes similar to the special use valuation of such property for estate tax purposes under Section 2032A of the Internal Revenue Code.

"We encourage a reasonable and flexible interpretation by the Internal Revenue Service of the 'material participation requirements' for the special use valuation of farmland under Section 2032A of the Internal Revenue Code.

"We recommend an immediate increase in the estate tax exemption to $500,000 and an increase in the annual gift tax exclusion to $10,000 per year."

Repeal of the federal estate tax is a legislative priority for Farm Bureau during the 97th Congress. Estate tax reform in 1976 and 1978 debatably "eased" the economic and administrative burdens associated with the estate tax. However, such reform provided no permanent remedy for the increasingly heavy taxation of farm estates whose major asset--land--is highly inflated. An effect of inflation has been to subject many small- and moderate-size estates to the estate tax. The $47,000 unified credit enacted in 1976 is now of little benefit to most farm and ranch estates. Special use valuation, which was hailed as an answer to estate tax problems for agriculture, has become so entangled in the regulatory efforts of the Internal Revenue Service that some estates have foregone its application entirely. Material participation requirements and valuation procedures are restrictive to the point of negating a law that was intended to benefit farms and other small businesses.

The estate and gift taxes are one of the smallest sources of revenue to the Treasury. In 1979, these taxes constituted 1.2 percent of all federal tax revenues for a total of $5.5 billion. It is true that repeal would mean a revenue loss; but it is also true that there are numerous other opportunities to further reduce federal spending to offset this relatively small tax revenue loss.

It has been suggested by some that the repeal of estate taxes would cause an influx of nonfarm investors because the absence of estate taxes would make farmland an attractive investment opportunity. In a business where the historic return on investment has averaged four percent annually and where farmers themselves must necessarily expand their production base to cover increasing costs of production, it is ironic to suggest that estate tax repeal would be a boon to nonfarm investors. On the contrary, the presence of the estate tax has caused many farm heirs in the past to sell a portion of the estate to pay the estate taxes.

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The estate tax is a disincentive to savings, investment, and productivity. It is a tool of those who adhere to the philosophy of using tax policy to accomplish social goals, i.e., the redistribution of wealth. The size of farming operations often increases in order to maintain a semblance of profitability in agriculture. We cannot pass our costs to consumers through increased commodity prices. As previously mentioned, our only alternative is to increase our production base. To penalize heirs for efforts of the decedents to establish profitable businesses is fundamentally wrong in America's capitalistic private enterprise system. At the least, such a notion is inconsistent with the emphasis on capital formation.

Farm Bureau supports repeal of the estate tax. We will work toward the accomplishment of this goal through the endorsement of S. 404, introduced by Senators Symms and Boren, to repeal federal estate and gift taxes.

Farm Bureau policy also addresses provisions contained in other legislation pending before the Subcommittee: S. 395, by Senators Wallop and Boren; S. 574, by Senator Kassebaum; and S. 858, by Senator Durenberger. While none of these bills provides for elimination of the federal estate tax, they do allow a greater measure of estate tax relief for farm families. We commend the sponsors of these bills and offer our support for them as steps in phasing out the estate tax.

Our general comments with regard to these bills are directed to four areas:

Unified Credit and Rate Reduction

The Subcommittee has received ample testimony on the effects of inflation on the value of farm estates. To adjust the unified credit against estate and gift taxes and reduce the tax rates is a matter of equity to farm families faced with rising production costs, depressed commodity prices, and increased land values resulting from inflation. Specifically, Farm Bureau supports modification of the unified credit to increase the equivalent estate tax exemption to at least $500,000.

Marital Deduction/Family Deduction

The use of an unlimited marital deduction would allow the transfer of farm property from one spouse to the other without estate or gift tax liability. Although careful estate planning must be used to achieve maximum benefit for the estates of both spouses, an unlimited marital deduction could reduce significantly the amount of taxes due on the estate of the first decedent. This reduction in estate taxes promotes the continuation of family businesses and recognizes the contribution of the surviving spouse to the farming operation. Likewise, a deduction with respect to interests passing to qualified heirs of the decedent other than the spouse is highly desirable.

Annual Gift Tax Exclusion

The transfer of farm property by gift is common among farm families. The making of gifts transfers assets from the parent generation of farmers to the children. This not only reduces the size of the parent's estate, but promotes continuation of the family farm. Just as inflation has necessitated an increase in the unified estate and gift tax credit, it has caused the present exemption of $3,000 per year/per donee to become obsolete. Farm Bureau supports an annual gift tax exclusion of $10,000 per year/per donee.

Special Use Valuation

In testimony to the Internal Revenue Service on April 3, 1979, North Carolina Farm Bureau President John Sledge voiced the concerns of the American Farm Bureau Federation on the issue of special use valuation under Section 2032A:

> "Farm Bureau supports the Internal Revenue Service in its attempts to prevent abuses in the special use valuation of farm real estate. We are concerned, however, that the proposed regulations may work to the detriment of many farmers, ranchers, and their heirs because of the restrictive aspects of the proposed definition of material participation. The regulations should maintain the flexibility necessary to reflect the intent of Congress to encourage the preservation of family farms.
>
> * * * * *
>
> "The proposed regulations present a double bind to farmers and their families. First, the restrictive definition of 'material participation' can discourage a decedent-to-be and his or her heir from engaging a nonfamily farm management specialist or firm to operate the farm, although business or family considerations might dictate such services. To employ a non-family member could mean the loss of the special use valuation for the farm. Second, when an owner does participate in the operation of a farm, within the meaning of the proposed rules, the related income becomes earned income under Social Security. Thus, material participation requirements can force a farmer to make a choice between eligibility for social security benefits or eligibility for the special use valuation."

In January 1980, Doyle Rahjes, Vice President of the Kansas Farm Bureau, presented Farm Bureau's position at the Internal Revenue Service hearing on the definition of gross cash rentals for purposes of the special use valuation of farmland. The definition of gross cash rentals included in the proposed regulations published on July 19, 1978, permitted crop share rentals if no actual cash rentals of comparable real property were available in the locality. The option to substitute crop share figures for cash rent figures is essential in areas of the country where rental operations are conducted primarily under crop share arrangements, a traditionally recognized way of conducting business. Unfortunately, proposed regulations published in September 10, 1979, withdrew this option to farmers and ranchers. In areas of the country where crop share arrangements predominate, such as Kansas and Illinois, it has become impossible to take advantage of the special use valuation under 2032A(e)(7). This leaves the alternative of a more cumbersome valuation procedure under 2032A(e)(8). Mr. Rahjes emphasized the importance of crop shares to farmers and urged the Internal Revenue Service to reexamine its decision to eliminate the use of crop share rentals. In a hearing on March 4, 1980 before the Senate Finance Subcommittee on Taxation and Debt Management, Farm Bureau's position was offered again in support of legislation allowing the use of crop shares as well as cash rentals.

In hearings before the Subcommittee on Taxation and Debt Management on August 4, 1980, and the Subcommittee on Oversight of the Internal Revenue Service on April 27, 1981, Farm Bureau reemphasized that the benefits of special use valuation can be realized by farm families only if reasonable guidelines for methods of valuation and requirements for material participation are presented. To date, the Internal Revenue Service has not offered workable guidelines. Therefore, Farm Bureau supports amendments to the Internal Revenue Code, such as those contained in S. 395 and S. 878, that would provide realistic requirements to qualify for special use valuation. In particular, we support provisions that address the interaction of Social Security benefits and special use valuation, as well as accommodate questions of material participation or active management of surviving spouses, minor children, and other similarly situated individuals who inherit property from a decedent who qualified for special use valuation.

We thank the Subcommittee for its consideration of estate and gift tax laws. Again, Farm Bureau reemphasizes its commitment to repeal. Estate tax reform is the management of the problem; repeal is the solution.

Statement of
Helen Timmermann, Chairman
National Association of Wheat Growers Committee on Taxation
before the
Subcommittee on Estate and Gift Taxation
Senate Committee on Finance
on
Estate Tax Reform
May 1, 1981

Mr. Chairman and members of the Committee:

The National Association of Wheat Growers appreciates this opportunity to present its views on estate tax reform. I am Helen Timmermann, chairman of the National Association of Wheat Growers Committee on Taxation. My husband and I farm a fourth generation farm near Pendleton, Oregon.

Estate taxation was designed to prevent accumulation of great wealth and not as a revenue raising measure. However, it will become a more major source of revenue unless drastic estate tax reform measures are adopted now. The rate of inflation we have been experiencing since the Tax Reform Act of 1976 is increasing the number of estates subject to estate taxation. The inflation factor is pushing modest estates, as well as sole proprietors, closely-held small businesses and farms into higher and higher estate tax brackets. The impact of current estate taxation in the next ten years will be detrimental to the continuation of small businesses and farms.

Following is an example of the acceleration in this trend to tax more and more estates at higher and higher rates due only to the effects of inflation:

> An estate of $250,000 on January 1, 1977 would incur an estate tax of $23,800. Assuming a 10% inflation rate the estate will be $500,000 in 7 years and incur an estate tax of $108,800 by 1984.[1].

In exhibit A, another example shows the effect of inflation on a farm estate of $975,000. You can see that the value increases to approximately $2,500,000 in 10 years at 10% inflation. Figure 3 shows the increasing estate tax burden relative

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[1]Eubank, Thomas, Congressional Record, February 5, 1981, page S. 1024, as referred to by Senator Malcolm Wallop.

to the current value of the estate. In 1981, the tax liability is $257,250 or 26%. This increases to $471,515 or 48% in five years and further increases to $853,000 or 87% of the current value in just 10 years. Even the debt due to estate tax liability of 1981 would be very difficult to service from the income of the farm land.

Total farm debt is at an all time high. How will farms and small businesses be able to "buy back" 25%, 48% or 87% of their business from the U.S. government each time property is inherited? Estate taxation results in a transfer of property, not to heirs, but in increasing levels to the government. Although the need is for capital formation in the private sector, current estate taxation rates will produce a capital drain.

The result will be that increasing numbers of farms will have to sell part or all of the farm to pay estate taxes. The impact will be to shift land ownership to owners with investment goals other than those based on productivity or to large corporate organizations with high equity.

It will not take very many years under the current estate taxation levels to produce this shift in ideology from the prevention of accumulation of great wealth to a revenue raising measure. As deaths occur over the next 10-20 years we will end up with a very different economic and social structure as fewer individual and family farms or businesses are able to survive this climate. NAWG believes this would be an undesirable course to choose.

We believe that repeal of estate taxes would contribute to the productive capacity of the U.S. economy. Short of repeal, we believe that the unified credit should be raised a significant amount immediately with provision for upward adjustments to take into account the inflationary effect on asset values. This should be coupled with a reduction in estate tax rates. Transfers of property between spouses, before or at death should not be taxed. Farm and other small business families work side by side in building the family's business and a spouse should not be forced to buy back a large proportion of the estate simply to satisfy

inheritance or gift tax assessments.

Since the intent of Congress is to have a special farm use valuation, to reflect the actual earning capacity of the land, we must have a valuation procedure treating all farm lands equally. Special farm use valuation is essential for farm continuity. The prevailing market price can be for investment reasons having no relationship to earnings capacity. Current IRS regulations on farm use valuation are drawn so narrowly as to permit the rent capitalization formula in Section 2032 (e) (7) to be used for only some farm lands - those based on a pure cash rent. The regulations permit the net return from cash leased land to be capitalized in the formula but exclude all others by definition. In many major agricultural areas of the country, few, if any, leases are written for cash rental, but all leases are convertible to cash. The in-kind, crop share rent can be converted to its cash equivalent to reflect the actual earning capacity of the land just as the cash lease can. In Exhibit B, when we look at four farms identical in net return to lessor but different in lease arrangement, we can see the extreme discrimination in valuation resulting from current regulations.

The proposed IRS regulations of July 19, 1978 recognize the need for converting crop share to cash and outlined a method of determinating its cash equivalent.

In the April 27 hearings conducted by the Senate Finance Subcommittee on Oversight of the Internal Revenue Service, Assistant Secretary for Tax Policy John Chapoton told Senator Lloyd Bentson that he would work with him legislatively on the matter of crop share rents and commented that in some parts of the country it is not that subjective.

The state of Oregon has developed a farm use appraisal method for property taxation that determines the annual net rent for all agricultural lands regardless of leases. Oregon uses the annual net rental return to owner capitalized over a Federal Land Bank interest rate to determine the farm use valuation. This provides a valuation method based on rent capitalization that is fair and equitable to all farm lands.

This concludes my remarks on estate tax reform and special use valuation, Mr. Chairman, and I would be happy to respond to any questions you and the other members of the Subcommittee may wish to ask. Thank you.

EXHIBIT A

IMPACT OF INFLATION ON
FARM VALUE SUBJECT TO ESTATE TAX

| | | |
|---|---|---|
| 1. | Value of Farmland (1981)[1/] | $ 975,000 |
| 2. | Value of same farm in 5 years at 10% inflation | $1,570,247 |
| 3. | Value of same farm in 10 years at 10% inflation | $2,528,899 |

| | | 1981 | 1986 | 1991 |
|---|---|---|---|---|
| 4. | Ratio of exemption equivalent of Unified Credit to value of land | $ 175,000 / $ 975,000 | $ 175,000 / $1,570,247 | $ 175,000 / $2,528,899 |
| 5. | Proportion of Farm Land value exempted from estate tax by exemption equivalent of unified credit | 18% | 11% | 7% |

Figure 1. *Inflation vs. farm value subject to Estate Tax.*

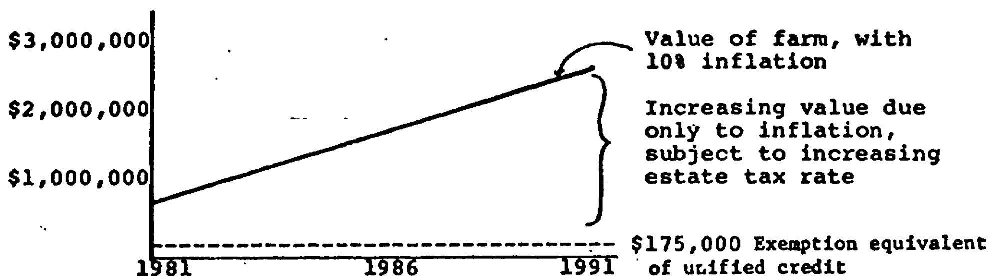


Figure 2. *Proportion of Farm Value Exempted from Estate taxes using 1981 unified credit and 10% annual inflation.*

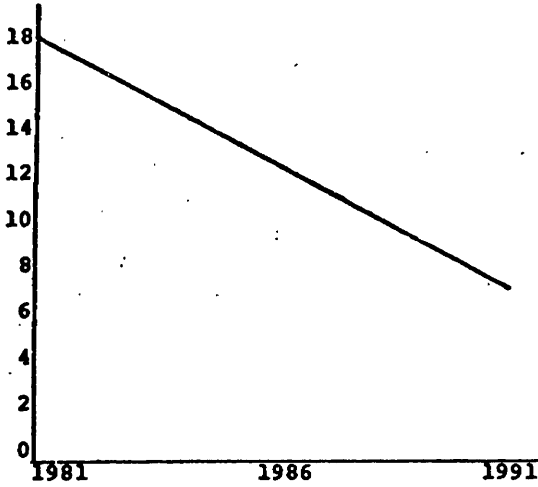
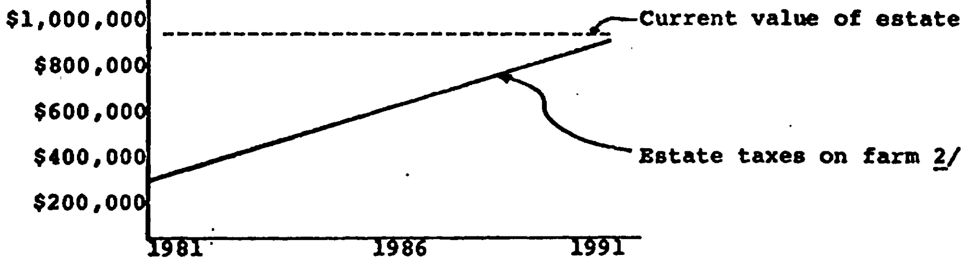



Figure 3. *Increasing Estate Tax burden relative to current value of estate.*




1/ Estimated value of Dryland Farm , of minimum size to support a farm family

2/ Figured on gross estate less unified credit and less credit for state death taxes

Prepared by:
Dr. Clinton Reeder, PHD
Agricultural Economics

EXHIBIT B.

DISCRIMINATORY EFFECT OF CURRENT REGULATIONS

re: Farm Use Valuation on farms, identical except for type of lease

| | Cash Rent Farms | | Crop Share Rent Farms | |
|---|---|---|---|---|
| | A | B | C | D |
| 1. Gross return to lessor: | | | | |
| 2. Cash Rent | $40,000 | $50,000 | | |
| 3. Crop share (cash equivalent value) | | | $40,000 | $50,000 |
| 4. Less: Real estate taxes | $ 5,000 | $ 5,000 | $ 5,000 | $ 5,000 |
| 5. Share of production exp. | | $10,000 | | $10,000 |
| 6. Net return to Lessor (land) | $35,000 | $35,000 | $35,000 | $35,000 |
| 7. Return used in valuation under 20.2032A-4(b) | $35,000 | $45,000 | Not Allowed | Not Allowed |
| 8. Farm valuation under 20.2032A-4(b) using average annual effective interest rate, Spokane Federal Land Bank Dist. 1980 -- 9.31% | $375,939 | $483,351 | Depends on other criteria including sales. | |
| 9. Return used in Oregon Farm Use Valuation Procedure | $35,000 | $35,000 | $35,000 | $35,000 |
| 10. Farm valuation under Oregon Farm Use using the same average effective interest rate in No. 8 above - 9.31% | $375,939 | $375,939 | $375,939 | $375,939 |
| 11. Ability to elect under 2032A(e)(7)(B)(ii) | yes | yes | no mandatory | no mandatory |

Prepared by:
Dr. Clinton Reeder, PHD
Agricultural Economics

Senator SYMMS. Next will be a panel consisting of Thomas F. Field, executive director, Taxation With Representation Fund, Arlington, Va., Mr. Keville Larson, Mobile, Ala., chairman, Estate and Property Taxation Committee, Forest Industries Committee on Timber Valuation and Taxation, and Mr. Dan Goldy, chief economist, Western Forest Industries, Portland, Oreg.

## PANEL OF DAN GOLDY, CHIEF ECONOMIST, WESTERN FOREST INDUSTRIES, PORTLAND, OREG., AND THOMAS F. FIELD, EXECUTIVE DIRECTOR, TAXATION WITH REPRESENTATION FUND, ARLINGTON, VA.

Mr. GOLDY. Mr. Chairman, I appreciate the opportunity to appear before you today. My name is Daniel L. Goldy, and I am consulting economist for Western Forest Industries Association, as well as for the newly organized National Committee to Preserve the Family Business.

We are an ad hoc umbrella group that is organizing to provide a focal point for efforts to reform gift and estate taxes.

In this effort, we are being assisted by Al Ullman, former chairman of the House Ways and Means Committee.

Mortimer Caplin, former Commissioner of the Internal Revenue Service, is serving as our legal counsel.

The committee is being organized to respond to the overwhelming burden that is facing many farmers, ranchers, woodlot owners, and small businessmen.

Estate and gift taxes in their present form are restructuring the U.S. economy by forcing family owned small businesses and farms to liquidate or sell out to large corporations.

Instead of preventing great aggregations of wealth, they are concentrating it. This is due to our failure to adjust tax rates for inflation or to correct basic inequities in existing law.

We believe that small family owned farms and businesses are among the most productive and innovative parts of the economy. But when the tax laws make it impossible to pass the business along to the next generation, they inhibit investment in new technology and more efficient operations.

Small businessmen are increasingly being faced with unacceptable alternatives. We do not believe gift and estate taxes should continue to handicap the farmer or small businessmen to the advantage of larger corporations.

He or she should be encouraged to build a business that will achieve stability and enrich the community, without the threat that taxes will cause their business to dissolve in the event of death.

For these reasons, we believe it essential that a strong provision be included in any estate tax reform package to relieve small businesses from unreasonable tax penalties. This might best be accomplished by providing for a significant tax exemption for closely held businesses and farms.

Additionally, we support the efforts of many members of this subcommittee to reduce gift and estate tax rates, as well as increase the unified credit.

We would also suggest that you consider reducing the maximum marginal rate to 50 percent, to parallel the likely cut in the marginal rate for investment income.

S. 395, the bill introduced by Senators Wallop and Boren and supported by many members of the Senate Finance Committee, has a number of excellent features.

We agree completely that special use valuation rules should be expanded to include woodlots, and that the $500,000 cap should be eliminated.

We would also welcome the opportunity to work with you to insure that a simple and reasonable valuation method be included in any legislation.

One suggestion we have is that the special use valuation be set at 50 percent of the assessed value of any property in question. This avoids many of the complicated technical and legal problems inherent in other approaches.

Another area we believe deserves consideration is the accumulation of funds within a closely held business for the payment of estate taxes.

Currently, section 531 of the Internal Revenue Code imposes a tax on excess earnings held within a business if there are no business reasons for the accumulation of the funds.

We would like to see a provision that would allow for the establishment of a special reserve fund in anticipation of estate tax liability.

Finally, let me say that it is our desire to work closely with you to fashion an equitable gift and estate tax reform package—one that addresses the concerns of the small business and farm communities.

With your help, small businesses will continue to thrive and contribute to a healthy economy.

Of course, Mr. Chairman, we would like to see repeal of the inheritance tax as an ideal solution. But we recognize the realities and are hopeful in obtaining effective relief for small, closely held businesses, farms, pending such an ultimate solution.

Thank you very much for the opportunity to testify today.

Senator SYMMS. Thank you for a very excellent statement. I will look forward to working with you.

Now, Mr. Field.

Mr. FIELD. Thank you, Mr. Chairman.

My name is Tom Field. I am Executive Director of the Taxation With Representation Fund which is a group of approximately 25,000 people, nationwide, who are interested in a fairer, simpler and more economically efficient tax system.

I want to make only three basic points, Mr. Chairman. I have a prepared statement which I assume will be included in the record.

Senator SYMMS. Without objection, both of your prepared statements shall be part of our record.

Mr. FIELD. On the one hand, Mr. Chairman, it seems to me that as a matter of political reality, and also as a matter of basic fairness, it is essential to remove from the estate and gift tax rolls the farmers and small businessmen for whom the estate and gift tax was never intended. It seems to me that is important as a means of paving the way for the reforms that need to be accom-

plished in the estate and gift tax area, so that our estate and gift tax laws will effectively curb the enormous concentration of wealth that characterizes our country.

The figures are that 1 percent of our population owns 25 percent of everything in this country that has value. One percent of our population owns more than half of all the corporate stock in this country. One percent of our population owns almost 80 percent of all the trust assets in this country.

In my view, Mr. Chairman, that degree of concentration of wealth is incompatible with democracy. It is also incompatible with economic efficiency. When wealth grows that concentrated, the opportunities for individual initiative are cut off. Small businessmen just can't make it against wealth that is that concentrated and capital that is that tightly accumulated.

It seems to me, therefore, that what this committee needs to consider seriously is, on the one hand, an exemption or change in the unified credit which would raise the exemption level to, say, $1 million. I also suggest that this committee move to an unlimited marital deduction, with appropriate provisions to take care of the so-called "child bride problem."

Those two steps taken together would effectively eliminate the estate and gift tax burden for more than 90 percent of all existing estates. It would reduce the number of returns filed from approximately 140,000 annually, to under 5,000 annually.

But those 5,000 returns, according to the latest available figures, report $12 billion in assets. It is those 5,000 returns which are important as a means of curbing the concentration of wealth that I have just outlined.

In conclusion, Mr. Chairman, I would like to leave the committee with a question. Does the committee really want to abolish the estate and gift tax so as to permit the tax-free transfers of estates totaling $500 million or $1 billion? There are such estates.

To relieve small businessmen and farmers from the estate tax is necessary and important, but to relieve an estate of $1 billion from any tax burden, to permit that degree of concentration of wealth to continue unchecked from generation to generation does not seem to me to be compatible with democracy or with the provision of economic opportunity for young people coming up through the system.

Thank you, Mr. Chairman.

Senator SYMMS. Thank you very much for—both of you for a very excellent statement. I wanted to ask one question directly to Mr. Goldy with respect to the forced landowner.

What is the situation and how often is it causing a problem where there are lands involved that have been newly reforested and how are those asset values, how are prices attributed to that and then how do they accumulate the cash if the trees aren't ready to harvest, say, for 50 more years?

Mr. GOLDY. Very difficult. What has happened in the State of Oregon and other States in the West, many timberland owners in that position are forced to sell the entire property as a part of the—in order to accumulate the funds to pay estate taxes.

So, in many instances, in anticipation of a death or to get ready for estate tax liabilities, the present owner sells out as a method of estate tax planning.

Senator SYMMS. Then who do they usually sell to, though?

Mr. GOLDY. They usually will sell to large corporations in other parts of the country.

In Oregon, for example, which I know quite well, in the State of Oregon we eliminated the State estate tax problem completely, except for the Federal offset, because of the gradual sales of timberlands and farms and ranches to people, corporations from outside the State.

These sales were prompted by attempts to anticipate the tax situation, the estate tax situation and dispose of it in advance.

So the State legislature, when I was the director of economic development for the State, we recommended the State legislature abolish the inheritance tax in order to minimize that problem. But, it was becoming an acute problem of absentee ownership.

Senator SYMMS. So, back to the point that you made, Mr. Fields. What has been happening is there has been a bigger concentration of wealth. True, it is in corporate hands, with many owners, but it is a concentration of wealth into one powerful block in, say, the large forest products companies or any other corporation whether it was primarily forest products company or not, accumulating control of those assets out there?

Mr. FIELD. Yes.

Mr. GOLDY. Mr. Chairman, I might say, the lumber and plywood industry probably sounds a little peculiar in this setting here. We would like to see, for example, a $2 million exemption, individual exemption. We would like to see something like a $15 million exclusion, exemption, for a business.

The reason is that a small lumber company or a small plywood company, to be efficient and be in business and still be small, has to have a net equity in it of about $15 million.

There is no such thing as an efficient operation in our part of the country of less than that. Yet, it is a small business.

One company, one profit center, as compared with the giant companies that are many profit centers.

What is happening is that some of the best technology, the greatest innovation are in that type of operation and they are being sold out to the very largest companies because of the estate tax problem.

Therefore, we see in this opportunity now, in the bills, in the statements I heard here this morning from the Senators which were very encouraging, the opportunity to solve that problem and keep the lumber plywood industry a competitive industry.

It is those independents, those small independent mills, efficient, competent, that keep the lumber plywood prices set in the open market.

Senator SYMMS. Thank you for a very, very excellent statement. I do know what you are saying about the technology certainly has been true in Idaho. I could name the mills, we have one in Princeton, for example, that is probably as modern as a forest product mill that there is with literally a very, very small business at the outset.

It requires certain millions of dollars worth of assets to have that kind of technology. Those size businesses are often the leaders and the cutting edge of entrepreneurial ability to do things better.

Just one last question, Mr. Field. Back to your point about the massive estates. Do you really believe that under our present tax laws that some massive estates are not able to have been transferred on using our present tax laws?

The foundation system and all those things. I would certainly agree with you that a $1 billion estate is not something we need to be—you know, most billionaires can take care of themselves, I think, without the help or the hindrance of the Congress, either way.

That is certainly not what this legislation is aimed at. But, do you believe that it is really—that the burden that is going to be put on the farmer with the $600,000 or the $700,000 or even the $1 million estate, and trying to pay all the CPA's and lawyers to plan his estate. Do you think giving that up is worth worrying about the massive fortunes which have been put into generation-skipping trusts and so forth and can go on for quite a while presently.

Mr. FIELD. It is, unless you want to see increasing concentration of wealth in a very few hands. We don't want to see all farms in a State owned by only a couple dozen farmers.

Senator SYMMS. That is what is happening now, though.

See, the problem, as I see it, under our present law is that that is what is happening. Because today, when the farmer has to sell out or the forest products company, they end up, the small, independent, family-owned plywood company, sells out to one of the giants.

Now, it may be true that one of the giant corporations may have several thousand stockholders, but still the concentration, the decisionmaking is made by the CEO of that company who has been hired by the board of directors, and you certainly have a concentration of wealth and power going in to a few hands in an industry, even though the ownership, through the stock system may be spread out.

But, the concentration is still there.

I wonder if we felt that somebody who had an estate of say $500 million, if that was a burden on society, I would think they could address that through some taxing law. Those people usually have paid, under our present tax code, let's say if there was a $500 million estate, and people had it in stock in a corporation that paid a dividend, they would be paying 70 percent of all those dividends, as unearned income in taxes.

So, they would not be completely sheltered from——

Mr. FIELD. Well, the chairman touches on a very important point. As things stand now, estate and gift taxes are to a degree a backstop for the income tax. Because, of course, anyone of genuine wealth is going to be able to largely avoid the income tax. The estate and gift taxes have functioned to this point as a backstop to protect against the abuse of the loopholes in the income tax law.

The thought has been that, although an individual can reduce his effective income tax rate nearly to zero, during his lifetime, at least at death there will be some kind of contribution from that individual to the Federal Government. That has been the tradition.

If we completely abolish the estate and gift tax, then there is no backstop at all for those who take undue advantage of the loopholes in the income tax law.

Senator SYMMS. Thank you.

Mr. FIELD. In short, at least for the very large estate, it seems to me we need to take into account the fact that an extremely wealthy individual, well advised by tax lawyers and accountants, is undoubtedly going to have exploited to the full the opportunities for tax reduction that the current income tax law provides.

Senator SYMMS. Of course, I guess that is where the big foundations come from. They still have those family fortunes tied up where they have been sheltered from the taxing law today.

I do think, if we would get away from the redistributing the income theory, and then just have a gross earned income tax on gross earned income, then everybody would pay their fair share in this country. It would go a long way toward avoiding whatever it is you are pointing at.

I think the big problem we have is the progressive income tax and these confiscatory tax rates that are in excess of 50 percent, because they stimulate people to try to figure out ways to shelter income and so forth.

I have to say, Dan, I certainly like your idea of a $15 million exemption for a close held business. In reality, a $15 million business today, with all the funny money that has been printed by Congress the last 40 years, really isn't all that much money any more when you start talking about a highly technical production line say in the timber processing plant or in many other types of businesses that because of the currency value we have today, because of the printing press that works so efficiently down here at 14th Street and Independence Avenue, has debased our currency literally for the Congress that allowed it to run 24 hours a day for so many years.

It has certainly put an impact on all these questions we address today.

Thank you both very much for excellent testimony.

Mr. FIELD. Thank you, Senator.

Mr. GOLDY. Thank you.

[Statements follow:]

Statement of

DANIEL L. GOLDY

Consulting Economist

Western Forest Industries Association

Mr. Chairman, I appreciate the opportunity to appear before you today. My name is Daniel L. Goldy, and I am consulting economist for Western Forest Industries Association, as well as for the newly organized National Committee to Preserve the Family Business. We are an ad hoc umbrella group that is organizing to provide a focal point for efforts to reform gift and estate taxes. In this effort, we are being assisted by Al Ullman, former Chairman of the House Ways and Means Committee. Mortimer Caplin, former Commissioner of the Internal Revenue Service, is serving as our legal counsel.

The committee is being organized to repond to the overwhelming burden that is facing many farmers, ranchers, woodlot owners, and small businessmen. Estate and gift taxes in their present form are restructuring the United States economy by forcing family owned small businesses and farms to liquidate or sell out to large corporations. Instead of preventing great aggregations of wealth, they are concentrating it. This is due to our failure to adjust tax rates for inflation or to correct basic inequities in existing law.

We believe that small family owned farms and businesses are among the most productive and innovative parts of the economy. But when the tax laws make it impossible to pass the business along to the next generation, they inhibit investment in new technology and more efficient operations.

Small businessmen are increasingly being faced with unacceptable alternatives. We do not believe gift and estate taxes should continue to handicap the farmer or small businessmen to the advantage of larger corporations. He or she should be encouraged to build a business that will achieve stability and enrich the community, without the threat that taxes will cause their business to dissolve in the

event of death. For these reasons, we believe it essential that a strong provision be included in any estate tax reform package to relieve small businesses from unreasonable tax penalties. This might best be accomplished by providing for a significant tax exemption for closely-held businesses and farms.

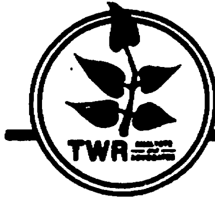
Additionally, we support the efforts of many members of this subcommittee to reduce gift and estate tax rates, as well as increase the unified credit. We would also suggest that you consider reducing the maximum marginal rate to 50%, to parallel the likely cut in the marginal rate for investment income.

S. 395, the bill introduced by Senators Wallop and Boren and supported by many members of the Senate Finance Committee, has a number of excellent features. We agree completely that special use valuation rules should be expanded to include woodlots, and that the $500,000 cap should be eliminated. We would also welcome the opportunity to work with you to insure that a simple and reasonable valuation method be included in any legislation. One suggestion we have is that the special use valuation be set at 50% of the assessed value of any property in question. This avoids many of the complicated technical and legal problems inherent in other approaches.

Another area we believe deserves consideration is the accumulation of funds within a closely-held business for the payment of estate taxes. Currently Section 531 of the Internal Revenue Code imposes a tax on excess earnings held within a business if there are no business reasons for the accumulation of the funds. We would like to see a provision that would allow for the establishment of a special reserve fund in anticipation of estate tax liability.

Finally, let me say that it is our desire to work closely with you to fashion an equitable gift and estate tax reform package -- one that addresses the concerns of the small business and farm communities. With your help, small businesses will continue to thrive and contribute to a healthy economy.

Thank you very much for the opportunity to testify today.




**TAXATION WITH REPRESENTATION FUND**

6830 North Fairfax Drive, Arlington, Virginia 22213 (703) 532-1850

Statement of the Taxation with Representation Fund
before the Senate Finance Subcommittee on
Estate and Gift Taxation

May 1, 1981

SUMMARY OF PRINCIPAL POINTS

1. Our existing estate and gift taxes are designed to raise revenue and to prevent undue concentration of wealth in only a few hands. Reducing wealth concentration is by far the more important of these two goals.

2. Wealth in the United States is highly concentrated, with one percent of the population owning approximately 25 percent of everything that has value. Transfer taxes have not been effective as a means of reducing this concentration of wealth.

3. The existing estate and gift tax laws have aroused intense opposition from farmers and small businessmen, which has made it impossible to achieve the reforms that are necessary if transfers of truly great wealth are to be taxed effectively.

4. Transfers of great wealth from generation to generation cannot be effectively taxed until capital gains are constructively realized at death under the income tax. Accordingly, constructive realization of gains at death is an essential part of any revision of our estate and gift tax laws that is designed to tax transfers of very large wealth.

5. To eliminate opposition from farmers and small businessmen, while making transfer taxation effective with respect to very large estates, the following is recommended:

   * A combined estate and gift tax exclusion of $1 million.

   * An unlimited marital deduction.

   * Constructive realization at death of gains in excess of $1 million on assets passing through estates.

   * Elimination of special farm valuation rules, orphans provisions, etc. that are unnecessary and inappropriate in a tax that falls only on great wealth.

# STATEMENT OF THE TAXATION WITH REPRESENTATION FUND

**before the Senate Finance Subcommittee on Estate and Gift Taxation**

**regarding**

# MAJOR ESTATE TAX ISSUES

**May 1, 1981**

Mr. Chairman and Members of the Subcommittee on Estate and Gift Taxation:

Thank you for this opportunity to present testimony regarding the major estate and gift tax issues presented by S.404, S.395, S.858, and S.574.

**The Purposes of Estate and Gift Taxation**

Estate and gift taxes have two major purposes. First, in common with other taxes, they are designed to raise revenue. But the amount of revenue raised by existing estate and gift taxes is so small, as a percentage of total federal revenue collections,[1] that the production of revenue clearly cannot be a major purpose of our existing estate and gift taxes.[2]

The second major purpose of estate and gift taxation is to prevent undue concentration of wealth in only a few hands. In my view, this is by far the most important purpose for these taxes. The concentration of great wealth in a few hands is incompatible with democracy. Similarly, undue wealth concentration inhibits the individual initiative that should characterize a free market economy.

These thoughts were admirably expressed by this subcommittee's chairman, Sen. Steven D. Symms, R-Idaho, when he introduced S.404 earlier this year. At that time, he said:

> *The fundamental purposes of the estate and gift tax laws were to tax the very wealthy very heavily, to limit undue concentration of wealth and power in a few, to break up those concentrations, and to enhance the equality of opportunity. (Congressional Record (Daily Ed.) February 5, 1981, pp. S1044-1045.)*

**Current U.S. Wealth Concentration**

Our existing estate and gift taxes have not been an effective means of lessening the extraordinary concentration of wealth that characterizes our nation. Figures on wealth holding are difficult to obtain, and are not compiled by any agency on a regular basis. Nevertheless, some idea of the degree of wealth concentration in the U.S. can be obtained from the following figures for the year 1972.[3]

**Table 1**

**SHARES OF RICHEST 0.5 PERCENT AND 1.0 PERCENT OF PERSONS IN NATIONAL WEALTH**

**1972**

| Type of Asset | Share Held by Richest One Percent of Population | Share Held by Richest One-Half of One Percent of Population |
|---|---|---|
| Real Estate | 15.8% | 10.1% |
| Corporate Stock | 56.5 | 49.3 |
| Bonds | 60.0 | 52.2 |
| Cash | 13.5 | 8.5 |
| Debt Instruments | 52.7 | 39.1 |
| Life Insurance | | |
| (Cash Surrender Value) | 7.0 | 4.3 |
| Trusts | 89.9 | 80.8 |
| Miscellaneous | 9.8 | 6.8 |
| Total Assets | 24.1% | 18.9% |
| Liabilities | 16.2 | 12.5 |
| Net Worth | 25.9% | 20.4% |

In my view, these figures indicate a degree of wealth concentration which is unacceptable in a democracy, and which necessarily limits opportunities and incentives for most of our population. For that reason, I strongly believe that our transfer taxes on wealth must be preserved and strengthened.

**Problems in the Current System of Wealth Taxation**

Our current system of wealth taxation is in need of major reform. On the one hand, although the system produces relatively little revenue, it is seen as a threat by influential segments of our population, including smaller businessmen and family farmers. Farmers, in particular, have been influential in obtaining legislation that alters our transfer tax system in ways that work against the longer-term interests of the farming community[4] and make the transfer

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[1]According to Treasury figures compiled on January 16, 1981, federal estate and gift taxes produced $5.4 billion in 1978 (the most recent year for which data are available) or 1.35 percent of total federal revenues.

[2]This is not to say that the production of significant amounts of federal revenue could not become a major goal of estate and gift taxation. Some states, for example, have used estate and gift taxes as major revenue producers. See, for example, the discussion of this point in Hellerstein, *State and Local Taxation* (Fourth Edition), pp. 755-759. Furthermore, estate and gift taxes appear to have much less impact on work incentives than do income taxes, and this is another reason favoring their use as a revenue source. Nevertheless, the small yield from the existing estate and gift tax rather clearly indicates a congressional judgment that the production of revenue should not become a major goal of estate and gift taxation. The statement in the text accepts this congressional judgment as a given, from which any politically realistic discussion of federal estate and gift taxation must start.

[3]These figures appeared in *Tax Notes* magazine for April 26, 1976 at page 20. They were compiled by Professor James D. Smith, now of the University of Michigan. Corresponding figures for 1953, 1958, 1962, 1965, and 1969 also appeared as part of the same article. Those figures make it clear that, although there have been some shifts from year to year in the composition of the assets held by wealthy individuals, the overall degree of U.S. wealth concentration has changed very little since World War II.

[4]For further information on this subject, see Davenport, Boehlje, and Martin, *The Effects of Tax Policy on the Structure of American Agriculture*, U.S. Department of Agriculture (forthcoming).

tax system less equitable. On the other hand, due to a variety of major estate and gift tax loopholes, the transfer tax system has been almost completely ineffective as a means of lessening the concentration of wealth that characterizes our country.

***It is essential to deal with the capital gains at death problem.***

In addition, our current system of estate and gift taxation is unduly complex. The marital deduction is a trap for the unwary. The special farm valuation rules, first introduced in 1976, are byzantine in character. Litigation is rife even though many of the estate and gift tax rules have been on the books in substantially their present form for two generations. This list could be extended.

However a far more serious problem—and one that is directly related to our failure to make any progress toward a lessened degree of wealth concentration in the U.S.—is our practice of forgiving the capital gains taxes that would otherwise be payable on assets passing through an estate. This income tax loophole is the single most important factor in the U.S. tax laws facilitating the transfer of great wealth (and the power that goes with it) from one generation to the next.

Congress has failed to deal adequately with the capital gains at death problem. In 1976—despite warnings from the TWR Fund and others—Congress adopted the carryover basis rule, as a compromise between the existing system of tax forgiveness and the correct solution, the taxation of capital gains at death. The repeal of carryover basis has restored the pre-existing system along with the pre-existing problems. Among those problems are massive tax-induced lock-ins of capital,[5] serious discrimination against ordinary income taxpayers who are not in a position to realize inherited gains, and a continuation of the aristocracy of wealth that has characterized this nation since the time of the Civil War.

***It is more important to reach and tax the few very great estates that pass each year...than it is to tax family farmers and small businessmen...***

**A Reform Proposal**

Against this background, I urge this Subcommittee to consider changes in the federal estate and gift tax laws that will simultaneously eliminate much of the existing political opposition to these levies and insure that they are effective in placing a once-per-generation tax on transfers of large wealth.

[5]A forthcoming econometric study by Mai Nguyen Woo, to be published in May 1981 in *Tax Notes*, concludes that "eliminating the archaic 'step-up of basis upon bequest' rule would start a powerful unlocking process, resulting in a substantial long-term increase in capital gains tax revenues."

Like most reform proposals, this one is a combination of carrot and stick. The carrot is a very large increase in the "unified credit" — i.e., the basic transfer tax exemption —combined with an unlimited marital deduction. The stick is constructive realization of capital gains at death in the case of assets in very large estates, combined with elimination of the other loopholes that now riddle our transfer tax statutes.

In particular, I suggest that this Subcommittee consider an increase in the estate and gift tax unified credit that will insure that substantially all farmers will escape federal transfer taxation. And because there is no equitable basis for treating farmers differently from others, similar treatment should be extended to other decedents. Accordingly, I suggest that the unified credit be raised to a level permitting the tax-free transfer of up to $1 million in assets during life and at death.

Setting the unified credit at this very high level should be accompanied by elimination of the special farm valuation rules, which family farmers will no longer need and which are currently playing a malign role in the structure of U.S. agriculture.[6] Similarly, it should also be possible to eliminate such well-intentioned but complex provisions as the special treatment of minor children under section 2057 and the combat zone provisions of section 2201 — since it can hardly be contended that orphans and military widows need special financial help after they receive a tax-free bequest of $1 million.

***It is time to begin the task of reducing the extraordinary concentration of wealth that characterizes our country...***

At the same time, we should also adopt an unlimited marital deduction, as a means of implementing the rule that the estate tax should be a levy that falls once — but only once — in each generation. However, to prevent abuse, rules will have to be devised to deal with the case of an aged decedent who happens to have married a much younger person shortly prior to death — the so-called "child bride problem."

As part and parcel of these changes, it is also essential to deal with the capital gains at death problem. Our failure to solve this problem, despite 20 years of effort by the executive branch and Congress, is a serious matter. It is high time that we address this issue in a way that promotes economic efficiency and the equitable treatment of similarly situated taxpayers. There is only one solution that meets both these criteria: the constructive realization of capital gains at death.

Specifically, I suggest that we tax on a decedent's last income tax return gains in excess of $1 million on assets passing through his or her estate. The existing step-up-in-basis rule would continue to apply to all other appreciated capital assets passing through estates.

Adoption of a proposal along these lines will accomplish several objectives:

- It will eliminate opposition to federal transfer taxes from substantially all farmers and members of the

[6]See footnote 4, above.

small business community, thus making it possible to reform our transfer taxes without encountering intense political opposition.

- It will insure that the taxes imposed at death (including both transfer taxes and income taxes on constructively realized capital appreciation) become an effective barrier to the continued concentration of great wealth in only a few hands.
- It will substantially reduce IRS and taxpayer administrative and compliance costs by reducing the number of taxable estates from approximately 140,000 annually under current law to less than 5,000 annually.

The philosophy guiding these recommendations is that it is more important to reach and tax the few very great estates that pass each year — estates on the order of $50 million, $100 million, and even $1 billion — than it is to tax family farmers and small businessmen, however substantial their wealth may appear in comparison with the holdings of the many millions of our citizens who die owning little more than the clothes on their back. As things stand, opposition from farmers and others has prevented us from reforming our estate and gift tax laws in ways that would permit us to tax effectively the relatively few transfers of very great wealth. It is time to begin the task of reducing the extraordinary concentration of wealth that characterizes our country, and if the price of doing so is a reduction of perhaps 75 percent in the estate tax base,[7] that is a price that I think we should be willing to pay.

— Thomas F. Field

[7] In 1976, the most recent year for which figures are available, the gross estates reported on 139,115 taxable estate tax returns amounted to approximately $40 billion, of which approximately $12 billion was reported on 4420 returns for estates of more than $1 million in size.

Senator SYMMS. The Chair will call the panel of the cattlemen, Mr. James Harper, of the National Cattlemen's Association and Bill Jones, tax counsel, National Cattlemen's Association, Washington, D.C.

The Chair will just declare about a 2-minute recess. I have a telephone call I have to make.

[A short recess was taken.]

Senator SYMMS. The committee will be back to order.

The hearing will continue.

Mr. Harper.

PANEL OF JAMES HARPER, VICE CHAIRMAN, TAX COMMITTEE, NATIONAL CATTLEMEN'S ASSOCIATION, AND BILL JONES, VICE PRESIDENT, NATIONAL CATTLEMEN'S ASSOCIATION, WASHINGTON, D.C.

Mr. HARPER. Mr. Chairman, I am Jim Harper, a Kansas cattleman, and vice chairman, of the National Cattlemen's Association Tax Committee.

With me is Bill Jones, of the NCA staff, who will assist me in answering questions.

Mr. Eller and Mr. Berry will not be appearing with us this morning.

The subcommittee is familiar with the Cattlemen's Association. So, I will not make further comment on the association.

I will ask that our complete statement be inserted in the record.

Senator SYMMS. Without objection, so ordered.

Mr. HARPER. Thank you.

Before the statement, I would like to acknowledge with gratitude, the position taken by Assistant Secretary of the Treasury Chapoton, on Monday, reversing the regulatory position taken with respect to the equity interest and present interest rules.

The National Cattlemen's Association is pleased to make this contribution to your hearing, Senator Symms.

Senator SYMMS. Thank you very much.

Mr. HARPER. It is a real pleasure to be here and take part in the proceedings.

Senator SYMMS. Proceed.

Mr. HARPER. Thank you, Mr. Chairman.

The National Cattlemen's Association, NCA, commends Senators Symms, Jepsen, and Boren for introducing S. 404 which would repeal the estate and gift tax laws.

NCA supports repeal of these laws which have caused forced liquidations of and inflicted financial burdens on estates of farmers, ranchers, and owners of other closely held businesses.

These laws have further impeded the formation of capital which is vitally needed for the health and well being of our economy and have acted as a disincentive to savings and expansion of capital intensive industries such as agriculture.

Until these laws can be repealed, significant amendments must be made in order to bridge gaps caused by the 1976 and 1978 legislation, to correct problems created by interpretation of this legislation by Treasury regulations and Internal Revenue Service rulings, and to remedy inequities which have developed in the estate and gift tax laws.

The Wallop-Boren-Byrd bill, S. 395, is the most comprehensive bill on needed changes in the estate and gift tax laws introduced in Congress.

NCA praises Senators Wallop, Boren, and Byrd for introducing this bill and also commends the other 28 Senators who are cosponsors.

NCA strongly supports this bill which would reduce estate and gift tax rates, increase the unified credit, provide an unlimited marital deduction, increase the gift tax annual exclusion, make needed and beneficial amendments to the special farm use valuation provision, change the estate tax treatment of gifts made within 3 years of a donor's death, permit a donor to pay gift tax rather than using all or a portion of the unified credit, combine and liberalize the provisions concerning installment payment of estate taxes and permit disclaimers made under Federal law to be effective even if such disclaimers do not result in the transfer of an interest in property under State law.

Introduced by Senators Durenberger and Thurmond, S. 858 contains many of the same provisions as the Wallop-Boren-Byrd bill and NCA commends Senators Durenberger and Thurmond and supports S. 858.

NCA does feel, however, that the Wallop-Boren-Byrd bill is broader and more inclusive and also more appropriately addresses changes needed in the rental valuation formula under section 2032A.

NCA specifically endorses the changes made by S. 858 in the interest rate for deferred payment of estate taxes and making retroactive to 1977 the amendments relative to qualified use under section 2032A.

NCA commends Senator Kassebaum for introducing S. 574 and supports this bill which would provide an estate tax deduction up to $1,500,000 for certain tangible property used in a farm, ranch, or other closely held business which passes to a surviving spouse and to other members of a decedent's family.

NCA and other agricultural and closely held business organizations worked for a number of years prior to 1976 to demonstrate the need to Congress for remedial relief from estate and gift taxation for family-owned farms, ranches, and other closely held businesses.

These efforts were, in part, productive and resulted in the enactment in the 1976 Tax Reform Act of a number of provisions which were directed to achieve this goal.

Analysis of these provisions enacted in 1976 as well as some of those contained in the 1978 Revenue Act has revealed the need for further major amendments to the estate and gift tax laws in order to bridge gaps which were created in the 1976 and 1978 legislation, to correct some oversights which occurred in this legislation and, also, to respond to serious problems which have developed as a result of interpretations given to these various estate and gift tax provisions by Treasury regulations and by rulings and interpretations of the Internal Revenue Service.

NCA commends Senator Symms who has been joined by Senators Jepsen and Boren in introducing S. 404 which repeal these laws.

While the revenue produced by estate and gift taxes has been relatively small, about $6 billion in 1980, these taxes have had and continue to have a devastating impact on family-owned farms, ranches, and other closely held businesses.

What incentive is there for a farmer-rancher or other businessman whose operation is capital intensive to expand the business to make it more efficient and productive when such an expansion will increase the amount of the estate tax and possibly cause a partial or a total liquidation on the death of the owner?

In fact, the disincentive for capital formation has been an ever-present offspring of the estate tax laws.

The results have been fewer jobs, productive inefficiency, and an economic decline. When this occurs in agricultural operations on which our Nation and the world depend for food and fiber, there is truly cause for alarm.

The avowed social purpose for enactment of the estate and gift tax laws—to prevent the unreasonable accumulation of wealth—is not applicable, if it ever was, to the perpetuation and preservation of family-owned farms, ranches, and other closely held businesses.

Further, this social purpose pales in light of the disorder caused by these laws on the formation of capital which is vital for a viable and healthy agricultural and business economy.

While NCA strongly favors repeal of the estate and gift tax laws, there are, in the interim, amendments which are needed in these laws to achieve certain equitable results and to correct interpretations and rulings which have been made by Treasury regulations and the Internal Revenue Service that are not in keeping with congressional intent.

NCA strongly supports the provisions of and concepts contained in S. 395, S. 858, and S. 574. These bills would have the effect of helping preserve the family-owned farm, ranch, and other closely held business when there is a death in the family and an estate tax is imposed.

These bills would correct most of the problems, oversights, and gaps in the 1976 and 1978 legislation which was designed to provide remedial estate tax relief to estates of farmers, ranchers, and owners of other closely held businesses.

These bills also contain provisions which would add desired equitable amendments to the estate and gift tax laws.

Additionally, some of these bills would remedy a number of problems which have been created by Treasury regulations and Internal Revenue Service interpretations.

NCA supports repeal of estate and gift taxes. Pending repeal of these taxes, NCA is of the strong opinion that amendments should be made to the estate and gift tax laws to bridge gaps created by the 1976 and 1978 legislation, to correct interpretations of such legislation by Treasury regulations and by Internal Revenue Service rulings, and to remedy inequities which have arisen in various provisions of these laws.

While NCA supports S. 858 and S. 574, it feels that the most comprehensive and beneficial legislation is contained in the Wallop-Boren-Byrd bill, S. 395.

NCA offers to work with the members of the subcommittee and with their staffs to determine if further amendments may be

needed to the Wallop-Boren-Byrd bill to correct any recent problems which have occurred as a consequence of Internal Revenue Service rulings.

NCA would urge that the Wallop-Boren-Byrd bill, with any additional modifications which may be appropriate, be enacted immediately.

Senator SYMMS. Thank you very much. I appreciate your statement, Mr. Harper.

Mr. HARPER. Thank you, Mr. Chairman.

Senator SYMMS. I might just say, your entire statement will be printed in the record.

On S. 395, how many of the farms and cattlemen of your association-type cattle operations do you think would be pretty well excluded?

Do you have any numbers?

Mr. HARPER. No.

Mr. JONES. No, Mr. Symms. We would not have an idea of how many more would be exempted. There would be a number more, but perhaps more than that with S. 395, the implementation would be made practical so that we can extend the provisions to those farms for which it was intended.

This would be the dominant thing which would cure—the cure that S. 395 would have.

Senator SYMMS. Bill, I know you are a tax counsel. You concentrate most of your effort working on tax law and policy; isn't that correct?

Mr. JONES. Well, to some extent. I would like to correct the listing for the record. Actually the title is just vice-president and the headquarters are in Denver. I do work in tax areas a lot.

Senator SYMMS. I was just wondering. We have had a lot of very excellent testimony today and some very interesting points of view presented.

Most of the people who would be members of the National Cattlemen's Association that would be involved in this would not be the big megamillion dollar estates. Most of these would be people that had $1 million estates to pass on or something in this neighborhood.

I just wondered, do you think, in your experience and watching this, that anybody who would be able to manipulate his income during his lifetime to not pay taxes, so to speak, would not also be smart enough to use our present law to set it up in some kind of a tax code to pass it on.

Are the cattlemen concerned or afraid of repeal of what it might do to completely allow that big——

Mr. JONES. No, the cattlemen very, very strongly support complete repeal.

Senator SYMMS. I understand that.

But there is no concern there?

Mr. JONES. No. As you know, the association does represent all sizes of cattlemen. As you know, it doesn't take a very long or large cattle operation today, to have a net asset of $1 million.

So, no, we have no——

Senator SYMMS. If a guy could live long enough, he won't have anything left the way the cattle business has been lately, because

he can manage to lose just enough so if he can space it out each year, there won't be anybody left to give it to.

Mr. JONES. That is true. We are hopeful though, that we will have at least a few years now that will be somewhat better than the last several years have been.

Might I comment before we leave the table? Senator Symms, I can't help but notice how well the word "Senator" rhymes with the word "Symms." We are awfully glad to see you over on this side.

Senator SYMMS. Well, thank you very much. I appreciate your both being here. I might just like to mention that Senator Dole sent a message over to me during the brief break we took here, that he is tied up in the Agriculture Committee, along with a couple of other of our colleagues, Senator Boren and others that had to leave, that are on the Agriculture Committee.

Senator Durenberger, I believe is over there, too.

Members of this committee that would liked to have been here, but Senator Dole, particularly sent his best to you.

We thank you very much for your excellent contribution and testimony.

Mr. HARPER. Thank you, Senator.

Mr. JONES. Thank you.

[Statements follow:]

NATIONAL CATTLEMEN'S ASSOCIATION
P.O. Box 569 1001 Lincoln St.
Denver, Colorado 80201

STATEMENT

of the

NATIONAL CATTLEMEN'S ASSOCIATION

to the

Subcommittee on Estate and Gift Taxation

Committee on Finance
United States Senate

Relative to S.404, S.395, S.858 and S.574

Concerning Amendments to Estate and Gift Tax Laws

Presented by
James P. Harper, Vice Chairman
Tax Committee

May 1, 1981

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The National Cattlemen's Association is the national spokesman for all segments of the nation's beef cattle industry--including cattle breeders, producers, and feeders. The NCA represents approximately 280,000 professional cattlemen throughout the country. Membership includes individual members as well as 51 affiliated state cattle associations and 18 affiliated national breed organizations.

SUMMARY OF STATEMENT

ON

S.404, S.395, S.858 and S.574

The National Cattlemen's Association (NCA) commends Senators Symms, Jepsen and Boren for introducing S.404 which would repeal the estate and gift tax laws. NCA supports repeal of these laws which have caused forced liquidations of and inflicted financial burdens on estates of farmers, ranchers and owners of other closely held businesses. These laws have further impeded the formation of capital which is vitally needed for the health and well being of our economy and have acted as a disincentive to savings and expansion of capital intensive industries such as agriculture. Until these laws can be repealed, significant amendments must be made in order to bridge gaps caused by the 1976 and 1978 legislation, to correct problems created by interpretation of this legislation by Treasury Regulations and Internal Revenue Service rulings and to remedy inequities which have developed in the estate and gift tax laws.

The Wallop-Boren-Byrd Bill (S.395) is the most comprehensive on needed changes in the estate and gift tax laws introduced in Congress. NCA praises Senators Wallop, Boren and Byrd for introducing this Bill and also commends the other 28 Senators who are cosponsors. NCA strongly supports this Bill which would reduce estate and gift tax rates, increase the unified credit, provide an unlimited marital deduction, increase the gift tax annual exclusion, make needed and beneficial amendments to the special farm use valuation provision (Section 2032A of the Internal Revenue Code), change the estate tax treatment of gifts made within 3 years of a donor's death, permit a donor to pay gift tax rather than using all or a portion of the unified credit, combine and liberalize the provisions concerning installment payment of estate taxes and permit disclaimers made under Federal tax law to be effective even if such disclaimers do not result in the transfer of an interest in property under state law.

Introduced by Senators Durenberger and Thurmond, S.858 contains many of the same provisions as the Wallop-Boren-Byrd Bill and NCA commends Senators Durenberger and Thurmond and supports S.858. NCA does feel, however, that the Wallop-Boren-Byrd Bill is broader and more inclusive and also more appropriately addresses changes needed in the rental valuation formula under Section 2032A. NCA specifically endorses the changes made by S.858 in the interest rate for deferred payment of estate taxes and making retroactive to 1977 the amendments relative to qualified use under Section 2032A.

NCA commends Senator Kassebaum for introducing S.574 and supports this Bill which would provide an estate tax deduction up to $1,500,000 for certain tangible property used in a farm, ranch or other closely held business which passes to a surviving spouse and to other members of a decedent's family.

## STATEMENT

### Introduction

The National Cattlemen's Association (NCA) and other agricultural and closely held business organizations worked for a number of years prior to 1976 to demonstrate the need to Congress for remedial relief from estate and gift taxation for family-owned farms, ranches and other closely held businesses. These efforts were, in part, productive and resulted in the enactment in the 1976 Tax Reform Act of a number of provisions which were directed to achieve this goal. Analysis of these provisions enacted in 1976 as well as some of those contained in the 1978 Revenue Act has revealed the need for futher major amendments to the estate and gift tax laws in order to bridge gaps which were created in the 1976 and 1978 legislation, to correct some oversights which occurred in this legislation and, also, to respond to serious problems which have developed as a result of interpretations given to these various estate and gift tax provisions by Treasury Regulations and by rulings and interpretations of the Internal Revenue Service.

### NCA Supports S.404 Which Would Repeal the Estate and Gift Tax Laws

NCA commends Senator Symms who has been joined by Senators Jepsen and Boren in introducing S.404 which would repeal the estate and gift tax laws. NCA supports the repeal of these laws which have been a disruptive influence and have had a damaging effect on the continuation of family-owned farms, ranches and other closely held businesses. The

estate tax is levied at the exact time— the death of the farmer or rancher — that the family has lost the principal manager and is undergoing a financial upheaval. The result has been forced liquidation in some circumstances and, in most all other situations, a slow and protracted recovery with added financial burdens.

While the revenue produced by estate and gift taxes has been relatively small, about 6 billion dollars in 1980, these taxes have had and continue to have a devastating impact on family-owned farms, ranches and other closely held businesses. What incentive is there for a farmer-rancher or other business man whose operation is capital intensive to expand the business to make it more efficient and productive when such expansion will increase the amount of the estate tax and possibly cause a partial or total liquidation on the death of the owner? In fact, the disincentive for capital formation has been an ever-present offspring of the estate tax laws. The results have been fewer jobs, productive inefficiency and an economic decline. When this occurs in agricultural operations on which our Nation and the world depend for food and fiber, there is truly cause for alarm.

The avowed social purpose for enactment of the estate and gift tax laws — to prevent the unreasonable accumulation of wealth — is not applicable, if it ever was, to the perpetuation and preservation of family-owned farms, ranches and other closely held businesses. Further, this social purpose pales in light of the disorder caused by these laws on the formation of capital which is vital for a viable and healthy agricultural

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and business economy.

While NCA strongly favors repeal of the estate and gift tax laws, there are, in the interim, amendments which are needed in these laws to achieve certain equitable results and to correct interpretations and rulings which have been made by Treasury Regulations and the Internal Revenue Service that are not in keeping with Congressional intent.

NCA Supports Provisions of and Concepts Embodied in S.395, S. 858 and S.574

NCA supports the provisions of and concepts contained in S.395, S.858 and S.574. These bills would have the effect of helping preserve the family-owned farm, ranch and other closely held business when there is a death in the family and an estate tax is imposed. These bills would correct most of the problems, oversights and gaps in the 1976 and 1978 legislation which was designed to provide remedial estate tax relief to estates of farmers, ranchers and owners of other closely held businesses. These bills also contain provisions which would add desired equitable amendments to the estate and gift tax laws. Additionally, some of these bills would remedy a number of problems which have been created by Treasury Regulations and Internal Revenue Service interpretations.

S.395

NCA strongly supports the Wallop-Boren-Byrd Bill (S.395) and urges its immediate passage. S.395 is the most comprehensive estate and gift tax bill which has been introduced in Congress. It addresses the major problems which exist today in administration

and compliance with the estate and gift tax laws. NCA commends Senator Wallop, Senator Boren and Senator Byrd for their introduction of S.395, which demonstrates their understanding of the problems and inequities which exist under present law, particularly as construed and administered by the Internal Revenue Service. For cosponsoring S.395, NCA also commends Senators Percy, Helms, Domenici, Symms, Baucus, Tower, Heflin, Bentsen, Hayakawa, Pryor, Lugar, Andrews, Durenberger, Thurmond, Zorinsky, Mathias, Nickles, Burdick, Abdnor, Matsunaga, Schmitt, Nunn, Melcher, Warner, Garn, Simpson, Mattingly and Cranston.

(1) Changes in Rate Schedules

Recognizing the depressive effect the estate and gift tax laws have had on capital formation, the Wallop-Boren-Byrd Bill would, in general, lower these tax rates by 10% at all taxable levels. NCA supports an across the board lowering of these tax rates.

(2) Increase in Unified Credit

Under present law there is a unified credit of $47,000, which means a person can transfer, during life or at death, property having a value of approximately $175,000 without being subject to estate or gift tax. The Wallop-Boren-Byrd Bill would increase this credit to $124,750 over a period of four years. This would result in no gift or estate tax liability for transfers of property under $600,000 in value after 1984. Similarly, if the gross estate of a decedent dying in 1985 and later years did not exceed $600,000, then no estate tax return would have to be filed. NCA endorses

these changes as they recognize inflation which has occurred in recent years.

(3) <u>Unlimited Marital Estate and Gift Tax Deduction</u>

Under the Wallop-Boren-Byrd Bill, no estate or gift tax would be imposed on certain transfers of property between spouses. This rule would apply whether spouses lived in common law or community property states. NCA strongly supports this unlimited marital deduction and feels it would be most beneficial in all situations, but particularly with respect to transfers of farms and ranches between spouses either during lifetime or at death. It is the position of NCA that transfers between spouses are not an appropriate time to impose a tax since there are reasons to maintain the family unit and family business and to provide needed continuity.

(4) <u>Increase in Annual Gift Tax Exclusion to $10,000</u>

The present annual per donee gift tax exclusion of $3,000 would be increased to $10,000 by the Wallop-Boren-Byrd Bill. The $3,000 annual exclusion has been in the law since the 1940's and NCA feels that a substantial increase in the annual exclusion is long overdue. Based alone upon cumulative inflation since 1940, there is adequate support for increasing the annual exclusion to at least $10,000.

(5) <u>Amendments to Special Farm Use Valuation Provision</u>

A number of amendments are made by the Wallop-Boren-Byrd Bill to the special farm use valuation provision (Section 2032A of the Internal Revenue Code) which was added by the 1976 Tax Reform Act. These amendments made to Section 2032A by the Wallop-Boren-Byrd Bill would further the

stated Congressional purpose of encouraging the continued use of farm property by members of the deceased farmer's family and would also rectify problems which have been caused by interpretations of Section 2032A by Treasury Regulations and by the Internal Revenue Service.

(a) Elimination of Equity Interest Rule

The Internal Revenue Service has interpreted the requirement that on a decedent's date of death the decedent must be using the farm or ranch for farming purposes to mean that the decedent must have an equity interest in the farm operation on date of death. Consequently, if the decedent cash leases his farm or ranch to family members who are running the farm business, the Internal Revenue Service says the farmer's estate cannot use Section 2032A special use valuation for the farmland. This problem would be cured by the Wallop-Boren-Byrd Bill which would provide that use of the farm or ranch land in farming by the decedent or members of his family would satisfy the qualified use rule of Section 2032A. NCA strongly supports this amendment.

(b) Retired and Disabled Decedents

Presently, farmers and ranchers who have reached retirement age and wish to draw social security benefits will have these benefits reduced or eliminated if they materially participate in the farm or ranch operation; but if they (or members of their family) do not materially participate in such operations for 5 out of 8 years prior to death, then Section 2032A special use valuation is not available. This troublesome issue would be corrected by the Wallop-Boren-

Byrd Bill which specifies that real property can qualify for special use valution if the decedent met the material participation test during 5 out of 8 years prior to the time he became eligible for social security benefits or became disabled. NCA endorses this important and needed change in the law.

(c) Special Rule for Spouses of Deceased Farmer

Under existing law, if a surviving spouse inherits a farm or ranch which qualifies for special use valuation, the spouse may have difficulty, either because of her health or otherwise, in satisfying the 5 out of 8 year material participation test in order to have the farm or ranch property qualify for special use valuation in the spouse's estate. This difficulty is recognized and corrected in the Wallop-Boren-Byrd Bill which states that a surviving spouse need only be involved in the "active management" (i.e. making management decisions other than daily operating decisions) of the farm or ranch. It is NCA's position that this amendment will adequately protect the interests of surviving spouses by permiting their estates to elect special use valuation.

(d) Special Rule for Certain Woodlands

It is extremely difficult under present law for the owner of woodlands to meet the material participation test prior to death because most privately owned timber operations do not require day-to-day management decisions and material participation by the owner. Under the Wallop-Boren-Byrd Bill, woodlands would qualify for special use valuation if for the ten year period prior to death, the decedent or a member of the decedent's family owned the woodlands and used

them for such farming purposes. A related rule would apply to use of woodlands by qualified heirs following a decedent's death. NCA endorses this special rule for woodlands.

(e) Reduction of 15-Year Recapture Period

Present law states that an additional estate tax will be imposed if qualified heirs who inherit specially valued farm or ranch land either cease to use the land for farming purposes or sell or dispose of it to a nonfamily member within 15 years after the decedent's death. The Wallop-Boren-Byrd Bill would reduce this recapture period from 15 years to 10 years. NCA supports this reduction in the recapture period and feels a 10 year recapture period is of sufficient length to conform with Congressional intent that specially valued farmland be used by surviving family members for a reasonable period after the decedent's death. NCA also agrees with several conforming amendments made by the Wallop-Boren-Byrd Bill concerning involuntary conversion of specially valued property and what constitutes cessation of qualified use by the decedent or members of the decedent's family.

(f) Special Active Management for Certain Qualified Heirs

A qualified heir who inherits specially valued farm or ranch land must, either personally or through a member of his family, materially participate in the farm or ranch operation during the recapture period in order to avoid the imposition of an additional estate tax. To prevent the incurrence of the additional estate tax where a qualified heir may not be able to materially participate in the farm

or ranch business, the Wallop-Boren-Byrd Bill would allow a qualified heir who was a surviving spouse, who was under 21, who was a student or who was disabled to take part in the "active management" of the business either personally or through a family member, agent or fiduciary. NCA supports this amendment since it may be impossible from a practical standpoint for these family members who inherit specially valued farm and ranch land to materially participate in the farm or ranch business.

(g) Repeal of $500,000 Limitation

Section 2032A presently provides that special use valuation cannot reduce the fair market value of farm or ranch land by more than $500,000. This provision would be eliminated by the Wallop-Boren-Byrd Bill and NCA strongly favors its elimination. By imposing a $500,000 limitation, the benefits of Section 2032A are significantly limited. With the growth in size of family-owned agricultural operations, and the historic pattern of increasing farm and ranch land values, the $500,000 limitation severely and unnecessarily restricts the intended beneficial effect of Section 2032A.

(h) Exchange of Qualified Real Property

Under the Wallop-Boren-Byrd Bill, a tax-free exchange of specially valued farm or ranch land by qualified heirs with unrelated parties will not result in the imposition of an additional estate tax where the qualified heirs use the property received in the exchange in a qualified use for which the property transferred was used. NCA supports this change which will reverse the position taken by the Internal

Revenue Service that such tax-free exchanges of property within the recapture period generated an additional estate tax to the qualified heirs.

(i) Repeal of Involuntary Conversion Election

To avoid an additional estate tax under present law when proceeds from the involuntary conversion of specially valued farm or ranch land are reinvested in like kind property, a qualified heir must file an election with the Internal Revenue Service. There is no justification for this filing requirement and the Wallop-Boren-Byrd Bill eliminates it. NCA endorses this amendment.

(j) Change in Valuation Formula

Section 2032A presently provides that when property qualifies for special use valuation, the executor of a deceased farmer's estate can elect to value the farmland by using a rental valuation formula. Under this formula, the value of the farmland is determined by dividing the average annual gross cash rental (less state and local real estate taxes) for comparable farmland in the locality by the average annual effective interest rate for all new Federal Land Bank loans. Averages are determined based upon the 5 year period prior to the decedent's death. Treasury Regulations have stated that crop share rentals cannot be used, the result of which has been to deny this valuation formula to many estates where, as is often the case, there are no cash rentals of comparable property in the locality of the decedent's farm or ranch. Further, the Internal Revenue Service has taken a very strict interpretation of what comparable land

is and has denied the use of this valuation formula in some areas of the country. These problems are addressed and corrected by the Wallop-Boren-Byrd Bill which would substitute a new rental valuation formula whereby the decedent's farm or ranch land is valued using the average annual gross rental value of such land rather than the cash rental value of comparable property. Under the Bill, the average annual gross rental value would be determined on the basis of the rental that would be paid in an arm's length transaction with an unrelated party and would be computed by use of cash rentals or crop share rentals.

(k) Increase in Basis Upon Recapture

Under current law, no adjustment in the income tax basis of specially valued property occurs when a recapture event takes place causing an additional estate tax. To remedy this situation, the Wallop-Boren-Byrd Bill provides that where a qualified heir is subject to an additional estate tax, the income tax basis of the specially valued property is increased to its fair market value as of the decedent's date of death. NCA supports this amendment.

(6) Estate Tax Treatment of Gifts Made within 3 Years of Death

Current law stipulates that when a gift is made within 3 years of the donor's death, the gifted property must be included in the donor's gross estate for estate tax purposes based upon the value of such property at the time of the donor's death. Valuing gifts as of the donor's death presents problems for executors, especially where the property has been disposed of or where the donee is not a family member.

Under the Wallop-Boren-Byrd Bill, the value of such gifts for estate tax purposes would be the value on the date of the gift rather than the value on the date of the donor's death. NCA favors this change in the law.

(7) Election to Pay Gift Tax

A recurring problem under present law would be remedied by the Wallop-Boren-Byrd Bill by permitting a person who makes a gift to elect to have all or a portion of the unified credit apply to such transfer. Present law states that any unused portion of the unified credit must be used to reduce the gift tax payable for taxable gifts, even if the donor of the gift would prefer to pay a gift tax and preserve all or a portion of his unified credit. Requiring the use of the unified credit against the gift tax prevents finalizing the valuation of gifts because the valuation of gifts is fixed only if a gift tax has been assessed or paid and the running of the statute of limitations for assessing additional tax has occurred. NCA feels this change is equitable and would correct problems which have developed in the past.

(8) Combining of Deferred Payment of Estate Tax Provisions

Present law contains two separate elective provisions allowing the installment payment of estate taxes where a major portion of the estate consists of an interest in a farm, ranch, or other closely held business. Each of these provisions has its own set of rules concerning qualifications, payout periods, interest rates and acceleration of payments. The Wallop-Boren-Byrd Bill combines these two and, thereby,

retains the more liberal payment rules while eliminating the less liberal rules. As specified in the Bill, an estate in which the value of a farm, ranch or other closely held business exceeds 35% of the value of the gross estate or 50% of the value of the taxable estate would generally be eligible for payment of the estate tax over a period of 15 years with interest only payable over the first 5 years. Special provisions are added by the Bill concerning acceleration of deferred payments, relating to late payment penalties and pertaining to qualified redemptions of stock to pay estate taxes and administration expenses. All of these modifications are essential and are supported by NCA.

(9) Disclaimers

NCA endorses the amendment made by the Wallop-Boren-Byrd Bill concerning disclaimers. Under the Bill, a disclaimer of an interest in a decedent's estate that does not result in the transfer of an interest under state law would still be a qualified disclaimer, if timely made, for purposes of avoiding the imposition of Federal gift tax. This would overrule the position announced in Proposed Treasury Regulations that a disclaimer is not effective under Federal tax law if it does not satisfy the state law rules.

S.858

Introduced by Senator Durenberger and Senator Thurmond, S.858 contains many of the same provisions found in the Wallop-Boren-Byrd Bill. NCA commends Senators Durenberger and Thurmond for their support of such legislation. S.858 would increase the unified credit for estate and gift taxes,

would make many of the same amendments to Section 2032A as contained in the Wallop-Boren-Byrd Bill and would lower the interest rate on certain deferred payments of estate tax attributable to a qualifying interest in a farm, ranch or other closely held business so that the maximum interest rate would be 6% and the minimum interest rate would be 4%. For the reasons enumerated for supporting the Wallop-Boren-Byrd Bill, NCA also supports S.858. However, NCA feels the manner in which the Wallop-Boren-Byrd Bill addresses the rental valuation formula under Section 2032A, by eliminating comparability and by valuing the deceased farmers' land on the basis of its agricultural income producing ability is preferable and would better remedy the problems which have been encountered with this formula. NCA does agree with the provision of S.858 which makes the amendment of the qualified use requirement retroactive so that it would apply to estates of decedents dying after December 31, 1976.

S.574

This bill, introduced by Senator Kassebaum and sponsored by other Senators, would allow the estate of a farmer, rancher or other owner of a closely held business to claim as an estate tax deduction up to $1,500,000 ($750,000 to surviving spouse and $750,000 to other family members) in value of certain tangible property used in a farm, ranch or other business which passes to a surviving spouse and other members of the decedent's family. NCA supports this legislation and commends Senator Kassebaum for introducing it. Unlike Section 2032A which is limited to special valuation of real

property used in farming, ranching and other closely held businesses, S.574 would apply to all tangible (and some intangible) property used in such businesses where certain requirements are met. In general, S.574 would follow the rules of Section 2032A in determining if a deduction were available to an estate and when a recapture event would occur if there was a premature disposition of the property or a cessation of qualified use within 15 years of the decedents' death. NCA would suggest that consideration be given to amending S.574 so that the modifications made to Section 2032A in the Wallop-Boren-Byrd Bill would be applicable to the provisions of S.574.

CONCLUSION

NCA supports repeal of estate and gift taxes. Pending repeal of these taxes, NCA is of the strong position that amendments should be made to the estate and gift tax laws to bridge gaps created by the 1976 and 1978 legislation, to correct interpretations of such legislation by Treasury Regulations and by Internal Revenue Service rulings and to remedy inequities which have arisen in various provisions of these laws. While NCA supports S.858 and S.574, it feels that the most comprehensive and beneficial legislation is contained in the Wallop-Boren-Byrd Bill (S.395). NCA offers to work with the members of the Subcommittee and with their staffs to determine if further amendments may be needed to the Wallop-Boren-Byrd Bill to correct any recent problems which have occurred as a consequence of Internal Revenue Service rulings. NCA would urge that the Wallop-Boren-Byrd Bill, with any additional modifications which may be appropriate, be enacted immediately.

Senator SYMMS. Is Mr. Keville Larson here now?
We will call him at this point to the witness table.
We will accept your statement.
Mr. LARSON. Thank you.

## STATEMENT OF KEVILLE LARSON, MOBILE, ALA., CHAIRMAN, ESTATE AND PROPERTY TAXATION COMMITTEE, FOREST INDUSTRIES COMMITTEE ON TIMBER VALUATION AND TAXATION

Mr. LARSON. My name is Keville Larson. I am a partner in the forestry consulting firm of Larson & McGowen and a landowner in Mobile, Ala. I am here today on behalf of the Forest Industries Committee for Timber Valuation and Taxation. And, as chairman of its Estate and Property Taxation Committee. This organization consists of some 5,000 timberland owners representing the 5 million timberland owners in the country. The Forest Industries Committee is vitally interested in legislative developments in the area of estate and gift tax reform and appreciates the opportunity to appear and testify today.

I am one of many consulting foresters in the country who have witnessed estate taxes damaging the forest. We have perhaps more direct contact with the problem than anyone else. The Association of Consulting Foresters has consistently taken positions in favor of estate tax changes to improve conservation and management in the Nation's forest. Owners seldom anticipate the problems and never see the result. There are a few others who repeatedly see the effect on the forest of decisions made to solve estate tax needs.

Frequently the death of the owner causes the death of a forest. Long-range plans are disrupted or abandoned. Trees are harvested prematurely. Land is left less productive or significant costs are incurred to start a new forest. An example, from my experience, is the knowledgeable landowner who spent most of a lifetime building a forest. He began cutting his timber heavily to provide liquidity for estate taxes and allow his family to retain the land. When he died, only part of the timber had been sold and his executor was forced to continue the heavy cutting, then was left with inadequate funds for management of the property. The property is now less productive than it could have been and his family faces many years of rebuilding the forest.

It is in the country's interest for the forests to be managed as productively as possible. We have many laws to encourage this. But every private, nonindustrial forest owner will die, and only if he has planned well and anticipated the timing of his death accurately, can he be sure of avoiding a disruption which may reduce productivity of the forest. In the economic analyses which motivate investment in forestry, estate taxes are a significant charge which occurs at unpredictable intervals and reduces the rate of return. The rate of return calculations for a forestry investment even without the estate tax are marginal and include substantial risks.

The estate tax could be the largest cost in growing trees on private, nonindustrial land, and therefore, could have the greatest impact on rate of return.

The National Forests Products Association has summarized the problem as follows: Present Federal tax laws work against forest

productivity increase on nonindustrial forest ownerships in two ways. First, the combined effects of present Federal income and estate tax laws tend to reduce rates of return to levels that make continued investment unwise. Second, an estate is often forced to sell a portion of the decedent's timber or land to meet estate tax bills, causing fragmentation of ownership and reduced productivity.

The Oregon Board of Forestry echoes that inheritence taxes deter landowners from holding timber to maturity and from practicing sustained yield management, because there is an insufficient exemption on net estate values.

This is a problem for all classes of ownership, but especially for the family tree farm type of operation.

I have presented here some of the reasons the Forest Industry Committee on Timber Valuation and Taxation favors substantial reform of the estate and gift tax laws along the lines of that proposed in S. 395.

We urge the committee's serious consideration of S. 395 and look forward to a further opportunity to testify with respect to special use valuation and other aspects of the bill, at the hearings of this committee, tentatively scheduled for early June. Thank you.

Senator SYMMS. Thank you very much, for a very excellent statement. I think it is most significant that both you and Dan Goldy made the point that not only are estate taxes wrong in principle, but they are very antienvironmental and very harmful to conservation practices that can be in the long-term, best interest of the country.

I think it will be very interesting to see if maybe some of our conservation groups pick up on this one when they realize that one of the most detrimental things to sound forestry management practices in this country is the estate and gift tax on any private land holdings, because of the lack of continuity of management or of disruptive harvesting practices, as you mentioned, because of harvesting at a wrong time in order to pay an estate tax, instead of a harvest that comes at the proper time, at proper maturity.

So, I appreciate very much, your testimony. Thank you very much for being before the committee.

Mr. LARSON. Thank you, Senator Symms.

[Statement follows:]

STATEMENT OF

FOREST INDUSTRIES COMMITTEE ON
TIMBER VALUATION AND TAXATION

My name is Keville Larson. I am a partner in the forestry consulting firm of Larson & McGowin and a landowner in Mobile, Alabama. I am here today on behalf of the Forest Industries Committee on Timber Valuation and Taxation and as Chairman of its Estate and Property Taxation Committee. This organization consists of some 5,000 timberland owners, representing the 5,000,000 timberland owners of the country. The Forest Industries Committee is vitally interested in legislative developments in the area of estate and gift tax reform and appreciates the opportunity to appear and testify here today.

The Forest Industries Committee supports major reduction of the burdens of the federal estate and gift tax laws. As this committee is well aware, from its inception the primary purpose of the estate tax has never been to raise revenue. Rather, the estate tax seems to have been perceived and justified as a social tax aimed at accomplishing the redistribution of wealth. We believe that the time has come once and for all to assess the social benefits and costs of the estate tax.

Although studies, which we hope to be able to cite to the committee at a later date, have not yet been completed, there appears to be strong evidence that the cost of the estate tax may be very substantial. To the extent that this present estate tax inhibits capital formation, thereby decreasing economic growth and inhibiting job formation, it has a detrimental effect on the nation's economy as a whole. The

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tax also places a premium on sophisticated estate planning and in many cases encourages the making of uneconomic investment decisions during life.

Moreover, the burden of the estate tax does not fall most heavily on the very rich. On the contrary, its harshest consequences befall millions of middle-class American families who may be forced, as a result of rampant inflation and resultant liquidity problems, to sell part, or in some cases, even all of the family-owned farm or business to pay the tax. These detrimental effects of the current estate tax system can be readily seen in the context of nonindustrial private timberland owners.

Close to 60% of the nation's forestlands suitable for commercial timber production are owned by private individuals. Although the individual ownerships are small, in the aggregate they account for a major portion of the resource. Many studies of nonindustrial private owners conclude that the combined effect of the present federal and state income tax laws is to reduce rates of return for growing timber below the levels required for continued investment. Estate and inheritance taxes reduce this rate of return even further. At the same time, the nation's demand for wood and wood products is rapidly increasing. Recent trends in reducing the harvest from national forests has put additional pressure on private

landowners to meet the country's wood needs. Thus, today, more than ever, efforts to encourage capital investment and to reward risks are required. More than ever, fair tax treatment of timber is necessary to keep it in diversified small and medium-sized ownerships and to avoid its liquidation.

By increasing the rate of return to be realized from investment, continued private investment in woodlands would be encouraged, rather than penalized; and forced sales of timberland and uneconomic harvesting to pay estate taxes would be reduced.

Specifically and as a step toward what eventually may be even more significant reduction of estate tax burdens, the Forest Industries Committee strongly favors substantial reform of the estate and gift tax laws along the lines of that proposed in Senator Wallop's bill, S. 395.*/ The Committee is particularly interested in a number of amendments to the special use valuation provisions of the Internal Revenue Code, including several changes specifically addressed to the unique

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*/ Co-sponsored by Senators Boren, Byrd, Percy, Helms, Domenici, Symms, Baucus, Tower, Heflin, Bentsen, Hayakawa, Pryor, Lugar, Andrews, Duremberger, Thurmond, Zorinsky, Mathias, Nickles, Burdick, Abdnor, and Matsunaga.

problems and characteristics of woodlands. With the Chairman's permission, however, we would prefer to address special use valuation in detail at the hearings tentatively scheduled for early June and confine ourselves now to more general comments on the estate and gift tax laws.

In addition to the special use valuation amendments, the Forest Industries Committee strongly favors a number of other estate and gift tax reforms:

1. Rate Reduction and Increase of the Unified Credit

The double-digit inflation of the last several years has pushed an increasing number of estates, particularly those consisting of family businesses and farms, into extremely high tax brackets, forcing the decedent's heirs to sell a part or all of the family farm or business to pay taxes. Although the special use valuation rules enacted in 1976 have provided a measure of relief in some instances, more is needed if the next few years are not to witness the demise of the family business and farm. Although the Forest Industries Committee supports Senator Wallop's bill which calls for a 10% across-the-board cut in rates and an increased unified credit equivalent to a $600,000 exemption, we believe that consideration should be given to dropping the rates still further. We understand that some groups are advocating a

reduction to a top rate of 30% phased in over a 4-year period and we would support such a schedule as one that would better accomplish our goals: encouraging investment in timberland; eliminating forced sales of farms or family business to pay taxes; and, with respect to the economy as a whole, encouraging increased capital formation.

2. Unlimited Marital Deduction

In too many instances, the contributions of women to the family estate, whether they be actively participating in a family business or farm or more indirectly contributing to the family welfare by running the home, go unrecognized under the tax laws. At the death of a spouse, the tax law presumes that the full value of all jointly owned property should be includable in the estate of the first to die. This presumption can be overcome only by proving that the surviving spouse contributed monetarily to the acquisition of the joint property. When one adds to this presumption the fact that a woman's husband is far more likely to predecease her than vice versa, it is obvious why the federal estate tax has come to be known as the widow's tax. Although Section 2040(c) of the Code provides limited relief where it can be demonstrated that the surviving spouse materially participated in a farm or other business, in the vast majority of cases the estate tax still discriminates against women. Given the

rampant inflation of recent years, it is clear why so many women, realizing their longer life expectancy, fear for their financial security after their husbands' deaths, even where every effort has been made during life to assure that they will be adequately provided for in later life. For these reasons, the Forest Industries Committee believes that the contributions of all women, whether they work inside or outside the home, should be recognized and it favors the unlimited estate and gift tax marital deduction contained in S. 395.

3. Increase in Annual Gift Tax Exclusion

The Forest Industries Committee also supports an increase in the annual gift tax exclusion from $3,000 to $10,000 per donee. As I am sure the committee is well aware, the annual exclusion has been $3,000 since 1943. Clearly, an increase is long overdue. Although the $3,000 exclusion may have been adequate in 1943 to exempt most small gifts from the gift tax, this is no longer the case today.

CONCLUSION

The need for tremendous amounts of capital in order to expand and compete has never been greater in the United States than it is today. Nowhere is this more true than in the timber industry. The Forest Industries Committee believes that every encouragement should be given to individuals to

accumulate capital and to put it to work in businesses creating new jobs. In particular, if the nation is to continue to meet its growing wood and wood products needs and the many small private ownerships which account for more than half the country's forest resources are to continue their necessary contribution to our wood supply, investment in timber must be encouraged, not discouraged. For these reasons, we favor substantial reform of the estate and gift tax laws along the lines of that proposed in S. 395. We therefore urge the committee's serious consideration of S. 395 and look forward to a further opportunity to testify with respect to special use valuation and other aspects of the bill at the hearings of this committee tentatively scheduled for early June.

Senator SYMMS. Our next panel consists of Laura Lane, contributing editor, Farm Journal, Philadelphia, Pa.; Mrs. Doris Royal, Springfield, Nebr., taxation chairman, American Agri-Women; and Mrs. Janet Allison, chairman, Government Relations Committee, Washington Women for the Survival of Agriculture, Zillah, Wash.

**STATEMENTS OF LAURA LANE, CONTRIBUTING EDITOR, FARM JOURNAL, PHILADELPHIA, PA.; DORIS ROYAL, SPRINGFIELD, NEBR., TAXATION CHAIRMAN, AMERICAN AGRI-WOMEN; AND JANET ALLISON, CHAIRMAN, GOVERNMENT RELATIONS COMMITTEE, WASHINGTON WOMEN FOR THE SURVIVAL OF AGRICULTURE, ZILLAH, WASH.**

Ms. LANE. Senator Symms, I am a self-employed writer living at 2018 Spruce Street, Philadelphia, 19103, and I am the owner of a 400-acre tree farm in Louisiana.

I have owned this property for 41 years, and since inflation has made it worth 60 times what I paid for it, I can't afford to sell it. I can't afford to die, either, because my heirs will then be faced with selling the farm to pay Federal estate tax.

For 10 years I have written about estate taxes and about the techniques of planning to avoid distress sales of family farms. My audience has been primarily the 1.2 million subscribing families of the national magazine, Farm Journal.

Farmers, whether male or female, are not prolific letter writers—they are too busy. However, since 1975, I have received more than 6,000 pieces of mail related to keeping a farm or ranch in the family.

I believe it's honest to say I have become a national wailing wall for farm family widows and other heirs. I had hoped to see an end to these hard-luck letters after the Tax Reform Act of 1976, and the repeal of the carryover basis provision in 1980.

But as inflation has continued, people—especially widows—are crying on my shoulder again.

At least Dear Abby has some variety in her mail. In mine, the villains are always agents or auditors of the Internal Revenue Service.

An Indiana widow with an estate tax deficiency of $146,640.53, plus huge bills for legal fees, deserves and gets my sympathetic understanding.

I have time only to pose some questions and suggest some answers.

What is the basic purpose of present estate tax law? If it is to make some attorneys and accountants wealthy, it is succeeding.

If it is to keep farms and ranches and small businesses in family hands, then you must change both laws and IRS regulations. But how?

1. The simplest approach is to set an ample unified credit for estate and gift tax and peg it to the rate of inflation.

With a fixed sum such as the $47,000 credit we now have, you will have to tinker with laws and rates every 2 or 3 years, just as you have done in 1976, 1978 and 1980.

This is an expensive way to govern people's financial affairs and it puts a costly burden on tax-paying citizens who in good faith revise their wills, break up joint tenancies, incorporate, create

trusts, and then have to do the whole thing over again soon because Congress changes the ground rules.

A Nebraska woman wrote me: "We taxpayers should not be penalized because lawmakers could not foresee this terrible inflation nobody seems able to cure."

A recent national survey of farmer opinion tabulated by the Kansas Experiment Station showed that 91.8 percent of U.S. farmers favor indexing of the estate tax credit or exemption; 3.8 percent oppose the idea and the remaining 4.4 percent didn't understand the question or had no opinion.

2. Congress should recognize that some of its legislative band-aids haven't worked and perform major surgery on the Tax Code.

For example, the fractional interest rule of 1976, code section 2040b, confused people and did not help them.

I've never known anyone who has used it.

Next, in 1978, we got the credit-for-services rule, section 2040c. That was Congress first feeble acknowledgment of a farm wife's role in estate building.

But, IRS auditor Merrill Smalley, of Des Moines, said last month that no Iowa widow has yet used this section to reduce estate taxes. That's probably because widows feel they cannot meet the IRS test for material participation since they have not paid self-employment taxes.

In 3 years I have found only two farm women who unquestionably qualify under this IRS definition. Both have legal partnership agreements with their husbands and pay the social security tax.

This diabolical definition of material participation puts an elderly person between a rock and a hard place. You force him or her to make a choice between social security benefits and helping heirs.

If an elderly man opts for social security, he may not materially participate in the farm operation during his last years. That means he may deprive his heirs of two tax benefits: the special-use valuation of real property under section 2032A and the 15-year stretch-out in estate tax payments, section 6166A.

I doubt if this was your legislative intent. Now is the time to correct these oversights by liberalizing eligibility requirements.

I coined that well-known phrase "the widow's tax" in 1975. In case anyone here doesn't understand, that means a wife often has to pay Federal estate tax where a husband would not if the wife were first to die.

This is because common law in 42 States assumes that a husband owns everything unless a widow can prove to IRS that she contributed money or money's worth by taking a job away from home or contributed an inheritance or gift from someone other than her husband.

It is time that Congress quits fooling around with complicated equations and recognizes that a woman's work in fields, barn and office is a financial contribution to estate building.

You can abolish the widow's tax by making all transfers between spouses tax free, whether by gift during lifetime or by will at death.

An Arkansas woman wrote me: "As a widow, I found out that a farm wife is just an unpaid servant under our tax code. Changing the law is too late for me, but it can help others."

I urge, beseech, implore and entreat you and your colleagues to take this discrimination out of the statutes and let my phrase "the widow's tax" disappear from the tax vernacular for all time to come.

Thank you very much.

Senator SYMMS. Thank you. That was a moving statement, indeed.

Mrs. Royal.

Mrs. ROYAL. Thank you, Mr. Chairman.

Estate taxes were never—my name is Mrs. Lloyd Royal, of Springfield, Nebr. My husband, Lloyd, and I own 220 acres of farm land and rent another 85 acres in Serpy County, Nebr.

We are family farmers in the true sense of the word with both of us working in the farming operation. It is still hard to believe that a simple campaign started by three women in 1975 to arouse the people in their county could spread across the entire United States without receiving any dissent.

The fact that this movement and the demand for a change in the estate tax laws is still growing is a very vivid proof that the law is still in need of change.

I am taxation co-chairman for American Agri-Women and taxation chairman for Nebraska Ag-Gals, and I also represent those people who still keep in contact with me from the 1975 drive.

I want to thank the committee for holding this hearing on the problems of estate tax. I am writing about farms because I am a farm wife. While estate tax hurts the farm heir more because of the huge investment needed for land, machinery, and so on, it should be remembered that the inflationary impact on our economy has raised valuations so high as to affect many urban heirs as well.

I firmly believe that in both the urban and rural middle-class families there cannot be much of an estate unless both spouses and their family members help. It is easy to spend; difficult to save.

It is time estate tax laws are recognized for what they are; not so much a tax on the rich, but as was intended when the law was passed, but a tax on members of the hard working middle class.

People who are truly wealthy hire expert tax advisers to keep their estates intact. Their estates are taxed very little, if any, because their wealth is held in trusts, foundations, and so on, which escape taxation.

For a long time the widow has endured the extra pain of paying for her home and property twice; once when she and her husband were working side by side to acquire the property and again, when she must repay the Government for the property at the death of the husband.

Since a good marriage is a partnership, there is no logical reason to justify the property being transferred tax free if the wife dies first, but place a burden of proof of contribution on the wife if the husband is the first to die.

Since the Government has not elected to allow husbands to contribute to a Keough plan for their wives, like the allowance for IRA's, often the property left is the widow's only retirement fund. Whether the husband or the wife dies, the farmland is their life savings meant to keep them in old age.

During the past several years I have visited with many people across the United States about the estate tax laws and their effect on surviving heirs.

Without exception I have found that the husbands and fathers of this country are very concerned with this law. Typical statements are: "My wife worked side by side with me all these years so the estate is hers as much as mine," or, "I hate to think that just because I passed away, my wife would have to work as hard as ever in her retirement years to buy our farm or business again," or, "Do you mean to tell me that if I die, Mom and the kids might not be able to carry on?"

Many find it unbelievable that the wife and children may not be able to continue operating.

Very often children have spent long tiring hours on the farm or in the small business helping Mom and Dad. Only at death do they realize the impact of the Federal estate and state inheritance and estate taxes, plus the legal fees to accomplish the paperwork necessary to satisfy the Government.

The business they felt they were helping build, which was to be theirs one day, is suddenly broken up. Part or all must be sold to pay the Government.

It has been very heartbreaking to visit with widows whose children could not continue the family farm or business because the widow had to sell all or part of the farm or business to pay all of the bills which accompany death; that is, doctors, hospital, funeral, attorney fees, State and Federal death taxes, and so on.

Very often the forced sale does not leave a viable unit and the children must search elsewhere for employment thus losing very capable young farmers or businessmen.

There is enough sorrow, especially in the case of sudden death, without placing the unnecessary burden of taxation on the remaining spouse or children. Often the payment of estate tax is the straw that broke the camel's back.

There are those who advocate giving an additional tax break to those families where the children continue to operate the farm.

Have you taken into consideration the family where the children did work hard on the farm or in the business while they were growing up?

In later years, because of health, finances or some other reason, the children are not able to continue.

Is it fair that they cannot retain ownership in the farm or business which means a great deal to them?

It is my contention this type of ownership is essential to maintaining the family farm in our country. No young farmer has the assets to buy all of the machinery, seed, chemicals, fertilizers, and so on, necessary to start farming and still be able to purchase a farm.

We must have absentee ownership and the children just described above are much more apt to rent to the young neighbor boy than is a large corporation.

This same philosophy should apply to those who have never married but have made a contribution to society by making their own way. Certainly those nieces and nephews should not be deprived simply because they are not children of the decedent.

In the interest of time, I will not go into any of the areas in the rest of my prepared testimony. But, I would like to close by saying that those who worry about loss of revenue should realize that once property, which is sold to pay estate taxes, is purchased by a large corporation, it will never again pay estate taxes.

I would like to say that it is my hope that Congress will move rapidly eliminating the estate tax or making it more in line with the original intent of the law, which will encourage the continued existence of small family enterprises which are a traditional American way.

We think of ourselves as a nation in the Judeo-Christian tradition. I wonder what pagan country in the world has the elected officials reading the death notices hoping someone will die so that they can balance the budget.

I thank you.

Senator SYMMS. Thank you very much, Ms. Royal, for another very excellent statement. I think it is probably one of the most inefficient revenue raisers in the Federal Government, anyway. I think that your point is certainly well taken. If the legitimate purposes of our taxing policy is to raise necessary funds to operate legitimate purposes of Government, well the estate tax is a very poor way to go about it.

Now, we will hear from Ms. Allison.

I might say, I was thinking here, when I met you earlier, that some 30 years ago, I went with my dad to Zillah, Wash. to buy a load of trees that I helped plant, that we still have apple trees, from the Morrison Nursery. That is where I first met your fine Congressman, Sid Morrison, was on that trip. We loaded up a truckload of trees and covered them with sawdust and watered them down, hauled them back to Idaho and planted them.

Ms. ALLISON. I am glad to hear you have some good Washington apple trees.

Senator SYMMS. Thank you. Please go ahead.

Ms. ALLISON. I am Janet Allison. I am chairwoman of the government relations committee for the Washington Women for the Survival of Agriculture.

I have a lengthy written statement. I would hope it would be included in the record.

I am deeply honored to be able to present not only our organization's testimony, but also what we believe to be the views of millions of small business and farmowners across our Nation.

My husband and I are in that category. We are owners and operators, with our sons, of a family farm, 140 acres of irrigated orchard, in Yakima Valley.

We, and today, I have come across the country, from Washington State, to talk to you and be a part of this panel, because I have a message from the farmers, from the farm family, a message of very deep anger and perplexity from people like me, across this country.

Most of us have become increasingly aware of the estate taxes, during the past decade, and as they have affected the modest landowners, or what we thought were modest landowners.

Our group, because of the efforts of Laura Lane, Doris Royal, and such, to get this information out, in turn, our organization in

Washington State was able to get legislation to phase out the community tax, on community property passing between spouses.

Congressman Sid Morrison introduced that amendment at our request. He was then a State senator.

We have tried then, again, after this success, to encourage the same thing on the national level, because we were very displeased with the 1976 revisions. The people out there—it is not working.

We conducted somewhat of a national education program sending out folders and also having them printed in national magazines.

From that we have received thousands of letters from people that you probably don't hear from. Many of them were written on the backs of envelopes, written on the backs of other letters, people who are distressed, upset, unhappy.

I would like to make my comments on what this is doing to the family.

Many planners, lawyers, judges, Congressmen, do not fully realize the extent of stress that the planning, under the present law, does to families.

I appreciate your comments, Mr. Chairman, on the problems of planning and what that does economically.

The planning for minimization of estate and gift tax as we are encouraged to do now, in the very best way to work with the present laws, is a very highly stressful situation for families.

This type of planning forces families into an artificial means of managing their land, farm or business, which is usually not in the best interest of either the family or the business, trying to plan for years ahead, when the death of either husband or wife, how business and farm best be handled, how to anticipate what the new laws the next year, or new conditions.

This places families in an almost crisis situation, to the point where many do not take that step. The large dynasties or large wealthy families that the original law was aimed at regularly employ financial advisers in many areas of their business or their lives.

It is not so with the farmers, and small businesses, owners and many families that are dependent upon the ownership of land for their livelihood.

They are just now beginning to realize what inflation and bracket creep or bracket leap as the estate taxes have done to us.

They never thought that their modest holdings were going to be affected by the Federal estate tax laws.

Also, the loss of a close family member, is of course, as high a stress level that there is. This is recognized by most mental health experts.

Less well known is this stress of the planning for death.

Another level of stress is trying to piece your life together after the loss of a spouse, trying to get along without his or her presence, as well as to continue to operate a farm or business with a large gap in the management area, plus the overwhelming financial burden of that one unit that before the loss of a member, assuming it made a comfortable living, now must come up with State inheritance tax, estate tax, law fees, and probate fees, as well as the

income tax, all of this out of new moneys, all from the same original unit.

We are for the greatest simplification of the tax system, total repeal. That is the word we are hearing. Lacking the political realities of getting that passed, we would be in favor of S. 395, with certain stipulations.

The marital unit must be the first consideration.

We are asking that Congress recognize the marital unit in implementing the 100-percent marital deduction, this year.

The Treasury Department recommended this as long ago as 1969, again in 1976.

The American Law Institute, many people have recognized that.

However, in implementing these 100-percent marital deductions, we feel rather than the unified credit that you have in S. 395, we do agree with the other provisions of S. 395.

We believe the $1 million exemption would be the best way to go.

Senator SYMMS. I thank you very much for a very excellent statement. We have added a new member to your panel here, so before I commence asking the questions, I would like to hear from my former colleague, in the House, and now the senior Senator from the State of South Dakota, Senator Larry Pressler.

## STATEMENT OF HON. LARRY PRESSLER, A U.S. SENATOR FROM SOUTH DAKOTA

Senator PRESSLER. Thank you very much, Mr. Chairman. I thank the members of the panel for yielding here, since I am on a busy schedule and I know they are too.

Let me say I am honored to be sitting here because I think the story is very much being told here that we talk about equal rights for women in this country. What has been forgotten are the surviving spouse, widows, farm wives, small business wives, who have worked in a business or a farm, and who are not recognized as such, and who have all sorts of estate problems.

I think there is probably more going on in this room about equal rights for women than in all the demonstrations we have seen on the streets about sort of unrelated topics.

Senator SYMMS. Right. I agree with you on that, Senator, not only that but the actuary tables tell us that one place men and women aren't equal is that women seem to be able to live longer, and then they are the ones that are stuck with all the burdens and we men escape it on into the happy hunting grounds.

Senator PRESSLER. That is right.

Senator SYMMS. So that they are the ones that are stuck with the burden of it. It is just absolutely tragic.

Senator PRESSLER. Yes; it is women who pay most of the estate taxes in this country and who have to deal with this. Women live about 7 years longer than men, on the average. They tell us they are going to be soon living 10 years longer.

I don't know why that is, but the point is that if there were——

Senator SYMMS. They are so much nicer.

Senator PRESSLER. Maybe that's it. But, the point is, if there were ever an equal rights movement for women, this is it.

So, I commend you for being a champion. I am proud to sit here with three women, because this applies to women, the estate tax

issue, more than anything, more than any of the other legislation up here.

Let me thank you for this opportunity to express my support for Senate enactment of meaningful estate and gift tax legislation.

Several worthy bills on this subject are now pending before the committee. They have been mentioned here. I wish to add my support.

Passage of the legislation, to change the Internal Revenue Code to help small family farmers and small businessmen is vital.

Indeed, without action now to correct these laws, this generation of family farmers, in my State, could well be the last generation. It applies across the board, throughout American life.

Mail comes into my Senate office daily, from South Dakotans and other Americans, concerned about the extremely burdensome Federal estate and gift taxes. These men and women are fearful that farms which have been in their families or businesses that have been in their families for generations will have to be sold to large corporate interests so that Federal taxes can be paid.

These are solid American citizens being unfairly forced off their farmland which has been the heart of our country's strength and stability.

Let me also say that the family farm system has produced more food and fiber and a surplus. Our country's problem is a surplus of food and fiber, not a shortage.

Part of it is a result of the system. We are destroying that system in part through our system of estate taxes.

Let me also say that we have almost come to the point in this country where we are encouraging people not to save, not to try to have something to pass on to the next generation and to spend all of their money and not to accumulate an estate.

That is contrary to what has made our country great.

Mr. Chairman, many of the neighbors I grew up with are still farming, but fear the future. Present Federal estate and gift taxes may prohibit such farms from being capitalized in the family, even though able young people are willing and eager to take over.

According to the most recent census of agriculture, over 3,000 farms were lost during a 4-year period in South Dakota alone.

During the same 4 years, the Nation's number of farms dropped over 10 percent. In fact, 7 of every 10 people engaged in farming have left agriculture over the past 30 years.

Currently, over 50 percent of farm sales are by a small number of the Nation's farmers. It is inevitable that the large corporate farms have an easier access to the marketplace. Small farms are discriminated against in the marketplace.

If small family farms continue to decline in numbers at the present rate, they will soon be lost, there will soon be an almost total takeover of small family farms.

These family farms are essential in maintaining a reasonable priced, top grade food supply for this country and the world.

The quality of American life could be seriously damaged by their absence.

So, Mr. Chairman, for this reason and for many others, I am happy to appear here and commend the work of your subcommittee.

Perhaps the amount of property which can pass free of Federal estate and gift taxes could at least be tripled.

Also, it may be a good idea to give a special deduction to widows and other heirs. The tax benefit would be recovered upon selling the farm.

Changes such as these would permit many small farms to remain in the family. Other proposals seeking this goal have also been advanced.

I am pleased and I come here to commend this committee for scheduling hearings. Through this process, testimony can be received from those with firsthand knowledge of the problem and from tax experts.

It is my hope that this process can produce wellbalanced legislation which will affect agriculture.

So, Mr. Chairman, in conclusion, I again compliment, and I am honored to be here sitting here with three women who are testifying on behalf of this legislation.

It brings to mind the fact that women are bearing most of the burden in this area and end up with the problems.

I want to commend you, Mr. Chairman, for your work in this area. I thank the committee. I will be submitting a statement for the record.

Senator SYMMS. Thank you very much. Your entire statement will be made a part of our record. We appreciate having you with us. We look forward to working with you on this in the future, Senator.

Senator PRESSLER. Thank you.

[Senator Pressler's statement follows:]

TESTIMONY OF SENATOR LARRY PRESSLER

Mr. Chairman, thank you for this opportunity to express my support for Senate enactment of meaningful estate and gift tax legislation. Several worthy bills on this subject are now pending before the Committee. Passage of legislation to change the Internal Revenue Code to help small family farmers is vital. Indeed, without action now to correct these laws, this generation of small family farmers could well be the last generation.

Mail comes into my Senate office daily from South Dakotans concerned about the extremely burdensome federal estate and gift taxes. These men and women are fearful that farms which have been in their families for generations will have to be sold to large corporate farmers so that federal taxes can be paid. These are solid American citizens being unfairly forced off the farmland which has been the heart of our country's strength and stability. They have paid for their farms many times over with the efforts of their labors. They have paid taxes for many years, but are concerned that upon their deaths, it will be impossible to pass the land on to their families.

I, too, am a farmer—one of the few Senators still engaged in agriculture—and I deeply share this concern. I own and operate land near my hometown of Humboldt, South Dakota. My parents still own and operate the small family farm where I grew up as well. Many of the neighbors I grew up with are still farming, but fear the future. Present federal estate and gift taxes may prohibit such farms from being kept in the family even though able young people are willing and eager to take over.

According to the most recent census of agriculture, over 3,000 farms were lost during a four-year period in South Dakota alone. During the same four years, the nation's number of farms dropped over 10 per cent. In fact, 7 of every 10 people engaged in farming have left agriculture over the past 30 years.

Currently, over 50 per cent of farm sales are by a small number of the nation's farmers. It is inevitable that the large, corporate farms have an easier access to the marketplace. Small farms are discriminated against in the marketplace. And if small family farms continue to decline in number at the present rate, there will soon be almost a total takeover of small family farms.

These family farms are essential in maintaining a reasonably priced, top grade food supply for this country and the world. The quality of American life would be seriously damaged by their absence.

In order to safeguard small family farms, several bills have been introduced in the Senate dealing with estate and gift taxes. Also, this Committee will be expending a great amount of energy creating the best possible amendments to the Internal Revenue code in many areas.

Perhaps the amount of property which can pass free of federal estate and gift taxes could be at least triple. Also, it may be a good idea to give a special deduction to widows and other heirs. The tax benefit could be recovered upon selling the farm. Changes such as these would permit many small farms to remain in the family. Other proposals seeking this goal have also been advanced.

I am pleased that the Committee has scheduled hearings on this subject. Through this process, testimony can be received from those with firsthand knowledge of the problem and from tax experts. It is my hope that this process can produce well-balanced legislation which will benefit agriculture.

The United States cannot afford to tax small family farms out of existence. Our nation's future is at stake.

Senator SYMMS. Ladies, I appreciate very much your excellent testimony this morning. Thank you. We will certainly keep close contact with you as this legislation progresses through the Halls of Congress. I hope that you will have an opportunity to present your views to the House, also.

Ms. ALLISON. Mr. Chairman, I do wish to commend you on your stand on this issue and your understanding of it and your willingness to introduce and promote legislation to correct it.

I just think it is outstanding. I am proud I am from a sister State to you.

Senator SYMMS. Thank you very much.

Ms. ALLISON. My husband was born in Idaho, incidentally.

Senator SYMMS. Where?

Ms. ALLISON. Caldwell.

Senator SYMMS. That is where my home town is.

Ms. ALLISON. He grew potatoes then.

Senator SYMMS. Well, I have grown some potatoes myself, too, I might mention.

[Statements follow:]

81-288 O - 81 - 20

TESTIMONY

For the Subcommittee on Estate and Gift Tax
of the Senate Finance Committee at a hearing
May 1, 1981

My name is Laura Lane. I am a self-employed writer living at 2018 Spruce Street, Philadelphia. 19103, and I am the owner of a 400-acre tree farm in Louisiana. I have owned this property for 41 years, and since inflation has made it worth sixty times what I paid for it, I can't afford to sell it. I can't afford to die, either, because my heirs will then be faced with selling the farm to pay federal estate tax.

For 10 years I have written about estate taxes and about the techinques of planning to avoid distress sales of family farms. My audience has been primarily the one million two hundred thousand subscribing families of the national magazine FARM JOURNAL.

Farmers, whether male or female, are not prolific letter writers--they are too busy. However, since 1975 I have received more than 6,000 pieces of mail related to keeping a farm or ranch in the family. I believe it's honest to say I have become a national wailing wall for farm family widows and other heirs. I had hoped to see an end to these hard-luck letters after the Tax Reform Act of 1976, and the repeal of the carryover basis provision in 1980. But as inflation has continued, people...especially widows...are crying on my shoulder again. At least Dear Abbey has some variety in her mail! In mine, the villains are always agents or auditors of the Internal Revenue Service. An Indiana widow with an estate tax deficiency of $146,640.53, plus huge bills for legal fees, deserves and gets my sympathetic understanding.

I have time only to pose some questions and suggest some answers.

What is the basic purpose of present estate tax law? If it is to make some attorneys and accountants wealthy, it is succeeding. If it is to keep farms and ranches and small businesses in family hands, then you must change both laws and IRS regulations. But how?

1. One of the simplest approaches is to set an ample unified credit for estate and gift tax and peg it to the rate of inflation. With a fixed sum such as the $47,000 credit we have now, you'll have to tinker with laws and rates every two or three years, just as you have done in 1976, 1978 and 1980. This is an expensive way to govern people's financial affairs and it puts a costly burden on tax-paying citizens who in good faith revise their wills, break up joint tenancies, incorporate, create trusts, and then have to do the whole thing over again soon because Congress changes the ground rules. A Nebraska woman wrote me:

"We taxpayers should not be penalized because lawmakers could not forsee this terrible inflation nobody seems able to cure."

A recent national survey of farmer opinion tabulated by the Kansas Experiment Station showed that 91.8% of U.S. farmers favor indexing of the estate tax credit or exemption; 3.8% oppose the idea and the remaining 4.4% didn't understand the question or had no opinion.

2. Congress should recognize that some of its legislative Band-Aids haven't worked and perform major surgery on the Tax Code. For example, "the fractional interest rule" of 1976 (Code Section 2040b) confused people and did not help them. I've never known anyone who has used it. Next in 1978 we got the credit-for-services rule (Section 2040c). That was Congress' first feeble acknowledgement of a farm wife's role in estate building. But IRS auditor Merrill Smalley of Des Moines said last month that no Iowa widow has yet used this section to reduce estate taxes. That's probably because widows feel they cannot meet the IRS test for "material participation" since they have not paid self-employment taxes (See IRS "Guide to Federal Estate and Gift Taxation," 1979, p. 35. col. 1). In three years I have found only two farm women who unquestionably qualify under this IRS definition. Both have legal partnership agreements with their husbands and pay the Social Security tax.

This diabolical definition of material participation puts an elderly person between a rock and a hard place. You force him or her to make a choice between Social Security benefits and helping heirs. If an elderly man opts for Social Security, he may not materially participate in the farm operation during his last years. That means he may deprive his heirs of two tax benefits: the special-use valuation of real property under Section 2032A and the 15-year stretch-out in estate tax payments, Section 6166A. I doubt if this was your legislative intent. Now is the time to correct these oversights by liberalizing eligibility requirements.

I coined that well-known phrase "the widow's tax" in 1975. In case anyone here doesn't understand, that means a wife often has to pay federal estate tax where a husband would not if the wife were first to die. This is because common law in 42 states assumes that a husband owns everything unless a widow can prove to IRS that she contributed money or money's worth by taking a job away from home or contributed an inheritance or gift from someone other than her husband. It is time that Congress quits fooling around with complicated equations and recognizes that a woman's work in fields, barn and office is a financial contribution to estate building.

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> "As a widow, I found out that a farm wife is just an unpaid servant under our tax code. Changing the law is too late for me, but it can help others."

I urge, beseech, implore and entreat you and your colleagues to take this discrimination out of the statutes and let my phrase "the widow's tax" disappear from the tax vernacular for all time to come.

ORVILLE W. BLOETHE
JAMES A. SCHWIEBERT

BLOETHE - SCHWIEBERT LAW OFFICE
702 THIRD STREET
VICTOR, IOWA 52347

AREA CODE 319
647-3121

2 April 1981

Ms. Laura Lane
Farm Journal
230 W. Washington Square
Philadelphia, Pennsylvania 19104

Dear Laura:

Thank you for your kind letter of March 25th. I want to get back to you promptly regarding your question as to the credit for services rule, Sec. 2040(c) of the Internal Revenue Code.

I read the new provision with a great deal of enthusiasm and tried hard to understand it when it first came out. It received the same treatment at tax school and there was much talk about it. Soon you never heard a great deal about it and now it is simply a provision that receives little, if any, use.

One of the problems, I think, is that the benefit is so small that one can do better by proving contribution. With very good documentation and a set of facts, I think one can come out better in this manner - at least I have.

To confirm my thinking that the section is little used, I checked with Merrill Smalley, who was the head of Audit for I.R.S. in Iowa. He said he had yet to run across a case where this section was used. This certainly confirms my thinking and I thought you might be interested in knowing this.

Sincerely yours,

OWB:bv

## Estate Tax Issues

by Betty Brand

I was glad to hear Farm Estate Tax was on the slate for IWA Annual Meeting.

We have just been through the long three-year settlement of my mother-in-law's estate. This estate was 640 acres with five heirs. One heir and his wife had received their land tax free, when the step-father-in-law passed away ten years ago. This heir was also named executor in that will, with the clause that if the will was changed or challenged he would receive everything, leaving my mother-in-law's hands tied. Of four other heirs, two were out of state and only one farms.

On the 120 acres where we live, now broken into two 160's, over one million dollars in estate taxes has been paid in less than 100 years.

The tax is only one factor. If one was not paranoid before, you surely would be now. It seems like everyone takes a lick at you. There is always someone wanting more money--first of all, the lawyers (I'm sure there are good ones, but you really get leary). Each of the four heirs in our case paid the lawyer $10,000 ($40,000 in total), and then the executor received $10,000 ($40,000 in total).

The lawyer would not talk to anyone except the executor and the executor wouldn't talk to anyone. One heir living in Texas and one in Florida spent a small fortune on phone calls to no avail. One heir, the sister from Florida passed away one and one-half years after her mother. Now her estate and her heirs are involved in the final settlement. At last, we each (4 heirs) received a bill for $1800 to finish paying the lawyer and executor, after three years of asking for a settlement sheet that any five-year old could have compiled. Besides that, we also have the cost of our lawyer fees for filing, land appraisal, and land surveys.

The trauma and emotion of family relations is at best upsetting. In a large family, this can really tear them apart. It's easy to say, "Oh, this won't happen to us", but believe me, it's hard on the best of families.

I have written mostly about the emotions of the tax settlement, because of the other heirs. I really haven't gone into the tax expense, but I do know that more and more family farm land is being sold because of this unfair and unjust tax.

I guess the biggest emotional impact is the feeling of helplessness that the tax-paying heirs feel; that they have no say, little input, and no sound advice. All the government, lawyer, and executor wanted was our money, and for us to get the heck out of their way.

## News From Abroad AAW Affiliates

United Farm Wives of America, Inc. (Kansas):

Senator Nancy Kassebaum of Kansas presided over a hearing in the Senate Special Committee on Aging on the impact of Inheritance Taxes on rural women. A request was received by your editor to submit written testimony. When sent, a request to keep IWA updated was included. Senator Kassebaum has responded.

The Senator has introduced S. 574, a bill to preserve family farms and non-farm businesses. She wrote, "This legislation achieves two goals: It alleviates inequities in the tax code which fail to recognize contributions a wife traditionally makes to the operation and productivity of a farm or business. It also promotes continuation of small family enterprises that are the backbone of our economy. Heirs of the family business will no longer be forced to dispose of productive property to pay the estate tax bill. Overall, the bill accommodates the needed reforms, yet continues to generate necessary revenue so as not to do violence to efforts to reduce federal budget deficits."

Senator Kassenbaum sent a copy of the bill to the IWA Editor. Copies will be mailed on request.

## Illinois Legislative Alert!

Introduced February 26, 1981, by Representatives Schraeder & Rigney an Act to protect farming operations from nuisance suits under certain circumstances. Synopsis reads: New Act declaring that farms which have been in operation for more than one year shall not be or become a nuisance when it began operation. Effective immediately. "House Bill - 0385". Heard March 24 by the House Ag committee, at the first hearing it was passed 11 to 1. Considered a Right to Farm bill, it was patterned after a North Carolina law. If you desire a copy of the bill, contact your Representative.

"Pullen's HB224 got to the House Revenue committee on March 19. Continue your calls and letters to assure that something gets done about the Illinois Inheritance Tax situation in 1981!!

## Another Bottle Bill

by Sandy Harrington

"The Illinois Beverage Container Act 1981"

Introduced by Rep. Dan Pierce and Woods Bowman in February with the support of the Il. Agriculture Asso., Il. Environmental Council, League of Women Voters of Il., Il. Asso. of Park Districts, Sierra Club, Izaak Walton League, Audohon, & Am. Asso. of Univ. Women. This bill would reduce solid waste, save vital energy and resources and lower consumer cost. This type of legislation has been introduced in Illinois before and the cry of loss of business and employment to the companies manufacturing glass has always won out.

As other farmers, I and my family are continually picking up cans and bottles along our roadside and in the ditches. They are a constant danger and nuisance when mowing or even working in the fields, let alone such an eyesore. We are now seeing many people picking up cans to be recycled. Their incentive is the cash they can sell them for. I believe we do need a law. A deposit system puts all costs of a container into the market place to be shared equitably by all. We are now tolerating the waste of these finite resource materials.

## Illinois Agricultural Youth Institute

The Illinois Agricultural Youth Institute--a program designed to help provide strong leadership for agriculture's future--has been formed by the Illinois Department of Agriculture.

One hundred high school juniors and seniors from across the state will be selected to participate on the basis of their activities, leadership abilities, achievement and involvement in agriculture.

The four-day institute, which will be held June 16-19 in Springfield, is designed to expose them to current agricultural issues and divergent viewpoints, as well as inspire them to devote their lives to a career in agriculture.

The institute will call on leaders from areas such as agri-business, agricultural politics, farming and state government to present programs on a wide variety of topics. Career seminars on ag-related jobs will also be featured. The speakers, panels, group discussions, slide shows, movies and other activities planned for the institute are designed to motivate the students and give them an insight into agriculture's future.

Cont. on page 5

# See discrimination in Tax Reform Act

(Last of two-part series)
By BILL WICKERSHAM
Waterloo Courier

MARSHALLTOWN (IDPA)—The Tax Reform Act of 1976, hailed as the savior of the family farm, has resulted in many unforeseen problems.

One aspect of the law, the "carryover provision," will require "record-keeping that very few people have," according to Arley Wilson of Marshalltown, chairman of the Iowa Bar Association's Special Committee on Probate, Property and Trust Law.

Wilson also believes that provision could result in huge increases in inheritance taxes paid by estates.

The second major disaster in the tax act, according to Wilson, is in the law's definition of "material participation," which is required to use the special use valuation.

What the special use valuation allows is that under certain guidelines, farmland, say, could be valued to estate tax purposes at its present use, rather than at the traditional "highest and best" use.

This provision was supposed to protect the family farm by protecting its land from being valued at, for instance, a commercial or residential use for estate tax purposes.

But despite that intent, there are several difficulties applying it, and the "material participation" provision is the worst, Wilson says.

"This requirement discriminates entirely against women and senior citizen farmers," he contends. "Material participation is a social security concept which has no significance at all in estate and gift tax law traditionally.

"A farmer will have to choose in a great many instances whether or not he wants to obtain social security or whether he wants his estate to remain eligible for the special use valuation.

"A retired farmer without any children, a widow without a son actively engaged in running the farm, or a retired farmer with daughters ordinarily will not qualify."

Wilson says of the 1,140 farm income tax returns in his own practice, there is only one in which the farm wife qualifies as a material participant, even though "she has driven the tractor, fed the pigs and walked the beans."

Wilson says in no way would a retired farm landlord on a cash rent basis qualify for material participation and generally a retired farm operator on a crop share basis wouldn't either.

"To materially participate, you have to prove such things as that your wife, say, made half of the business decisions and contributed half of the equipment or capital to the enterprise," Wilson says.

"These requirements," he says, "just show how ignorant the people who wrote this law are of farming. Can you imagine most tenant farmers putting up with the landlord or the landlord's wife telling them what kind of fertilizer to use, how to plow and when to cultivate?

"Somebody," he says, "must have forgotten that the IRS has had a definition of a "farmer" for years. That is, a farmer is one who receives two-thirds of his gross income from the sale of farm production."

To meet the material participation criteria, both the decedent and the heir must meet the test of material participation for five of the past eight years. In addition, the business assets of the farm or small business must equal half of the total estate at its highest and best value. Also, the business real estate less mortgage indebtedness must equal at least 25 percent of the value of the whole estate at its highest and best use.

The requirement that the assets must equal at least 50 percent of the adjusted gross estate on the highest and best use is another pitfall in the law, Wilson says.

Because money is not considered a business asset in a sole proprietorship even though the intent is to invest it in new product to produce additional funds, a 'double swing' in an estate's business assets can occur, Wilson says.

He points out that a farmer who sold 1,000 head of cattle and received $500,000 for them two days before his death may have eliminated himself as a decedent qualified for the special use valuation. He might, by that sale, have only $400,000 in other assets while the cash isn't considered a business asset.

On the other hand, if the cattle were unsold at his death, he would have $500,000 more in business assets and be perfectly qualified for the special use valuation.

What the law does, Wilson reiterates with some irony, "is to encourage people to plan their deaths."

While material participation and the carryover basis are the two major flaws in the 1976 act, Wilson says there are several others worth mentioning.

To determine what the real estate's value is under the special use, the law requires the determination of what the average cash rent for such comparable real estate has been for the past five years, Wilson says.

"The problem is that figure is not available to the United States government, it is not available at Iowa State University. Farmers do not as a rule advertise to their neighbors what they are paying cash rent, because they consider it privileged information.

"That kind of information is only available to a lawyer with a large number of clients in a small community, who can check with his clientele."

Another problem is that to obtain the special use valuation, the fiduciary has to find out the effective rate of interest on new Federal Land Bank Loans for the past five years. "Not even the Land Bank is sure what they are," Wilson says.

The act also says material participation is not allowed by "agency," so a farm manager acting for the owner cannot as such produce a material participation on behalf of the owner.

Estates, family farm corporations and trusts are all agencies, Wilson says, so apparently none of these ways of running a farm qualify it for the special use.

Another problem is that the payment of the estate taxes [illegible] the farm and therefore the on[illegible] heir. If the on-farm heir or heirs [illegible] to use the special use valuation [illegible] with the off-farm heirs, the on-fa[illegible] heir runs a heavy tax risk.

If the special use valuation is used the real property must be kept in that use for 15 years. If the on-farm heir through illness or some other reason has to stop using the land for farm[illegible] he has to pay the difference in [illegible] between the special use rate and [illegible] highest and best use rate.

The off-farm heirs will have had the taxes paid for by the whole estate before its distribution, and the [illegible]ditional taxes will fall solely on [illegible] on-farm heir.

"What this does in effect," Wil[illegible] says, "is to extend the old theory [illegible] indentured serfdom to 15 years [illegible] encouraging death as the only way to terminate the government's lien.

In the early days of this country a person indentured himself for five years as somebody's servant in exchange for his passage over here from Europe. Through this law, [illegible] have now indentured a man for [illegible] years.

"Other countries," Wilson comments, "have nationalized industry, utilities, and transportation. Th[illegible] is the only country which [illegible] nationalizing the taxpayer."

If the 1976 act is not changed Wilson says, there may be ver[illegible] [illegible] verse effects on the social morality of the whole country.

"Most people in this country [illegible] rural areas at least, are bas[illegible] honest," he says. "But when [illegible] charge somebody in taxes more [illegible] he's got coming and when [illegible] discriminate so heavily again[illegible] women and senior citizens, their [illegible] voluntary assessment and pay[illegible] of taxes will collapse totally [illegible] people will do here what they do [illegible] foreign countries.

"They will cheat."

STATEMENT
of the
AMERICAN AGRI-WOMEN
to the
SUBCOMMITTEE ON ESTATE AND GIFT TAXATION
SENATE COMMITTEE ON FINANCE

Relative to
Major Estate Tax Issues

Submitted by
Mrs. Lloyd Royal, Co-Chairman
Taxation Committee

May 1, 1981

SUMMARY

Estate taxes were never intended to be a major source of revenue. Originally they were intended to tax the very wealthy and limit undue concentrations of wealth. It is clear the original intent is no longer serving its purpose, but instead, because of inflation and the many tax loopholes created, it is now having just the opposite effect.

Marriage is a partnership and the government should not legislate that away. There should be no gift or estate tax collected when property is transferred from one spouse to the other.

The tax credit is still not large enough to compensate for inflation. The inflationary impact on estates still causes the property of many middle class citizens to be sold to pay the death taxes, attorney fees, etc. This often does not leave a viable unit and, as a result, our country is losing many outstanding young farmers and businessmen.

Estate taxes which are taken out of a community hurt not only the surviving heir, but the entire community. Money left in the community will improve production, generate jobs and growth of business.

The $3,000 annual exclusion is completely outdated. An exclusion of $20,000 might be more realistic.

The valuation according to use, while a step in the right direction, needs more clarification so as to make it applicable to farmland in all parts of the United States.

Those who worry about loss of revenue should realize once property which is sold to pay estate taxes is purchased by a large corporation, it will never again pay estate taxes.

STATEMENT

Major Estate Tax Issues

My name is Mrs. Lloyd Royal of Springfield, Nebraska. My husband, Lloyd, and I own 220 acres of farm land and rent another 85 acres in Sarpy County, Nebraska. We are family farmers in the true sense of the word with both of us working in the farming operation. It is still hard to believe that a simple campaign started by three women in 1975 to arouse the people in their county could spread across the entire United States without receiving any dissent. The fact that this movement and the demand for a change in the estate tax laws is still growing is a very vivid proof that the law is still in need of change.

I am Taxation Co-Chairman for American Agri-Women and Taxation Chairman for Nebraska Ag Gals, and I also represent those people who still keep in contact with me from the 1975 drive.

I want to thank the committee for holding this hearing on the problems of estate tax. I am writing about farms because I am a farm wife. While estate tax hurts the farm heir more because of the huge investment needed for land, machinery, etc., it should be remembered that the inflationary impact on our economy has raised valuations so high as to affect many urban heirs as well. I firmly believe that in both the urban and rural middle class families there cannot be much of an estate unless both spouses and their family members help. It is easy to spend; difficult to save.

It is time estate tax laws are recognized for what they are; not so much a tax on the rich, as was intended when the law was

passed, but a tax on members of the hard working middle class. People who are truly wealthy hire expert tax advisors to keep their estates intact. Their estates are taxed very little, if any, because their wealth is held in trusts, foundations, etc., which escape taxation.

For a long time the widow has endured the extra pain of paying for her home and property twice; once when she and her husband were working side by side to acquire the property and again when she must repay the government for the property at the death of the husband. Since a good marriage is a partnership, there is no logical reason to justify the property being transferred tax free if the wife dies first, but place a burden of proof of contribution on the wife if the husband is the first to die.

Since the government has not elected to allow husbands to contribute to a Keough Plan for their wives, like the allowance for IRA's, often the property left is the widows only retirement fund. Whether the husband or the wife dies, the farm land is their life savings meant to keep them in old age.

During the past several years I have visited with many people across the United States about the estate tax laws and their effect on surviving heirs. Without exception I have found that the husbands and fathers of this country are very concerned with this law. Typical statements are: "My wife worked side by side with me all these years so the estate is hers as much as mine.", or, "I hate to think that just because I passed away, my wife would have to work as hard as ever in her retirement years to buy our farm or busi-

ness again.", or, "Do you mean to tell me that if I die, Mom and the kids might not be able to carry on?" Many find it unbelievable that the wife and children may not be able to continue operating.

Very often children have spent long tiring hours on the farm or in the small business helping Mom and Dad. Only at death do they realize the impact of the federal estate and state inheritance and estate taxes, plus the legal fees to accomplish the paperwork necessary to satisfy the government. The business they felt they were helping build, which was to be theirs one day, is suddenly broken up. Part or all must be sold to pay the government. It has been very heartbreaking to visit with widows whose children could not continue the family farm or business because the widow had to sell all or part of the farm or business to pay all of the bills which accompany death; i.e., doctors, hospital, funeral, attorney fees, state and federal death taxes, etc. Very often the forced sale does not leave a viable unit and the children must search elsewhere for employment thus losing very capable young farmers or businessmen. There is enough sorrow, especially in the case of sudden death, without placing the unnecessary burden of taxation on the remaining spouse or children. Often the payment of estate tax is the straw that broke the camel's back.

There are those who advocate giving an additional tax break to those families where the children continue to operate the farm. Have you taken into consideration the family where the children did work hard on the farm or in the business while they were growing up? In later years because of health, finances or some other

reason, the children are not able to continue. Is it fair that they cannot retain ownership in the farm or business which means a great deal to them? It is my contention this type of ownership is essential to maintaining the family farm in our country. No young farmer has the assets to buy all of the machinery, seed, chemicals, fertilizers, etc., necessary to start farming and still be able to purchase a farm. We must have absentee ownership and the children just described above are much more apt to rent to the young neighbor boy than is a large corporation.

This same philosophy should apply to those who have never married but have made a contribution to society by making their own way. Certainly those nieces and nephews should not be deprived simply because they were not children of the decedent. More often than not, they worked together and loved each other much as children and their parents.

The quote most often heard from Congressmen who favor the continuation of estate tax is, "We cannot lose the revenue." Well, death is a pretty heartless time to be worrying about collecting taxes. We find it hard to believe anyone could be so callous. According to Senator Wallop in the Congressional Record, February 5, 1981, "In 1980 the revenues from estate taxes amounted to only about $6 billion out of the total federal collection of $650 billion." Those who stress revenue loss usually quote the gross amount received. The cost of administration is not subtracted. Since so many of the large estates escape estate taxation by means of estate planning, it might be advantageous to this committee to see just how much of the

revenue gained is actually spent just to administer the estate tax laws. Is the government really gaining revenue or just exchanging dollars? What a cruel hoax that would be.

To those who worry about loss of revenue, I would say; Have you ever thought how much government money might be saved if heirs were allowed to keep the farm or business intact? Money which is taken from the community by means of estate tax hurts not only the surving heir but the entire community. These dollars are not spent locally to allow growth in the businesses of that area. Money left in the community will improve production, generate jobs and growth of business. It occurs to me, if we would spend more attention to this aspect, the increase of jobs, taking people off welfare and making them a part of the tax paying public, it might have the final effect of putting more money in the treasury. Besides this, we would be developing pride in our people.

We should also remember revenue is revenue whether it is being collected or being spent. It does not seem logical that the government does not mind spending money for projects, such as those quoted in Sen. Proxmire's Fleece Awards, and yet the same government cannot lose the revenue when it comes to giving widows or children a fair break.

In the future revenue will be lost if a farm or business must be sold to pay estate taxes and falls into corporate hands. Once into corporate hands it will never again be subjected to estate tax. Farms are still being sold in many estates even after the Tax Reform Act of 1976 because the heir cannot pay 15% - 20% interest to pay

estate taxes on land that generates 3% - 4% per year.

Somewhere along the way we have lost sight of the original intent of Congress as to estate tax. The tax was never meant to raise a lot of revenue, but was supposed to insure we would never become a two class society. It was supposed to be a tool for breaking up large estates. Todays laws have created so many loopholes that those of large means can hire expert legal advice and pay little, if any, taxes; whereas, the middle class of little means end up paying the bill. If this is allowed to continue, our children will not have a country in which there are small farms, ranches or businesses. I feel, if estate tax is necessary, every estate should be taxed at every death regardless of how property is held. Trusts, corporations, etc., should be taxed equally with other forms of ownership. The present law which creates loopholes that allow estate planning to avoid taxation is merely legalizing tax evasion.

It appears to me we are advocating a system which says, in effect, we will keep the law and tax those who do not have the wealth to hire expert legal advice or are too dumb to do estate planning. Even then estate planning is not always the answer. I know one case where the people had not one, but two, attorneys. They said the attorneys who handled all of their business matters were not well enough versed in estate tax laws to have the knowledge to write the deeds in the correct manner to avoid estate taxation and the money they paid the attorneys was lost.

Probably the saddest cases are those of so little wealth they do not owe any estate tax, but must spend much of their slight sav-

ings for attorneys, accountants, etc., to do the necessary paper-work demanded by the government at death.

I, and the people who contact me, agree wholeheartedly with the move by President Reagan and Senator Symms to eliminate the estate tax entirely. Letters come all of the time asking that I do all in my power to accomplish total elimination. The feeling is, let's pay our way as we go and leave the dead alone. Estate planning is contrary to the American way. Gifts between husband and wife or children should be generated by love and should not be cheapened by gift tax consideration or estate tax evasion.

IF CONGRESS CANNOT SEE THE ERROR OF ESTATE TAXES, THEN REFORM OF CURRENT ESTATE TAX LAWS IS BADLY NEEDED.

We must at least have legislation which permits property to be transferred tax free between spouses. Anything other than this is contrary to marriage.

The current tax credit, while much better than the old $60,000 exemption, still is not high enough to compensate for the inflationary values of our property. While the inflationary impact is greater on farms and small businesses, many urban people find that by the time they evaluate their home, life insurance, campers, boats, etc., they, too, are over the allowable tax credit. This credit should be adjusted higher to be realistic and then given an automatic inflationary raise every year. There should be no time limit on this raise as is suggested in many bills now introduced in Congress. It should be continuous so long as inflation keeps rising.

The current annual exclusion of $3,000 is so outdated as to

be laughable, but it certainly is not funny. The $3,000 figure has not been changed in 35 years. I would imagine this law is broken many times every day. Consider the cost of a college education or a decent used car. Certainly parents could never give a child a new car without paying gift tax, but I doubt the government has collected one penny from gifts of this nature. I am sure there are many who contribute more than $3,000 towards the care of an elderly parent, friend or relative. Who would think of paying gift tax on a wedding present? The $10,000 exclusion as suggested by Senators Wallop, Symms, Boren, Byrd, etc., in S. 395 would certainly be better, but $20,000 might be even more realistic.

The valuation according to use provision as passed in 1976, while a step in the right direction, needs much change and clarification to be beneficial to more estates.

a. The 15 year lien is much too long. We do not know what will happen to us tomorrow, let alone 15 years from now. Five years would be more realistic and should be sufficient to keep speculators from using it as a tax dodge.

b. The material participation clause makes it hard for retired persons. They must choose between collecting Social Security or keeping the valuation according to use provision for their heirs. A more realistic provision would be allowing a farmer to qualify by having material participation figured on 5 out of the 8 years prior to retirement or death.

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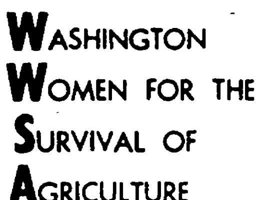
c. The valuation according to use formula needs to be broadened as to the requirement for comparability and rental valuation formulas so as to have a formula appropriate for all areas of the country. The concept of permitting crop shares to be used in the rental valuation formula of Section 2032A is in keeping with and fosters the original intent of Congress.

In closing I would like to say that it is my hope Congress will move rapidly. Eliminating the estate tax law or making it more equitable will encourage the continued existence of small family enterprises. I can think of no more fitting legislation than to pass estate tax laws which will keep the small and middle class people from losing their savings just because one happens to die. This kills their pride which is something no amount of medication can help. There are still many of the old school who try to save for retirement. They pay income tax, land tax, personal property tax, sales tax, etc., all their life. Can't the government let a person grieving a death alone? Even then it shows even greater lack of compassion by making the survivor file the necessary paperwork within 9 months. Very few are over the shock of the death before the tax man asks them to make major decisions on their property. We call ourselves a Christian nation, yet I wonder what pagan country in the world has its elected officials watching the death notices hoping someone will die so they can balance the budget.




SUMMARY OF STATEMENT
FOR SUB-COMMITTEE ON ESTATE AND GIFT TAX
OF THE
SENATE FINANCE COMMITTEE
MAY 1, 1981
by
JANET ALLISON, CHAIRMAN
GOVERNMENT RELATIONS COMMITTEE

We support S-395 to minimize and simplify laws relating to estate and gift taxes of family owned farms and businesses. We are specifically requesting that Congress enact into law this year the 100% marital deduction for both gift and estate taxes for these reasons:

The marital unit is a unique spiritual, legal and economic unit and should be treated as one for tax purposes. Recent laws that have helped smaller landowners still contain complexities that should not exist when property passes between spouses. Taxes are detrimental to an economic unit whose capital holdings and equipment are geared to the most efficient operation of that unit, and are therefore detrimental to the country's economy. Sale of part or all of this unit is destructive to the family farm structure, encouraging sale to larger, prosperous businesses. It also depletes a capital unit historically utilized for pensions.

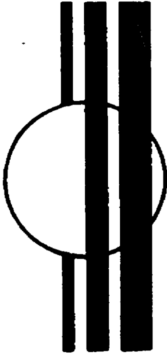
Taxes are also deleterious to the economy, taking needed capital from the private sector. These taxes are not major revenue raisers (all estate and gift taxes are less than 1% of projected revenues for 1981). The fiscal impact of loss of these taxes is not as great as has been feared. Increased production is available when the marital unit is left intact, contributing to the economic strength of our country, creating more jobs and generating more revenue, due to the graduated tax rates,as income is maintained or increased.

Run-away inflation and "bracket creep" have placed modest landowners into positions where these taxes are a major factor. The impact is both economic and emotionally damaging. These factors include: the stress of planning for minimization of taxes which might conflict with the best interest of the family or business; the complexities of dealing with probate after death of a spouse while trying to continue to operate farm or business; and paying NEW monies for taxes, lawyers, accountants, etc.

Estate and gift taxes are a greater burden on those who are dependent on ownership of land for their livelihood. They also punish the family business which happens to be a little more successful, or whose property has reached an unrealistic value, due to inflation.

These punitive death taxes pose a real question to the right of U. S. citizens to own property. We believe that the government by imposing estate and gift tax, takes away individual and family rights to bequeath and inherit property, thereby jeopardizing the freedom of private ownership of property in our country.

The 1976 tax changes in regard to the marital deduction and the unified credit reflect the recommendations of special interest groups whose members profit from the complex tax structure. We ask the Senate Estate and Gift Tax Committee to take the lead in getting Congress this year to correct the inequities in the death tax.




STATEMENT
FOR SUB-COMMITTEE ON ESTATE AND GIFT TAX
OF THE
SENATE FINANCE COMMITTEE
MAY 1, 1981
by
JANET ALLISON, CHAIRMAN
GOVERNMENT RELATIONS COMMITTEE

I am Janet Allison, Chairman of the Government Relations Committee of the Washington Women for the Survival of Agriculture (WWSA). I am presenting the testimony of our organization as developed by our committee with the help of WWSA Tax Chairman, Dorothy Reid. Also, we believe that these views are representative of millions of small business and farm owners across our nation. My husband and I are in this category. We are owners and operators, with our sons, of a family farm, 140 acres of irrigated orchard in Yakima Valley in Washington State. It is an honor for me to be able to present our views to this committee today.

The members of our organization have long been concerned about the unfairness of state and federal gift and death taxes, especially between spouses. In 1979 we were able to get legislation passed in our state to start a phase out of the state inheritance tax between spouses, thanks to an amendment introduced by Congressman Sid Morrison, than a state senator. We believe that the same type of revisions should be made to the Federal Tax Code. We support the provisions in S-395 that minimize taxes and simplify laws relating to estate and gift taxes of family owned farms, businesses and other landowners. If it is not possible to have all these needed changes this year, we request that the one change Congress makes is to eliminate all tax on interspousal transfers, both gift and estate. We think this change is long overdue for the following reasons:

(1) Marriage is a unique partnership which is spiritual, legal and economic in nature. Man and woman are united as one in the eyes of God and the laws of our country. Therefore, their property, possessions and money should also be treated as one unit within this marriage contract. This is especially important if this partnership is involved in farming or other small family businesses. Recent laws have helped smaller landholders, but increased complexities that should not exist on transfer of property between spouses.

(2) Taxes can break up this unit by forcing the survivor to sell property, equipment or both to pay these taxes. This can cripple or even end the business or farm, as most equipment, buildings and other capital investments are geared to the size of the economic unit. Also, productive businesses usually have few liquid assests available to pay estate taxes. Congress recognized the illiquidity of landowners in recent laws, such as the 15 year payment plan, which is essential to help keep the family business and farm system.

(3) The sale of part or all of this unit to pay taxes is destructive to the family farm and small business system, and encourages larger farms and business structures. A surviving spouse cannot afford the gamble of selling except to the very best off financially. This means selling to a larger farm, business or corporate structure, or to land developers, rather than to the young family struggling to make that first land purchase or trying to increase a unit that is too small for economic purposes.

(4) The farm or business has historically been the capital unit needed for old age pensions, for farmers, small business owners and spouses. Present Social Security, IRA and Keogh plans are completely inadequate to fulfill this purpose.

(5) Estate taxes pose a greater burden on the surviving spouse of a partnership that is dependent on ownership of property for earning its livlihood. Run-away inflation has driven up the value of land far in excess of the earning capabilities, especially for farms. There has been no concurrent jump in the production income of farmers, and there is no way for a farmer to adjust his operation so that income will increase as much as his land values.

(6) Estate Taxes have a deleterious effect on the economy. This money is taken from the private sector, decreasing funds available for capital formation. Increased production on the other hand, is available when the economic unit is left intact. This contined or increased production contributes to the economic strength of our country, creating more jobs and generating more revenue as income is maintained or increased.

(7) The fiscal impact on total revenues collected by the IRS will not be as great as some think because: (a) if the marital unit is not taxed upon the death of the first spouse, it is not a total avoidance of this tax. The tax in the long run stands a chance of being as much or more on the second spouse's death as the unit would probably be valued at least as high and due to graduated rates of estate tax could possibly bring more revenue. (b) Revenue from income tax will undoubtedly increase as the unit will be at least as large, one deduction is gone and again due to graduated rates increase is likely. (c) Many people now going thru complex and costly tax avoidance schemes such as trusts, incorporations and foundations would probably not do so if one spouse was able to keep the marital unit intact without the initial tax and if the unified credit was increased. This means the possibility of some revenue generated that is not now available.

(8) Estate and gift taxes were never intended as major revenue raisers ( a projected 1% of total 1981 revenues, according to the Economic Report of the President, 1980). It is widely accepted that its intented result was to break up very large estates. This is not working now as these people have been able in the past to avoid most of these taxes with plans worked out by tax advisors, and continue to use tax loopholes to evade many of the taxes. These devices bring much income to these advisors, but not much revenue. Also, the value of an estate can be depleted by the expense of these plans. Meanwhile, the tax now hurts the small business owner, farmer and other property owners. Inflation and "bracket creep" or "bracket leap" as it relates to estate taxes, have now

placed many persons who have regarded their worth as very modest into the tax category where the trust route or incorporation is the only way to continue an economic unit. These methods have strong drawbacks in the operation of a farm or business.

(9) Planning for minimization of estate and gift taxes, which we are encouraged to do as the best way to work with the present laws, is a very highly stressful situation for families. Trying to plan for years ahead for death of either husband or wife, not knowing what new laws might bring, what new conditions might be, trying to anticipate how best the business or farm can be handled, places families into an intensely emotional situation. This type of planning forces families into an artificial means of managing their business that might not be the best for either the farm or the family. The stresfulness of this situation is not clearly understood by most of our financial planners, and probably not by most Congressmen. Loss of a family member is the highest stress level we face, a concept accepted by most mental health experts. Less well known is the stress involved in the planning for death. It is very real, we have had a lot of imput from people who have experienced this, and from many who just have not done any planning because of unwillingness to be placed in this distressing situation.

Another area of stress is just trying to piece your life together after losing a spouse-trying to get along without his or her presence, as well as continue to operate a farm or business with a large gap in the management area. Add to this the overwhelming finacial burden of that one unit, with loss of one major partner,(assuming that the unit made a comfortable living for that family) now must come up with NEW monies for state inheritance tax, estate tax, still pay income tax, probate, lawyer and accountant fees, court cost--and still support that same family. Add to this the complexities of trying to work with a trust and that cost, and you have an almost unbearable situation. We believe that no husband or wife should be subjected to these additional emotional and economical burdens--ones that have been imposed on them by the laws passed by Congress.

(11) We believe that the Estate and Gift tax laws pose a real question to the right of a U.S. citizen to own private property. This right has been abrogated when punitive tax laws penalize you when you bequeath or give property to anyone you might choose. We believe that the government, by imposing these tax laws, takes away the freedom of private ownership of property in our country. We also question the validity of a law that allows a person to bequeath or give property tax free to a charity, but not to a family member, even a spouse. Laws that penalize those who have been a little more successful, or whose property has reached an unrealistic value, due to inflation, do not fit into a system that supports free enterprise.

(12) We are angry and puzzled that when the 1976 revisions in the Estate and Gift tax laws were being developed, that the recommendations of such groups as the American Bar Association, the American Bankers Association, the American Institute of Public Accountants, the American College of Probate Council seemed to be the ones that were accepted

when the law was revised. These groups, as we all know, earn a considerable amount of money from the present tax structures, and I do not begrudge them earning what they can from our ridiculous tax structure. Also, they certainly have the right to lobby for laws that benefit their professions. I would defend this right for anyone. However, considering these monetary interests, it does not seem right that Congress accepted their recommendations over those of many other representatives of farmers, small business-owners, the U.S. Treasury, the American Law Institute, as well as from individuals of this country who are effected by these laws.

Not all persons involved in estate planning and probate procedures and trust officers endorse the positions of their associations. We have heard personally from many who recognize the unjust and burdensome nature of the current estate and gift tax laws, and feel that they should be ended. These are persons who deal daily with the bereaved spouse and family who have suffered the loss of their loved one, and must also face the estate tax blow. They know first hand how onerous this burden is in all ways.

From all the imput that we have had since we have been working on this issue, with all the evidence in the tax hearings of 1976 and others, we believe that the people of our country are "fed up" with the present system. The Treasury Department recommended the recognition of the marital unit for tax purposes as early as 1969--again in the 1976 tax hearings--as did the American Law Institute and many others. We are asking that Congress now recognize that unit in law for tax purposes.

In working with this issue thru the years, and in preparing for this hearing, we have studied the statistics gathered by the Congressional Budget Office, The Department of Agriculture, the Staff of the Joint Committee on Taxation, and others. These statistics show the declining number of American farms, their increasing size, the rising age of the average farmer, how our tax structure is helping to bring this about, the small amount of revenue loss from enacting the 100% marital deduction (.0067% of total revenues). This data is available to all of Congress and will probably be presented by one or more persons in these hearings. However, you as members of the most powerful--the greatest body in all the world--must sometimes take the step beyond data--when you must decide an issue based on right or wrong, decide what is right about these tax laws--what are they doing to our families--to our children and our grandchildren--how is our country benefited by these laws--why are they there--what can I as a Congressman do--what should I do.

We are asking this Sub-Committee on Estate and Gift Tax both collectively and individually to place high on your priority list the complete revision of these punitive laws, starting this session with the provisions as contained in S-395-with the first priority this year being the elimination of all estate and gift tax on interspousal transfers. We know that all of you are for these revisions as you have sponsored bills to do this and more. Now we are asking for your commitment to work for this. We commend you for introducing the legislation that you have, and for having these hearings.

Senator SYMMS. Is Mr. John Gourley here?
[No response.]
Senator SYMMS. How about the panel of Mike McKevitt, Louis Granados, William Kolbe, and Don Schapiro?
Is that panel here?
Would that panel like to come forward? We would accept your testimony now.
The Chair is disposed to go ahead and close the hearing—if we can, finish it this morning.
You are Donald Schapiro?
Mr. SCHAPIRO. Yes.
Senator SYMMS. Are the rest of your panel members here?
Mr. GRANADOS. I am Mr. Granados.
Senator SYMMS. Very well.
Why don't I take you two gentlemen, if you prefer.
Mr. KOLBE. I am William Kolbe.
Senator SYMMS. William Kolbe, all right.
Why don't you join them at the table. The Chair probably will, unless the other witnesses arrive, in the next few minutes, just recess through the noon hour and then come back for a short session this afternoon.
But, Mr. Schapiro, why don't you go ahead.
Mr. SCHAPIRO. Thank you very much, Mr. Chairman.
Senator SYMMS. We are glad to have you here.

## PANEL OF JAMES D. "MIKE" McKEVITT, DIRECTOR OF FEDERAL LEGISLATION, NATIONAL FEDERATION OF INDEPENDENT BUSINESS; LUIS GRANADOS, LEGISLATIVE COUNSEL, THE ESOP ASSOCIATION OF AMERICA; WILLIAM S. KOLBE, DE MARK, KOLBE, BRODEK, S.C., RACINE, WIS., REPRESENTING THE INDEPENDENT BUSINESS ASSOCIATION OF WISCONSIN; AND DONALD SCHAPIRO, BARRETT, SMITH, SCHAPIRO, SIMON & ARMSTRONG

Mr. SCHAPIRO. My name is Donald Schapiro. I am a practicing tax lawyer and a partner in the New York law firm of Barrett, Smith, Schapiro, Simon & Armstrong.
I appreciate the opportunity of appearing to testify, and I would ask that my prepared statement be added to the record.
Senator SYMMS. Without objection, so ordered.
Mr. SCHAPIRO. Thank you, Mr. Chairman.
Now, we have heard a great deal of testimony today about the unquestioned fact that our present system of Federal estate and gift taxation frequently forces owners of family businesses to sell their businesses in anticipation of the need to pay estate tax. I think that is unchallengeable.
What I would like to bring to the committee's attention is the fact that in my experience, owners of family businesses suffer two major disadvantages as compared with owners of publicly held shares.
I am not now talking about rates. I am talking exclusively about the fact that the family held businesses, intrinsically, are different.
First, they are terribly difficult to value. If an individual owns shares of A.T. & T. or other publicly traded stocks, that individual knows what the transfer taxes are.

When you own shares of a family business you can't tell. The uncertainties of valuation are very great indeed.

The second major problem is that you can't sell for cash, some part or all of these interests.

For example, an owner of shares of a publicly held corporation can sell some part of his shares to raise money to pay estate taxes or raise money to pay gift taxes, and an owner of a family business can't.

There just isn't any market. There is no way that an owner of shares, in my judgment, of less than 100 percent interest in a closely held corporation, can dispose of their entire interest and even an owner of 100-percent interest must dispose of all of it.

The owner can't dispose of part of the interest and use the money to pay the tax.

Now, I would like to point out that the gift tax rate on transfers is materially less than the estate tax rate.

Let me take the case of an owner of shares under the integrated rate structure. An owner of say publicly traded shares has shares of $100 in value. Let's assume now that this is to be taxed at the highest rate, 70 percent.

The owner of those shares dies. The estate tax is 70 percent, beneficiaries take 30 percent.

If, instead, the owner transfers the shares during his lifetime, uses the $100 to make a transfer and pay gift taxes, he can transfer about $59 and pay gift taxes of $41; $41 being 70 percent of $59.

Thus, the heir, in the case of the gift, receives twice as much, $59, as compared with $30, on the estate tax.

Now that is true, irrespective of rates, and that is the case for people who can sell a part of what they have and give away another part.

Owners of family businesses can't do that. There is no one who is going to buy a piece of their business to provide the cash.

I would like to make a suggestion, in order to meet this problem of equality between the two—I am not talking about rate structure now—I am not talking about anything else. I am just talking about trying to keep things equal.

I would like to suggest that your committee consider that, in the case of family held businesses, that Code section 303, of the income tax law be expanded to permit corporate funds to be used to pay gift taxes.

In other words, if a person who owns stock in a publicly held business can sell some of it to finance gift taxes, if an owner of a family held business can pay estate taxes by taking funds out of the corporation under section 303, it seems to me that, with an integrated rate structure, it would make a great deal of sense to permit funds to come out of a corporation under section 303 to pay the gift tax or to pay loans incurred to meet them.

The second suggestion, probably more controversial, that we are making is that some special use value be accorded family held businesses, like those used for farms.

The fact you can't sell them seems to us to suggest the possibility of a discount from value, provided the interests are retained in the family, the business is a family business, and it meets other tests.

That is the burden of our suggestion, that you try to equate in some way family held businesses and publicly held businesses.

Senator SYMMS. I thank you very much. That is very interesting. I just wanted to ask one question on those numbers, before I lose track, if you gentlemen would allow me to do this.

You said if you had—you were using the figures $41 and $59?

Mr. SCHAPIRO. That is right; $100.

Senator SYMMS. Let us say it was $100, if it is gifted over.

Mr. SCHAPIRO. You have to visualize a person having $100 of assets. If he dies, there is an estate tax of $70; $30 goes to the heir.

If, instead, the individual says, "I will make a gift," he can transfer $59 to the heirs, and pay $41 in gift tax, at 70 percent; $41 is 70 percent of $59. The reason for it is that there is no gift tax on gift tax.

There is an estate tax on estate tax.

Now, that is an accepted policy and our law recognizes it and gifts made within 3 years of death are brought back into the estate.

But, in the typical case of the family planning, when you have children in the business and you would like to give them a piece of the business, that is the difference in rates.

It just seems to me it ought to be possible for us to allow, in an integrated rate structure, corporate funds to be used to finance gift taxes, as well as estate taxes; that's all.

There is no reason why people who own publicly held shares ought to be able to use the gift tax route any more readily than family businesses.

Senator SYMMS. Thank you very much. That is very interesting. I hadn't thought about that point on the difference in the rate on that. Most certainly it is correct that in the case of the family business, that they don't have a market.

But, if they have stock on some exchange that has a price every day, it is easy to figure out where they are.

Mr. SCHAPIRO. I don't really think there is an existing policy opposed to it with an integrated rate structure any more.

Senator SYMMS. Mr. Granados.

Mr. GRANADOS. Thank you, Mr. Chairman.

My name is Luis Granados. I am the legislative counsel for the ESOP Association of America, and I appreciate the opportunity to share our views with you today.

I ask that my statement be made a part of the record.

Senator SYMMS. Without objection, so ordered.

Mr. GRANADOS. The ESOP Association of America is a trade association of companies with employee stockownership plans, which, as the name implies, are plans providing for corporate employees with shares of stock in the companies for which they work.

Typically, the stock is provided at no cost to the employee. Over 4,000 American corporations have adopted some form of ESOP since 1975.

It is our view, as has been mentioned by many witnesses today, the original purpose of the estate tax, when it was enacted in 1916, was to broaden the ownership of capital wealth by preventing undue accumulations of capital wealth in the hands of the few.

Thus, denying to the many, the ability to own the principal means of production.

Congress sought at the time, to break up such accumulations of capital, by taxing them away at death.

If that was the purpose of the estate tax, Mr. Chairman, then it is a dismal failure.

As Mr. Fields mentioned earlier, the statistics show that 1 percent of the people in the country today own over one-half of all the individually held corporate capital wealth, and 6 percent own about three-quarters of it.

We think that this concentration of wealth is neither just nor economically efficient, and we would hope that the Congress would take steps to do something about it.

We have two suggestions today for improving the estate tax that we believe would do something to help in the spreading of capital wealth more broadly among the American working population.

The ESOP, we submit, is a very excellent mechanism for achieving such a broadening of wealth. It is designed to and does provide share ownership of capital to the employees of a corporation. It does so according to all of the nondiscrimination rules of ERISA which guaranteed that the lowest paid employees will get stock, just like the highest paid employees will.

ESOP also has the effect of uniting the interests of labor with the interests of the owners of the capital, and thereby creating a more harmonious, efficient, and productive corporation.

Our first suggestion is to provide charitable tax treatment for gifts and bequests that are made to ESOP's.

The way the law is today, an owner of a large estate, if he wants to, can leave that estate to a society say for the study of voodoo or something like that, and pay no estate or gift tax at all, on that transfer.

If, however, that owner chose to leave his stock to an ESOP representing the employees, who had helped him build that corporation, who had helped build the estate in the first place, he would have to pay an enormous tax for the privilege of doing that.

We think that is an anomaly in the law that ought to be corrected and the State of Minnesota has already made that change in its law. It passed a law in 1974, permitting charitable treatment for bequests to ESOP's.

We think Congress ought to do likewise.

Our second proposal is a new idea that would permit an estate to transfer its entire tax liability to an ESOP simply by transferring the stock, an equivalent amount of stock to the ESOP.

I don't have time to explain it fully. It is in my—in my prepared testimony.

Assume for a minute that an estate owed $1 million of estate tax. That estate could transfer $1 million worth of closely held stock to the ESOP and then the estate would owe no more estate tax.

The ESOP would owe that $1 million of estate tax, payable over a period of years, just as the estate can do presently, under section 6166, of the Internal Revenue Code.

In fact, under our proposal, the payment period would be even shorter than the estate could have under section 6166.

Section 6166 gives you 15 years. We would be willing to make that so the ESOP could pay the tax within 10 years.

That would mean several things. It would mean the Government would get its money faster. It would mean the estate would be off the hook immediately, instead of having to drag things out for 15 years.

It would mean the corporation would become at least partially, employee owned, which the studies show does seem to lead to a more productive operation.

Most importantly, what that would mean is that the employees of that corporation, for the first time, would have the real opportunity to become owners of capital.

I would conclude by commenting on a statement Mr. Jepsen said, earlier, "That it is the dream of all Americans to own a piece of the action."

Well, we totally agree with that. We think that dream ought to be shared more broadly than 4 percent of the Americans who presently pay estate taxes.

By plugging the ESOP into the estate tax law, we think that we can accomplish that.

Thank you, Senator.

Senator SYMMS. Thank you very much for a very interesting suggestion you make. I will certainly take a very careful look at it.

Mr. Kolbe.

Mr. KOLBE. Thank you, Mr. Chairman.

My name is William F. Kolbe. I am a practicing lawyer in Racine, Wis. We have a seven-man law firm there. We specialize in a tax practice. We do not represent any publicly traded companies. We represent approximately 150 local manufacturing concerns.

We also represent a few farms.

My remarks today are going to be directed primarily to the impact of the Federal estate tax on small business. I have handed out something like 20 copies of a prepared statement and I would like to file with the committee, a corrected copy and have it made part of the record, which corrects some typographical errors in the prepared statement.

I also hope that the chairman has a copy of my statement, because in a moment, I would like to refer to page 4 of it.

Senator SYMMS. Without objection, your corrected copy will be made a part of our committee hearing record.

Which page did you want to refer to?

Mr. KOLBE. Well, I will get to page 4 of my statement in just a moment, Mr. Chairman.

The Federal estate tax, as it applies now to closely held business, is often thought of as a tax on the heirs, as a tax on the people who inherit that business. It is not a tax on the heirs; it is a direct tax on the business.

The reason for that is that there is no way to pay that tax, other than by extracting the capital from the business required for that purpose.

If a person has a 100-percent ownership of a closely held business and death occurs, the table on page 4, of my outline, shows the impact of those taxes.

The Congress has wisely seen that there is no way, if your tax rate is an effective 40 percent, and you have a $2 million business and the Government, let's say there is a marital deduction that goes through two estates, wants approximately $700,000.

That is 35 percent of that business' total value. That 35 percent isn't going to be obtained by selling 35 percent of the stock, because there isn't anybody around who is going to buy 35 percent of the stock.

If you have a 35-percent tax rate imposed on your A.T. & T. stock, you simply take it to the broker, raise the money, and pay the tax.

But, if it is 35 percent of a closely held business, there isn't anybody around who is going to buy that 35 percent. You are going to sell the whole business or you are not going to sell any of the business.

Well, the Congress has recognized this and has provided in section 6166, 6166A, and section 303, methods through which capital can be removed tax free from the business to pay those taxes and a substantial period of time for the payment of those taxes.

However, those sections only permit the crippling of the business. I don't know of any other solution. I don't know where the money would otherwise come from that has to be paid. But those sections permit the crippling of the business.

If you take a look, Mr. Chairman, at the chart on page 4, if we have a business, and our practice is largely manufacturing businesses, and they are largely incorporated.

If we have one with a total value of $5 million, and we pass that business 100-percent owned, through two estates, making the assumption there are some other assets like a home, savings, life insurance, and such things, that are going to use up the unified credit.

By the time we pass that business through two estates, utilizing a full marital deduction, there will be over $2 million to be paid to the Federal Government which is 40 percent of the value of that business.

Mr. Chairman, if IBM or General Motors were told by the Federal Government that within the next generation, within one generation, and let's say it is at a particular point in time, which may occur in not too long a time, they are going to have to pay 41 percent of the total present value of their business to the Federal Government in estate taxes, their stock would go on that day to zero.

That business would be closed up. It would no longer be a viable producing entity. It would be the end of General Motors. It would be the end of IBM. It would be the end of any publicly traded business in this country.

Yet, for some reason it is thought that closely held businesses, who are far less able to withstand such financial pressures, can somehow marshal and generate the funds within their own businesses to pay out these staggering taxes.

They cannot do it.

What has happened in Racine, Wis., is just this.

We have had many of our companies acquired because people cannot face that Federal estate tax and it can't be paid from the business.

If I might take a moment more. We had Western Publishing Co., one of the key publishing companies in this country, acquired by Mattel; J. I. Case, a tractor company; Walker Manufacturing which makes exhaust systems, all acquired by Tenneco; Racine Hydraulics, by Rexnord, In-Sink-Erator, Dremel Manufacturing, have been acquired by Emmerson Electric, Jacobsen Lawn Mower has been acquired by Allegheny Ludlum, Wrapping Machinery Co., that makes the soft film wrapping of meats in markets, acquired by Reliance Electric Co.; Hartman Hydraulics by Koehring, Voorlas Manufacturing by General Signal; Gettys Manufacturing by Gould, Inc.

Just some of these have been through our office. It is a partial list. There is a massive, pervasive, constant acquisition of local businesses by nationally held concerns because there is no way these businesses are going to be able to survive.

One we are doing the estate planning for now, had to put in a program of cash management that is going to deny the development of a new product. It is going to deny a plan expansion. Somehow or another this business is going to try to raise approximately 30 percent of its total value in cash, so that it can pay the estate taxes over a period of time. The accountants are working on it.

The business, as a result, is stagnant. It is now stagnant before death, due to the cash preservation and cash generation programs that have to be instituted.

My statement, my written statement goes into a number of other additional facts on this point.

My recommendations are that if the Congress were to conclude that yes, this is unacceptable, we cannot do this to closely held businesses, if the Congress were to say that, then it has to do something about it.

If it were to repeal the Federal estate tax, then I think that would be wonderful, if we could put a lid on State inheritance taxes which would explode at that invitation.

I also suggest, though, that the tax on closely held businesses be deferred until the interest in the business is sold. That basis in the inherited stock could be reduced to compensate the Government for interest on that tax. That tax would then be collected when the interest in the business has been disposed of.

That isn't going to mean that these people live the life of Riley that they wouldn't otherwise live. Their lifestyles remain the same in either event.

I have a couple other suggestions on the last page of my written statement.

The point is that these businesses, when they are substantial in value, cannot survive and pay these Federal estate taxes at the time of death.

Thank you.

Senator SYMMS. Thank you very much for an excellent statement that certainly puts a perspective on the situation. I happen to agree with you. You make a very good case. You have certain

numbers of good examples that the committee can certainly use in the coming months.

Now, we have been joined by Mike McKevitt, who is representing the National Federation of Independent Business, in Washington.

Mike, welcome to the committee. It is nice to have you here this morning. I look forward to hearing from you.

Mr. McKEVITT. Thank you, Mr. Chairman. I just got the call. Pardon me for being late. So, I just shot right up here.

Mr. Chairman, on behalf of our over half million members, I think, and I might say this in reaction to surveys of our members, responsive individuals, the concerns they have is what we like to call death taxes rather than estate taxes.

But, death taxes, to me, within the next couple of years is going to be the OSHA of the tax field. Our members are howling mad about it. They want to see it abolished or they want to see it really significantly modified.

I can give you two examples. Wilbur Doyle, one of our members, has a lumber yard here in Virginia. Last year he paid 20 percent of his net profit for life insurance premiums to cover his death taxes.

That is not right.

Another member, Harry Austin, Morris, Pa., is a third generation soap manufacturer. He keeps paying increased life insurance premiums every year to cover his death taxes.

He was offered a buy-out 3 or 4 years ago, by a major company. I won't name its name, but it was a very major, major. He didn't want to to it. He didn't want to do it for several reasons.

He wants to pass the business on to a fourth generation, his son. He wants to keep the business in Morris, Pa. If he doesn't, the business will go bust and that will be the end of Morris, Pa., because that is the principal business there, in that town.

We have just done a recent survey and the results will be announced next week. Right up there among the top three priorities is death taxes. We want to have a change.

We feel and I have brought this subject up for the last 4 years now, like an old drum, down at the Department of Treasury, where I have served on the Small Business Advisory Committee, and they never raised much of a hue and cry over it.

There is not that much of a revenue loss, if, for example, you start by kicking up, the exemption for taxes up to $2 million, at the time of death, or if you kick it up even higher for closely held family businesses.

My goodness, there are all kinds of opportunities in the Tax Code for mergers and stock transfers and everything else, but what in the sam hill are we doing about continuation of family businesses.

I say not a heck of a lot.

As a result of it, we don't see small businesses on the uprise. We see them on the decline. We see it in our own membership. We see it in the small business community in this country.

Therefore, in summary, I say these are the problems of small business, with the death tax.

One is the inflated valuation of business assets that is causing inflated estate taxes to be paid.

The result is that the Treasury Department, through the estate and gift tax provisions of the Tax Code, is subsidizing the life insurance companies, period.

No. 2, the family-owned business is being threatened by high estate taxes and the attractive tax benefits of nontaxable exchanges that encourage the sale of many family-owned businesses to larger firms.

No. 3, the rules that govern the determination of a business' fair market value are in need of revision.

Fourth, the rules that allow an estate to spread out any estate tax liability payments need to be liberalized to make this option more readily available to the heirs of a business.

Solutions of various designs have been proposed by the members of this committee. I would counsel you to at least attempt to attain at least three policy goals.

One, the overall reduction in estate taxes or abolition of estate taxes.

No. 2, simplification of estate tax rules.

Three, the certainty of estate tax responsibility.

Our membership, by a vote of 83 to 14 percent, has endorsed a concept of deferral of estate taxes as long as the business remains in the family.

This concept provides a large measure of certainty for a businessman to determine whether to spend large amounts on life insurance premiums or estate planning.

Alternatively, raising the estate tax ceiling to a level of at least $1 million and hopefully $2 million of gross estate would alleviate the problem many individuals have because of inflated values.

The problems of the special valuation rule for family-owned businesses and spreading out of estate tax liabilities needs to be considered within the context of our three basic guidelines.

The taxpayer should be allowed to know in advance whether or not he will have estate tax problems and to what extent he must deal with the problems.

Two bills which have been introduced, S. 404 and S. 395, broadly address the two possible alternatives which need to be explored.

Outright repeal of estate tax may require extensive study and review by the responsible tax committees. Many of the recommendations in S. 395 would be a helpful and positive short term step.

May I say to you, Mr. Chairman, you are to be commended for finally bringing this thing out in the open where it belongs. I hope that you have speedy action in addressing this problem. It is a serious, serious problem for small business, particularly from a family-owned business, which needs to be continued in this country.

Thank you.

Senator SYMMS. Thank you very much for your very concise and direct statement, Mike. I just had one question before you arrived here, but Mr. Kolbe touched on it in his very excellent testimony.

He said that if the estate and gift tax is repealed, which the chairman certainly thinks it should be, then we better look for a rash of 50 State legislatures trying to raise revenue and pass new estate taxes at the State law.

Do you view that as anything that we couldn't handle at the State-by-State level?

Mr. McKEVITT. Well, for one thing, we lobby in all 50 States. As of this year, we have 50 State offices. You may rest assured we would be on guard and ready to go and so would many other business groups to see that didn't crop up there.

There is that possibility that would happen. I think it is something we can't lose sight of, but we have to be very careful of that possibility.

Senator SYMMS. My own State has a very poor estate tax as far as people who want to move there, in spite of the Wall Street Journal article about the high percentage of millionaires in Idaho, it is still a very difficult State for people to bring fortunes to that State.

Mr. McKEVITT. The only saying about farmers about how they live poor and die rich is applicable to many small businesses in general, those who have warehouses, buildings and so on.

So, I think that is something we ought to consider on all counts for all of us.

Senator SYMMS. Well, I thank all of you very much.

Did you want to make another comment on that, Mr. Schapiro? I thought you made an excellent point, too.

Mr. SCHAPIRO. I think all three of us have been saying essentially the same thing. The shares of a family business are not liquid and I think all of us are touching on the need if not cut out the tax, at least to recognize that the illiquidity justifies reducing values or postponing tax and meeting the policy.

It reminds me a little bit, Mr. Chairman, of a treasure map. If there are three of us who each have a piece of it, the whole treasure map is worth a lot. But no one is going to pay very much for a third of it.

Yet, you can't say, when someone dies with a third of the treasure map, it is worthless. It isn't worthless, but you just can't sell it.

Now, this is really the problem we are all talking about in the case of family businesses. We are all looking for some method to try to allow this thing to go on in the family at some sensible value.

On the other hand, if we were to face the prospect of immediately after death of everybody having to get together and take these three pieces of the treasure map and selling them off, my heavens, that wouldn't be right either.

So, you need some period of time in which if we are going to keep values down, the business has to be run as a family business.

Now, there is some precedent in the farm case, for doing that. It seems to me if we recognize the policy problem and we recognize we are really not trying to change things, apart from rates. Obviously, if we eliminate the estate tax altogether, that is different. But, if we don't, and we reduce rates, and try to keep the family businesses about equal with others.

Senator SYMMS. Thank you all very much.

Do you want to make another comment, Mr. Kolbe? You look like you are ready to say something.

Mr. KOLBE. No, sir, thank you.

Senator SYMMS. Thank you. I appreciate it.

81-288 O - 81 - 22

The committee will stand in recess for just about 5 minutes to see if we can find John Gourley.

[A short recess was taken.]

[The prepared statement of Mr. James D. McKevitt follows:]

STATEMENT OF

JAMES D. "MIKE" MCKEVITT

DIRECTOR OF FEDERAL LEGISLATION
NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Before: Subcommittee on Estate and Gift Taxation, Committee on Finance

Subject: Estate and Gift Taxation

Date: May 1, 1981

Mr. Chairman, my name is James D. "Mike" McKevitt, Director of Federal Legislation for the National Federation of Independent Business. On behalf of our more than one half million member firms I would like to discuss the impact of estate taxes on small business.

Upon initial consideration your reaction may be to ask what major problem a small business could have with estate taxes. After all, the unified credit exempts from taxation all gross estates with values of less than $175,000 without taking into account other allowable exclusions such as the marital deduction.

The public's general perception is that estate tax laws somehow force the very wealthy few to redistribute enormous amounts of family wealth upon death. We know that the truly wealthy actually redistribute very little family wealth because these wealthy few have sophisticated inter-generational tax planning devices to substantially avoid estate taxes. Table A illustrates that approximately 95% of all 1976 estate tax returns filed represented gross estates of $500,000 or less in size.

The estate tax has been affected by inflation and bracket creep in much the same way as the income tax. Inflation has also affected the problem of placing a fair market value on a business and continues to cause great concern because of complex valuation rules that create inflated values. Valuing an ongoing business at a specific point in time is difficult under normal conditions but impossible when the economy fluctuates as it has been doing over the last few years. Often the difficulties result in inflated asset values and substantial estate tax liabilities that can force the liquidation or sale of the business to provide sufficient cash to pay the estate tax bill.

Naturally strategies do exist for minimizing estate taxes, but they create their own distortions. One NFIB member in Virginia owns a lumber mill and is currently using 20% of his profits to purchase life insurance to ensure that there will be sufficient cash to satisfy an estate tax liability.

Another member owns a soap manufacturing plant in a small city. The plant is a major economic factor for the city and for years the company has been very involved in community affairs. If the owner dies, the estate tax would force his heirs to sell the business so he pays exorbitant life insurance premiums which will allow the family to retain the business. A less expensive alternative would be to sell the business and take advantage of certain nontaxable exchange provisions in the tax code. Unfortunately, selling the business involves the real probability that the plant would be closed and the community would lose its major source of employment.

The continuity of small businesses are being threatened by ever increasing estate taxes. While we are not espousing a policy goal that does not allow for changes in business ownership, by the same respect our tax laws should not encourage or make it more advantaegeous to sell a business than to keep it.

In a recent survey of urban areas participants were asked how they went into their present business. The response from northeastern cities indicated a substantial number either inherited or purchased the business from a member of the family. Policy considerations on the estate tax need to consider whether this factor could create the potential for distortion of business ownership patterns in these areas. Northeastern cities are already facing severe resource drains that would be further exacerbated if the rising cost of estate taxes forced the liquidation or sale of a business to a larger business.

In 1976, $5.3 billion dollars in tax revenue was generated by the estate and gift tax.1/ According to Table A the major number of filers of estate tax returns were the smaller estates. We do not have the data on the distribution of taxes paid by the size of the estate. The facts lead to a question that needs to be answered. Is the estate tax necessary? Based on the percentage of small estates filing estate returns, it is probable that substantial financial resources are being spent on tax counsel and life insurance premiums. It might be that when the costs of government administration, tax counsel, and life insurance premiums are compared to the revenue generated, that the estate and gift taxes

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1/ Office of the Secretary of Treasury, Office of the Tax Analysis

are not cost effective. If this is so can another, less costly way of raising this revenue be found.

Additionally, is current estate tax policy placing too great of an administrative burden on the small business. Since the wealthy minimize their estate taxes, it is possible that a relatively higher burden is being placed on smaller firms.

To summarize, the following are the problems of small business with the estate tax:

1. Inflated valuation of business assets is causing inflated estate taxes to be paid. The result is that the Treasury Deparment, through the estate and gift tax provisions of the tax code, subsidizes life insurance companies.

2. The family owned business is being threatened by high estate taxes and the attractive tax benefits of non-taxable exchanges that encourage the sale of many family owned businesses to larger firms.

3. The rules which govern the determination of a business' fair market value are in need of revisions.

4. The rules that allow an estate to spread out any estate tax liability payments need to be liberalized to make this option more readily available to the heirs of a business.

Solutions of various designs have been proposed by members of this committee. I would counsel you to attempt to attain three policy goals:

1. Overall reduction in estate taxes;
2. Simplification of estate tax rules; and
3. Certainty of estate tax responsibility.

NFIB's membership by a vote of 83% to 14%, has endorsed a concept of deferral of estate taxes as long as the business remains in the family. This concept provides a large measure of certainty for a businessman to determine whether to spend large amounts on life insurance premiums or estate planning.

Alternatively, raising the estate tax ceiling to a level of at least $1,000,000 of gross estate would alleviate the problem many individuals may have because of inflated values.

The problems of the special valuation rule for family owned businesses and spreading out of estate tax liabilities need to be considered within the context of our three basic guidelines. The taxpayer should be able to know in advance whether or not he will have estate tax problems and to what extent he must deal with the problems.

Two bills which have been introduced, S.404 and S.395, broadly address the two possible alternatives which need to be explored. Outright repeal of estate tax may require extensive study and review by the responsible tax committees. Many of the recommendations in S.395 would be a helpful and positive short term step.

Overall, a review of the purpose served by the estate and gift tax is necessary. If it is not a cost effective tax, elimination of the estate tax should be strongly considered..

I am available for any questions this committee may have. Thank you for this opportunity.

DISTRIBUTION OF GROSS ESTATE ON RETURNS WITH TAXABLE ESTATE

(Fiscal Year 1976)

| Size of Estate on Taxable Returns (dollars) | Number of Taxable Returns | Gross Estate ($000) | Average Gross Estate | Gross Estate As Percent of Total Estate on Taxable Returns | Gross Estate as Percent of Total Estate on All Returns |
|---|---|---|---|---|---|
| Under 500,000 | 125,617 | $22,690,208 | $180,630 | 55.9% | 47.1% |
| 500,001 - 1,000,000 | 9,078 | $6,169,559 | $679,616 | 15.2% | 12.8% |
| 1,000,001 - 5,000,000 | 4,117 | $7,327,346 | $1,779,777 | 18.1% | 15.2% |
| 5,000,001 - and over | 303 | $4,391,227 | $14,492,498 | 10.8% | 9.1% |
| Total reported on taxable returns | 139,115 | $40,578,380 | | 100.0% | 84.2% |
| Total reported on non-taxable returns | 61,632 | $7,623,356 | | | 15.8% |
| Total estates reported on all returns | 200,747 | $48,201,736 | | | 100.0% |

Source: Office of the Secretary of the Treasury
Office of Tax Analysis

# STATEMENT OF

LUIS L. GRANADOS

LEGISLATIVE COUNSEL

THE ESOP ASSOCIATION OF AMERICA

BEFORE THE

SUBCOMMITTEE ON ESTATE AND GIFT TAXATION

of the

SENATE FINANCE COMMITTEE

May 1, 1981

## SUMMARY OF PRINCIPAL POINTS

1. The estate tax has failed in its original purpose of broadening the ownership of capital wealth.

2. The estate tax should be reformed to encourage transfers to ESOPs, which provide stock to employees on a nondiscriminatory basis.

3. Gifts and bequests to ESOPs should be treated as gifts and bequests to charities for tax purposes.

4. Estates tied up in closely-held stock should be permitted to transfer their tax liability to an ESOP by transferring stock to the ESOP.

Mr. Chairman and members of the Subcommittee, my name is Luis Granados. I am the Legislative Counsel for The ESOP Association of America, and I very much appreciate the opportunity to share with you today our views on the proper structure of estate taxes.

The ESOP Association of America is a trade association of companies with Employee Stock Ownership Plans, which, as the name implies, are plans for providing employees of corporations with stock in the companies for which they work. Typically, the stock is provided at no cost to the employee. Over 4,000 American corporations have adopted some form of ESOP since 1975, and Congress has enacted 12 laws encouraging their use. And, as might well be expected, the studies that have been done of the performance of ESOP companies have all reached similar conclusions: that when you give employees a meaningful "piece of the action" in their companies, when you give them a real reason for taking an interest in the profits at the bottom line, those employees will begin to become more productive.

You may have seen the recent news stories and advertisements about the employees of Continental Airlines, who have agreed to give up 15 percent of their wages in order to purchase control of that company. That's just one very recent example of the kind of teamwork and cooperative spirit that the ESOP can generate.

Our interest in the estate tax has its origins in the philosophy of Louis O. Kelso, the father of the ESOP as we know it today. That philosophy involves recognition that there are really two factors of production: the human factor, or labor; and the non-human factor, or capital, including all manner of land, plant, equipment, and technology. Not only does the capital factor produce goods and services in exactly the same physical, logical, and moral sense that labor does, but the whole thrust of the continuing industrial revolution is to shift the burden of production away from the labor side and toward the capital side. This shift can be of tremendous benefit to mankind, since it frees up man's time to engage in pursuits other than laboring to sustain the needs of his body. However, both justice and efficiency require that if capital is to do the bulk of the production in an economy, the ownership of that capital must be spread broadly among the people. Otherwise, serious dislocation and disruption of the free-market system will result.

Unfortunately, a severe concentration of capital ownership has already occurred in America. Studies show that one percent of the people now own over half of all individually-held capital wealth, and 6 percent own almost three-quarters of it. We believe that this concentration of wealth is neither just nor healthy for the economy.

The original purpose of the estate tax when it was enacted in 1916 was precisely to prevent such undue accumulations of capital wealth in the hands of the few, thus denying to the many the ability to own the principal means of production. Fifty years earlier, President Lincoln had sought to spread the ownership of capital — at that time, land — broadly among the American people by signing the Homestead Act of 1862. In 1916, Congress sought to break up accumulations of capital by taxing them away at death.

Unfortunately, Congress chose an inartful means of accomplishing its laudable purpose. The 65-year history of the estate tax, and the statistics I cited earlier,

show that it has utterly failed in its mission of broadening the ownership of capital wealth. What Congress failed to realize in 1916 was that tax payments to the government are not the only way, or even a good way, to accomplish such a beneficial deconcentration of capital ownership. Taxation destroys private wealth. But destruction ought not to be the object; deconcentration ought to be the object.

The ESOP Association has some suggestions for ways to reform the estate tax to make it less of a device for destroying private wealth and more of a device for simply spreading it out.

These suggestions employ the very simple concept of tying some form of forgiveness of the estate tax to a transfer of capital from the estate to an ESOP. We submit that the ESOP offers an ideal mechanism for achieving a deconcentration of capital wealth ownership in a practical, non-confiscatory manner. One hundred years ago, President Lincoln broadened ownership by enabling each independent family to own its own 160-acre homestead farm. Today, we can break ownership of capital down into shares of stock, and distribute those shares to millions of Americans. The ESOP does exactly that: it provides share ownership of capital to the employees of a corporation, according to all of the non-discrimination rules of ERISA, so that the lowest-paid employees get shares just like the highest-paid employees do. Furthermore, as I said earlier, by uniting the interests of labor with the interests of the owners of capital, the ESOP can create a harmony and a commonality of purpose that leads to a more efficient and productive corporation.

The "Expanded Ownership Act" to be introduced shortly by Senator Russell Long incorporates two practical proposals for reforming the estate tax to broaden the ownership of capital wealth through ESOPs:

1. Provide charitable treatment for gifts and bequests to ESOPs. A generous capital owner who wishes to leave his estate to a society for the study of voodoo can do so without paying any estate or gift tax. However, if the generous owner wants to leave his estate to the people who worked for him faithfully and helped him to achieve his success by leaving his stock to an ESOP, he would have to pay an enormous tax for doing so. We think this anomaly ought to be corrected in any general revision of the estate and gift tax laws. In fact, a good case can be made that it is better for society to have estates go to ESOPs than it is to have them go to the "charitable" purposes defined in the tax regulations. Transfers of corporate stock to "charitable" foundations really destroys private ownership in the same way that estate taxation destroys it. They destroy the connection between wealth-producing capital and the average working people who need it. They permit the government and the long-dead to exercise control over the capital that could otherwise be owned and controlled by millions of average working Americans. And they do nothing to improve American productivity, as transfers to ESOPs undoubtedly do. Only by restoring the vitality of American productivity can we as a nation become wealthy enough to afford a flourishing charitable sector. Thus, The ESOP Association strongly supports the idea of treating gifts and bequests to ESOPs on the same basis as gifts and bequests to charities for tax purposes. Senator Russell B. Long will include a proposal along these lines in his forthcoming "Expanded Ownership Act." The State of Minnesota in 1974 recognized the wisdom of such a change and enacted it into law. We believe that it is time for Congress to do likewise.

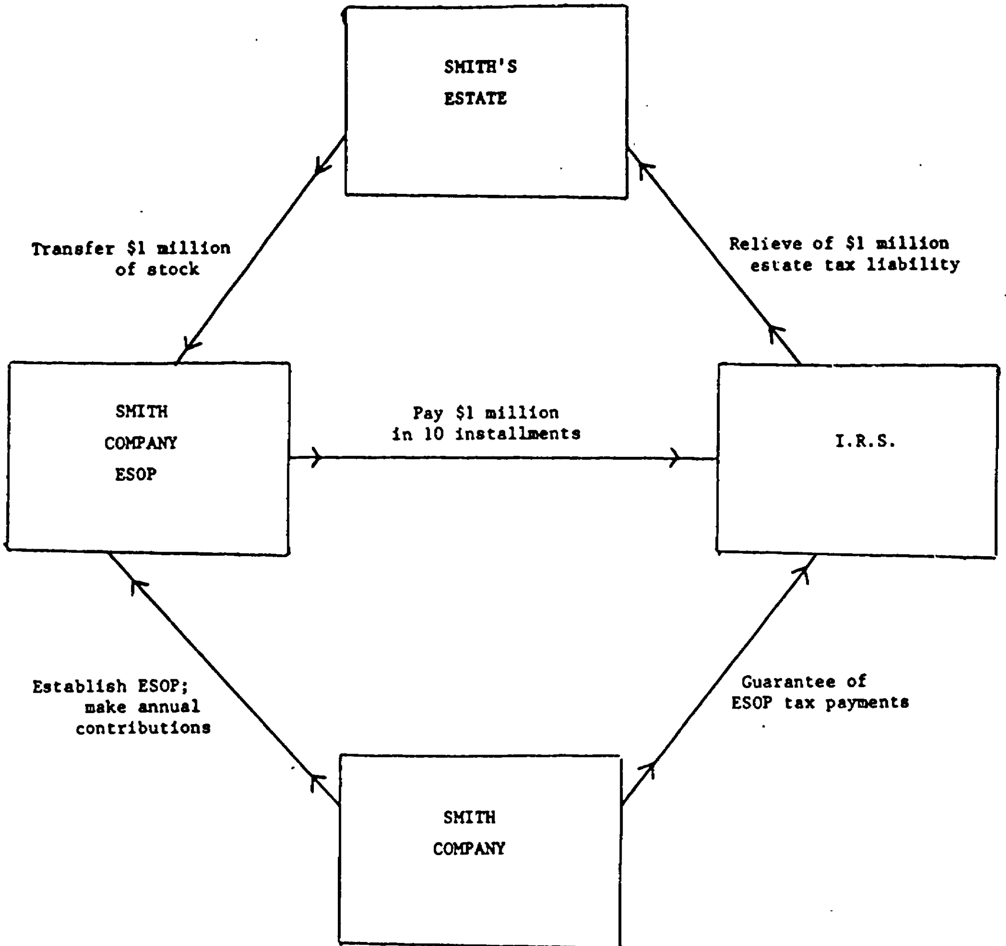
2. Permit the shifting of estate tax liability to an ESOP. In 1958, Congress recognized the serious problem that estate taxes can cause for estates tied up in the stock of a closely-held company, by enacting what is now § 6166A of the Internal Revenue Code. That section, along with the more recently added § 6166, permits estates that are tied up in closely-held stock to take up to fifteen years to pay their estate taxes. Any transfer of stock from the estate, however, would result in the estate's having to pay the full amount owed immediately. This law does provide some relief from the harsh effects of the estate tax, but still results in the eventual destruction of wealth through taxation. Moreover, it does nothing to spread out the ownership of wealth, since a handful of heirs would still wind up with what is left after taxes.

We have come up with a plan based on § 6166 that would result in a revenue gain for the government and a substantial spreading of capital ownership among average working people. Under this plan, (See accompanying chart), an estate that would qualify for § 6166 would be permitted to transfer its estate tax liability to the company's ESOP by transferring an equivalent amount of stock to the ESOP. The ESOP would receive the stock, and would owe the estate tax to the government, with the right to pay it over a period of years, just as the estate would have under § 6166. In fact, we would be willing to make that period of years even shorter than is provided under § 6166, so that the government would get its money faster. The government in most cases would also have a greater likelihood of actually being paid someday, since it would be owed by an employee group with a very strong interest in keeping the company alive and well. Accelerated payment of the tax bills may also result, since many ESOPs may want to get out from under the debt to the government as quickly as possible. The estate receives no windfall under this plan, because it still is parting with value equivalent to the estate tax it owes; it is simply enabled to pay in stock rather than in cash. Furthermore, this plan will enable many businesses to continue to operate that might otherwise be forced to liquidate in order to provide the cash to pay the estate taxes. Everyone benefits from this plan: the estate, the company, the government, and most of all the employees, who are given the opportunity to become substantial owners of capital. The ESOP Association urges the Congress to enact this sensible proposal as quickly as possible.

In conclusion, The ESOP Association does not believe that the estate tax ought to be abolished, or that it should be changed in such a way as to encourage the continued concentration of ownership in the hands of the few. Rather, it should be changed in such a way as to encourage a broadening of the private ownership of capital among millions of working Americans. Encouraging transfers to ESOPs is the most practical way now available to achieve this goal, and we have suggested two different methods for providing such encouragement. We would be delighted to work with any of the members of this Subcommittee to put these ideas in legislative form.

Thank you again for the opportunity to present these thoughts today.

ESOP ESTATE TAX ASSUMPTION PROPOSAL



STATEMENT BY

WILLIAM F. KOLBE

ON BEHALF OF

THE INDEPENDENT BUSINESS ASSOCIATION OF WISCONSIN

Mr. Chairman and members of the Committee, my name is William F. Kolbe. I am a practicing attorney in Racine, Wisconsin with the firm of DeMark, Kolbe, & Brodek S.C. I will first make some introductory statements concerning the Independent Business Association of Wisconsin and myself and then address myself to the impact of Federal Gift and Estate Taxes on small business.

The Independent Business Association of Wisconsin (IBAW) is in its tenth (10th) year representing independent owners and managers of Wisconsin small businesses. We generally define a small business as one having less than Five Hundred (500) employees and approximately ninety (90%) percent of our Six Hundred (600) members have less than Two Hundred (200) employees. Thirty-five (35) out of the fifty-three (53) delegates elected from Wisconsin to the White House Commission on Small Business,

which submitted its report in April of 1980, were members of IBAW. IBAW is a member of the Coalition of Small and Independent Business Associations and of "Small Business United", "Washington Presentation" which annually presents to the members of the House of Representatives and United States Senate the needs and recommendations of small business throughout the Country on many subjects. Their members will be visiting you next week, May 4th, 5th and 6th.

As to myself, I worked as a trial lawyer for the Tax Division, U.S. Department of Justice, representing the Internal Revenue Service, from 1955 until 1960 and have been engaged in the private practice of law, specializing in tax matters, from 1960 to date. For two (2) years I have taught at our State Bar Tax School and for eight (8) years I taught a course in adult education on estate planning at the University of Wisconsin. Our firm represents over One Hundred and Fifty (150) small closely-held businesses in Southeastern Wisconsin. We do not represent any publically traded companies. One of our primary and constant concerns is the impact of the Federal Estate Tax on those businesses. Please note that I am describing it as a tax on the businesses and not as a tax on the owners for this is where the problem lies and I will elaborate further on the importance of this distinction.

Let us first look at the role of small business in our economy, then at the amount of estate tax imposed upon it, the effect that the imposition of these taxes has on those businesses, whether that effect is acceptable and, finally, if not, what should be done about it.

As to the role of small business, President Reagan summarized the bottom line last Tuesday night when he noted that these businesses provide over fifty (50%) percent of all private employment and over eighty (80%) percent of all new jobs. Since these same businesses, by comparison, only provide forty-three (43%) percent of the Gross National Product, it is evident that they are more labor intensive than major industry and provide our most fruitful source for maintaining and creating jobs.

Federal Estate and Gift Taxes impose crushing burdens on these businesses--burdens which would destroy the major publically traded industries if they also had to bear them. This burden is illustrated by the following chart which is based upon these assumptions:

1) The business is owned by one generation,

2) Other assets such as the home, savings, life insurance, etc. produce additional tax which is absorbed by the Unified Credit, and

3) Deaths with and without a surviving spouse.

| Value of Business | One Death-No Surviving Spouse | Percent of Value | Two Deaths-- Surviving Spouse | Percent of value |
|---|---|---|---|---|
| 1MM | 345M | 34.5% | 311M | 31 % |
| 2MM | 780M | 39 % | 690M | 34.5% |
| 3MM | 1,290M | 43 % | 1,112M | 37 % |
| 4MM | 1,880M | 47 % | 1,560M | 39 % |
| 5MM | 2,550M | 51 % | 2,050M | 41 % |
| 14MM | 8,850M | 63 % | 7,900M | 56.4% |

Though Sections 6166, 6166 A and 303 of the Internal Revenue Code, Congress has provided for ten (10) and fifteen (15) year deferrals of this tax, bargain rate interest on the deferrals and for the tax-free extraction from the Company of the money necessary to pay the taxes. Due to these provisions many, but not all, small business which are not sold to larger businesses do manage to survive. However, many are sold to the large corporations. Racine, Wisconsin, where I practice law, is a City of approximately ninety-five thousand (95,000) in a metropolitan area of approximately two hundred thousand (200,000) and we have seen most of our major small businesses sold. Western

Publishing has been acquired by Mattel, J.I. Case and Walker Manufacturing have been acquired by Tenneco, Racine Hydraulics has been acquired by Rexnord, In-Sink-Erator and Dremel Manufacturing have been acquired by Emmertsen Electric, Jacobsen Lawn Mower has been acquired by Textron, Wrapping Machinery Company has been acquired by Reliance Electric Co., Hartman Hydraulics has been acquired by Kohring, Voorlas Manufacturing has been acquired by General Signal and lately Gettys Manufacturing has been acquired by Gould, Inc. From 1960 through 1976 there were 37,500 acquisitions small business which has resulted in a 24.5% decrease in small business contribution to the Gross National Product despite the fact that new business starts are averaging 1/2M per year. I have been Counsel in several of these acquisitions, I can assure the Committee that impending Federal Estate Taxes were a significant factor in the decisions to sell. For many companies there is really no other escape; it is impossible to pay out half (1/2) of a company's net worth, even over as much as fifteen (15) years with interest, and remain competitive--much less be able to grow. They do not wish to face the forced sale situation created on the first or second death and, therefore, select a negotiated sale prior to the owner's death.

Unlike owners of publically traded securities, the owner of a closely-held business cannot simply sell forty (40%) percent of the stock in order to raise the money to pay an effective forty (40%) percent tax rate on its value. No one is buying

minority interests in closely-held businesses and very few even wish to purchase control and then have to contend with continuing minority shareholders. The Congress has recognized this total lack of market by providing for the referred to deferrals in tax and for the tax-free withdrawal of funds to pay these taxes through stock redemptions. It is because the business itself is the only available purchaser that this Federal estate Tax is actually a tax on the business rather than upon its owners. It is the business that must marshall and payout these percentages of its total value and, where goodwill is a factor, any given percentage of value may be a much higher percentage of book or net asset value. Surely, if one of our major industries, such as IBM or General Motors, were to embark on a program of distributing over one-half (1/2) of its present value over the next ten (10) or fifteen (15) years it would simply cease to exist as a productive or competitive company. The same is true with small business. As an illustration of the problem, we are now working on an estate plan for a gentleman who owns seventy (70%) percent of his business. In order to provide for Federal Estate Taxes, which represent twenty-eight (28%) percent of the corporation's total value, management must institute plans of cash preservation which have stunted development of a new product and have prevented a plant addition. This Company will be stagnant for the next fifteen (15) years. This stagnant company will not provide jobs or be able to produce the production equipment which can increase productivity.

I have described these estate taxes as taxes on the business and not on the owners. This is because it is the business which will part with the capital to pay the tax. The inherited stock will certainly lose value but that will only have a serious effect on those inheriting it when and if the business is sold. The owners will still send their children to the same colleges, live in the same homes and generally maintain the same lifestyles. However, production machinery will not be purchased, workers may be laid off and those seeking new jobs will not find them. Those people are hurt immediately. I submit that this situation is unacceptable.

The White House Commission on Small Business, April 1980 Session, concluded that relieving this estate tax burden was the third most important thing which could be done to assist capital formation for small business; it rated only behind adjustment of income tax rates and depreciation reform. The Commission determined that it was fourth among its fifteen (15) top priority recommendations and was only preceded by income tax rate reductions, more rapid depreciation and balancing the Federal budget.

If the Congress concludes that the imposition of these estate taxes on small businesses is not acceptable, then the next question is "What should be done about it?" Perhaps I

should stop my presentation at this point as there are economists and tax technicians available to the Congress and the Treasury Department who can certainly come up with solutions. However, I do have these suggestions:

1. The tax would be deferred until the inherited stock is sold. Interest on that tax would result in basis reductions. Full implementation would require numerous technical provisions to achieve equity.

2. The deferral period could be further extended without interest and the interest not charged would be reflected in reduced basis.

3. The four (4%) percent interest now available under Section 6166 should be extended to 6166A and applied to the entire amount of deferred tax, under both Sections.

Thank you for the opportunity of addressing your Committee.

William F. Kolbe

Testimony of Donald Schapiro
before the Subcommittee on
Estate and Gift Taxation
of the Committee on Finance
United States Senate
May 1, 1981

The name of the witness is Donald Schapiro, partner in the law firm of Barrett Smith Schapiro Simon & Armstrong, 26 Broadway, New York, New York 10004, telephone (212) 422-8180.

A summary of the principal points included in the statement is as follows:

(1) Our present system of Federal estate and gift taxation frequently forces owners of family businesses to sell their businesses in anticipation of the need to pay estate taxes.

(2) Owners of family businesses suffer two major disadvantages under the estate and gift tax laws when compared with owners of publicly-held shares.

(a) The fact that shares of the family businesses are extremely difficult to value can add unacceptable uncertainty in the administration of the estate with respect to ultimate tax liabilities; and

(b) An interest in a family-held business is often virtually unsalable for cash except at extremely depressed prices so that the estate of the holder is faced with the prospect of having no liquidity with which to pay the estate tax.

Thus, it is often necessary for family businesses to be sold either before death to avoid burdening the decedents' heirs with the consequences of these disadvantages, or as soon as possible after death to obtain needed cash.

(3) By way of contrast, the holder of publicly traded shares can readily value his assets, and sell them or borrow against them to pay taxes. Because of these advantages, a holder of marketable securities who is subject to the highest estate tax brackets has the ability to pay estate taxes. More important perhaps, he can make lifetime gifts bearing an effective tax rate of between 42% and 50% as compared with an estate tax rate of 70%, thereby virtually doubling the amount passed on to the object of the donor's bounty.

(4) Lacking liquidity, the owner of a family business does not have the option of making lifetime gifts of shares in the business at far more favorable rates.

(5) In order both to encourage owners of family businesses not to sell, and to make it possible for them to pass their businesses to their heirs, we suggest the following:

(a) In the case of corporations which meet the test of being "family-held businesses", Section 303 of the Internal Revenue Code should be amended and expanded to apply to redemptions of stock for the payment of gift taxes or for the repayment of loans incurred to pay gift taxes.

(b) Interests in businesses which meet the test of being family-held businesses and which are transferred to family members should be specially valued for gift tax and estate tax purposes at 50% of the value that those interests would be assigned if the businesses did not meet the test of being family-held businesses, subject to appropriate "recapture" rules if the interests are later disposed of by family members within specified periods of time.

Testimony

My name is Donald Schapiro. I am a partner in the law firm of Barrett Smith Schapiro Simon & Armstrong in New York City.

* * *

The Congress has before it proposed legislation dealing with significant revisions of the estate tax. I will address myself to the problems of owners of family businesses presented by the present system of estate taxation.

The owner of a family business, upon being advised of the estate tax problems his family will face after his death, will frequently see no alternative but to sell out his business while he is alive.

The business owner is forced to reach the decision to sell because of the risks involved in continuing the business after his death and at the same time meeting uncertain estate tax obligations.

The decision to sell is compelled by two major disadvantages the owner of stock in a closely-held corporation suffers under the estate and gift tax laws, as compared with owners of publicly-held shares. First, the closely-held shares are difficult to value, and the

value ultimately to be assigned to them is uncertain and often determined only after lengthy proceedings; second, the closely-held interest is highly illiquid and, unlike publicly-held shares, cannot be converted to cash in whole or in part except at distress prices. Often, there is literally no fair market value for these interests in closely-held businesses.

The consequences of the two facts of difficulty of valuation and illiquidity frequently pose insuperable problems on the death of the holder of closely-held interests. The problems become more pronounced as estate tax rates rise and can be quite severe in the case of estates which will be taxed at the above 50% bracket.

Consider the dilemma of an executor of a decedent who died owning a majority interest in a closely-held business, and whose estate is in the 70% estate tax bracket.

In the first place, the executor has no idea of the size of the estate tax that the estate will have to pay, because he does not know at what amount the business will be valued in the tax proceeding.

Second, the closely-held business does not represent a liquid asset which he can sell, or use to support financing, to pay the tax that is finally determined.

Third, the executor frequently cannot consider electing a deferred estate tax payment program because he has no assurance that the continuing business will produce the necessary values to "buy back" the business from the government at a price of 70¢ for each dollar of the determined estate tax value, plus interest.

Faced with these insuperable problems, the executor will often be compelled to take immediate advantage of any sales opportunity that may be available. Frequently, the only opportunity will be to make a "fire sale". Or there may be no sales opportunity at all.

The owner of the family business, once having learned of the difficulties which can face his heirs, would be well advised to investigate the feasibility of making lifetime gifts to mitigate the estate tax impact at his death and, perhaps, allow his business to be retained by the family. However, he faces the same problems as his future executor: he cannot quantify his potential gift tax liability, and his business is not a liquid asset which can be used to provide payment of that liability.

When the family business owner compares his position to that of a holder of publicly-traded shares, his inclination to dispose of his business and convert the proceeds to liquid assets may well be confirmed.

The holder of publicly-held shares can pass those shares to his family by way of lifetime gifts at a federal gift tax cost of not more than 42¢ for each dollar available to make gifts and pay taxes,[1/] thus virtually doubling the amount which can be transferred to the objects of his bounty, as compared with an estate tax rate of 70%. The owner of publicly-held shares also has a readily available market to finance, by sale or by loan, the transfer tax on the gift.

The owner of a closely-held interest, by contrast (i) does not have the liquidity to make significant lifetime gifts, and (ii) is aware that his heirs will be faced with providing for federal estate taxes which will take up to 70¢ of each dollar of value he owns at his death.

In these circumstances, a decision by an owner of a closely-held business to sell his shares is economically sound.

In 1976, the Congress recognized the desirability of avoiding forced liquidation of family farms and real

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1/ Even if the publicly-held shares have a low cost basis, the aggregate tax cost of selling shares to fund the gift tax, plus the gift tax, will be less than 50% of each dollar available for the gift and tax.

property used by family businesses by enacting §2032A of the Code. That section permits such real property to be valued for estate tax purposes on the basis of its special use so long as that use continues for a specified period.

In order both to encourage owners of family businesses not to sell, and to make it possible for them to pass their businesses to their heirs, we suggest the following:

> (a) In the case of corporations which meet the test of being "family-held businesses", Section 303 of the Internal Revenue Code should be amended and expanded to apply to redemptions of stock for the payment of gift taxes or for the repayment of loans incurred to pay gift taxes.
>
> (b) Interests in businesses which meet the test of being family-held businesses and which are transferred to family members should be specially valued for gift tax and estate tax purposes at 50% of the value that those interests would be assigned if the businesses did not meet the test of being family-held businesses, subject to appropriate "recapture" rules if the interests are later disposed of by family members within specified periods of time.

For purposes of the above rules, we suggest that a "family-held business" be defined by taking into account the number of shareholders (with appropriate attribution rules), the relationship of ownership to management and the existence of business activity as compared with investments or other passive activity.

Since the purpose of the provision is to permit family transfers, and the estate tax rates rise with increases in value, we recommend that there be no limit on absolute size of the business or the interest. If it is a desirable policy to permit intra-family transfers of family businesses, the policy should apply no matter how large the business.

The special valuation rule, providing a 50% discount, should be subject to reversal and recapture if the business ceases to be a family-held business or if the transferred interest is not retained by family members for a designated period, possibly 10 years.

Thank you for the opportunity of appearing before the Committee.

Senator SYMMS. The committee will come to order. We will continue our consideration of various bills which have been introduced, this afternoon. Our witness is Mr. John G. Gourlay, from Jackson, Miss.

Is that correct, Mr. Gourlay?

Mr. GOURLAY. Yes, Senator; Jackson, Miss.

Senator SYMMS. Jackson, Miss., is a very pretty place. You have a very important assistant with you today.

Mr. GOURLAY. Well, we have been seeing some of the historical and other sights here in the city. I brought my son, George.

Senator SYMMS. That is wonderful.

Mr. GOURLAY. He is in the fourth grade.

Senator SYMMS. That is wonderful.

Please proceed.

## STATEMENT OF JOHN G. GOURLAY, JR., ESQ., JACKSON, MISS.

Mr. GOURLAY. First, I would like to apologize, Senator, for not being here this morning and making you come back. But I will keep my remarks to a bare minimum.

Senator SYMMS. Your apologies are unnecessary because we went faster than we even thought we could this morning. It was very easy for me to walk back over from my office. It would have been quite hard for you to fly back to Mississippi.

Go right ahead.

Mr. GOURLAY. Thank you, sir.

In 1976, on October 4, the President signed the Tax Reform Act of 1976, to become effective generally, December 31, 1976, and to apply to estates of decedents dying after December 31, whose estates could qualify, these decedents could elect section 2032A, of the Internal Revenue Code.

As to estates which were required to file their estate tax returns before July 13, 1978, no estate or no advisor could know with any certainty whether the estates would in fact qualify for 2032A.

The two clients who own family farms which we are representing, had estate tax returns that were required to be filed before July 13, 1978.

The attorney who was representing these two estates did not elect 2032A, the fact that it was irrevocable, and also, he didn't know for sure whether the estates would qualify for the election, when the returns were filed.

If regulations had been issued by the Service or if the information releases adequate to inform this attorney of 2032A, and the regulations and information that would be included in them had been released prior to the due dates, then he could have made a decision as to whether 2032A should have been elected.

But, unfortunately, there were no answers to his dilemma when the returns were filed.

Of course, as you are aware, there were many other complications with the new estate and gift tax laws that he and every other professional advisor had to answer also.

Our clients were discriminated against and penalized simply because their estate tax returns happened to fall due prior to July 13, 1978.

One of my partners, Warren B. Littleton, Jr., and I, are both active members of the Agriculture Committee of the Tax Section of the American Bar Association. We come into contact with attorneys and CPA's from across the country. We have been advised that similar estates whose returns were required to be filed before July 13, 1978, have likewise been penalized and denied 2032A.

This problem is not isolated in the State of Mississippi.

The proposed regulations which were first published by the Service on July 13, 1978, contain provisions for protective elections. This would have been ideal for both of the two estates we are representing, since the Internal Revenue Service, on audit, increased the value of the farm land as returned on one estate, by 600 percent, and increased the value of the farm land returned on the other estate by 400 percent.

Had a protective 2032A election been made, this would have eliminated all additional taxes, plus the cost of the estate and the small town attorney who is worried about a malpractice suit, having to pay legal fees and expenses and the anguish which the attorney has who failed to elect 2032A.

The proposed regulations not only allowed protective elections to be made, but they also allowed any 2032A elections that were made before the regulations were published to be revoked.

Had our attorney for our clients known this when he filed the estate tax returns, he would not have hesitated to elect 2032A.

But, frankly, he was afraid to leap into 2032A before he looked at the regulations.

Many questions about the availability of 2032A were answered by the regulations and much of the doubt as to when 2032A is available has been removed.

But, unfortunately, this came about at a time when it was too late for our estates to elect 2032A.

From October 4, 1976, when the President signed the Tax Reform Act of 1976, until July 13, 1978, when the first of the proposed regulations were issued, a period of 21 months and 10 days, the Internal Revenue Service, through its employees around the country, informally dispensed very much information, opinions and a lot of speculation about 2032A, what would be in the proposed regulations, et cetera.

It was obvious that no one in or out of the Service knew what estates would or would not qualify for 2032A.

The Service should have recognized the confusion that existed and should have issued information releases or some other forms of public announcements during this 21-month and 10-day period from October 4, 1976, when the last was enacted, until July 13, 1978, but they didn't.

Instead of doing this, they let many estates forgo the 2032A election; namely, those estates whose returns were required to be filed by July 13, 1978.

My partner who I referred to earlier, Warren Ludlum, and I, have been told of Internal Revenue Service employees telling, during this interim period, telling advisers, attorneys, and CPA's, that based on given facts, their estates would not qualify for 2032A.

Well, these advisers were told and didn't elect 2032A when they filed the estate tax returns. When the regulations subsequently

came out, it was clear from a reading of the regulations, that these estates would have so qualified. But it is too late now for them to elect 2032A.

As late as May 1979, Warren Ludlum, was told by a Service, Internal Revenue Service employee, here in Washington, D.C., that no estate tax return electing 2032A had been closed and that all district offices across the United States had been advised and instructed to pull all estate tax returns that had 2032A elections on.

I don't know whether the purpose of Internal Revenue in doing this was to compare these electing returns with the new regulations that it was promulgating, in order to be in a position to deny the elections to those estates which were not in compliance.

But, I suppose that this was one of those purposes.

This, I submit is unfair and it is one sided. Now, we are not complaining about the Internal Revenue Service being in the driver's seat. We are merely complaining about them not giving any turn signals.

Also, Senator, since most of the material participating that is required to elect 2032A is done, usually by the husband and the father, and since most women survive their husbands, and most farmers own their farm land, a marital deduction is usually decreased when a 2032A election is made with the direct tax benefit to the estate of the deceased farmer and husband being worth only one half of the 2032A reduction.

The other one half would otherwise be deducted as a marital deduction.

Also, since the heirs of 2032A land will take the lower 2032A value as their income tax basis, for purpose of later sale, the gain which will be ultimately subject to income tax, will be that much greater.

From a standpoint of tax revenue loss, the proposed bill introduced by Senator Cochran would, in my opinion, have a minimal impact upon the Treasury.

But the impact from a failure to enact Senate Bill 557 will profoundly affect our clients and many other estates around the country.

Especially one of our clients who bought his farmland during the 1930's and in fact bought it from the Federal Land Bank when no one else wanted to buy farm land in this area, he lived in a shack on his farm for years. He did virtually all of the physical labor himself, with his wife, and this poor man's farmland is going to have to be sold unless Senate Bill 557 is enacted or unless Internal Revenue Code of 1954, section 6166 will allow his estate to pay this additional estate tax in installments.

I submit that a failure to enact Senate Bill 557 will frustrate the intentions of Congress in enacting 2032A, in its original form; namely, to prevent the forced sale and liquidation of family farms to pay estate tax.

That is the end of my summary of my testimony, Senator.

Senator SYMMS. Well, I thank you very much for your testimony. Your entire statement will be made a part of our record. I am pleased you were able to testify today. The problem you are describing here in Mississippi, we have heard from people from Idaho

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who have exactly the same problem. I am sure this is true all over the country.

I was wondering what is your opinion of whether or not the Treasury and the new IRS Commission could do if they would side with congressional intent, because of the—rather than the regulations that were handed to them from the Carter administration. Do you think it would be possible they could reverse this thing?

Mr. GOURLAY. Well, the only problem that I see is if the statute of limitations on a refund of estate taxes would have run. I don't think they could administratively waive securing a refund of taxes brought about by electing 2032A.

Otherwise, I think they could.

Two years ago, when we first got in this, they could have done that. One of my law partners spent a lot of time in Washington, talking to the Service employees before the regulations came out. They were unwilling to administratively correct this oversight.

Senator SYMMS. Well, thank you very, very much.

The Chair will now announce that there are a few other witnesses who have contacted us. I would ask unanimous consent that Mr. Boyd Hill, among others, from Idaho, their testimony will be submitted to our record.

NEZPERCE, IDAHO, May 10, 1981.

ROBERT E. LIGHTHIZER,
*Chief Council, Senate Committee of Finance,*
*Washington, D.C.*

DEAR SIRS: As a farm wife and partner, I feel the Federal Estate and Inheritance tax laws should be repealed. This tax is unfair to the small businessman and farm, forcing sale of properties to pay the inheritance taxes. Widows are having to pay tax on what they helped their husbands accumulate. Grandpa Gertje died in 1940, with estate taxes of about $2,500.00 on 1280 acres. Grandma Gertje died in 1957, with estate taxes of $40,000.00 on 1280 acres, which was real bargain at that time. The costs of our estate taxes on 1160 acres (829 tillable) are so high we can't afford to die.

Laws to repeal Estate and Inheritance taxes should be enacted to save the small to medium American farms, which are the backbone of American Agriculture.

Sincerely,

LORENA THOMPSON.

P.S. Please make this statement part of the printed testimony.

STATEMENT OF JOHN G. GOURLAY, JR., ESQ., JACKSON, MISSISSIPPI
BEFORE THE SUBCOMMITTEE ON ESTATE AND GIFT TAX
OF THE SENATE FINANCE COMMITTEE
IN SUPPORT OF S. 557
INTRODUCED BY SENATOR COCHRAN
TO AMEND THE INTERNAL REVENUE CODE OF 1954 TO ALLOW
ESTATES REQUIRED TO FILE ESTATE TAX RETURNS BEFORE
JULY 13, 1978, TO ELECT THE VALUATION OF CERTAIN FARM,
AND SO FORTH, REAL PROPERTY UNDER SECTION 2032A OF SUCH
CODE WITHIN NINETY DAYS AFTER THE ENACTMENT OF THE
AMENDMENT TO SUCH CODE PROPOSED BY THIS BILL.

Submitted by
John G. Gourlay, Jr., Esq.,
On Behalf of Two Clients, Estates Owning
Family Farms in Copiah and Hinds Counties, Mississippi

May 1, 1981

STATEMENT OF JOHN G. GOURLAY, JR., ESQ., JACKSON, MISSISSIPPI
BEFORE THE SUBCOMMITTEE ON ESTATE AND GIFT TAX
OF THE SENATE FINANCE COMMITTEE
IN SUPPORT OF S. 557
INTRODUCED BY SENATOR COCHRAN
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Submitted by
John G. Gourlay, Jr., Esq.,
On Behalf of Two Clients, Estates Owning
Family Farms in Copiah and Hinds Counties, Mississippi

May 1, 1981

Section 2032A of the Internal Revenue Code of 1954, as amended, was enacted by the Tax Reform Act of 1976 to avoid the forced sale of farms and small businesses by estates to pay Federal estate taxes. Subject to certain requirements, this section provides for the election of a special use valuation which allows a farm or small business to be valued on the basis of its actual use rather than its highest and best use. Through the use of the special use valuation, many estates have been able to avoid selling farms and small businesses because of lower valuations and the resulting lower estate taxes. Unfortunately, because of a protracted delay in implementation of regulations pursuant to Section 2032A, certain estates have been unable to avail themselves of the special use valuation. Also, a failure of Treasury to issue timely

information releases and other public pronouncements relating to the manner of electing special use valuation before the regulations were implemented, severely prejudiced many estates which were required to file estate tax returns before the regulations, in proposed form, were implemented.

As to making the election, Section 2032A(d)(1) provides as follows:

> "(1) ELECTION. - The election under this section shall be made not later than the time prescribed by section 6075(a) for filing the return of tax imposed by section 2001 (including extensions thereof), and shall be made in such manner as the Secretary or his delegate shall by regulations prescribe."

Section 6075(a) provides that estate tax returns shall be filed within nine months after the date of the decedent's death.

Section 6081 provides that generally an extension of time for filing returns, including estate tax returns, shall not exceed six months.

Section 2001 imposes the estate tax.

Although Section 2032A was effective for estates of decedents dying after December 31, 1976, the <u>first</u> proposed regulations issued under Section 2032A(d)(1) were not published until July 13, 1978.* As a result, the time prescribed for filing the estate tax return (determined without regard to extensions) expired for many estates before the publication of any regulations. Without the benefit of the regulations, and having no knowledge that the proposed regulations would allow protective elections and elections

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*These and subsequently proposed Section 2032A regulations were finally adopted on July 28, 1980 by T.D. 7710.

which were made before the regulations were issued to be revoked, many estates decided not to elect the special use valuation simply because their advisers were unwilling to leap before they looked. When the estates attempted to make the election on an amended return after publication of the proposed regulations, the Service refused to accept the election.

The following are relevant facts as to the questions involved with regard to the two estates which have retained us. These estates will be referred to as "The April, 1977 Estate" and "The May, 1977 Estate," these being the months in which the respective decedents died.

The April, 1977 Estate -- The decedent died on April 29, 1977. The estate tax return was filed on January 27, 1978 but 2032A was not elected. The audit of the return was begun in June, 1978, and the first of the 2032A proposed regulations, i.e., Section 20.2032A-8, was published on July 13, 1978. The attorney filed an amended estate tax return making the election on September 14, 1978. On December 13, 1978 by letter to the attorney, the Mississippi IRS District Director's office acknowledged a Notice of Intention to Elect and stated that an Amended Notice should be filed by January 15, 1979, which Amended Notice was filed on January 10, 1979. Thereafter, on January 26, 1979 the IRS estate tax examiner notified the attorney by telephone that IRS had determined that the 2032A(d)(1) election should have been made when the original estate tax return was filed (January 27, 1978), and, therefore, that the election was too late and was not effective.

The <u>May, 1977 Estate</u> -- The decedent died on May 13, 1977. The original estate tax return was filed on October 28, 1977, but 2032A was not elected. The audit of the return was begun in June, 1978, and the first of the 2032A proposed regulations, i.e., Section 20.2032A-8, was published on July 13, 1978. The attorney filed an amended estate tax return making the election on August 31, 1978. On December 13, 1978 by letter to the attorney, the Mississippi IRS District Director's office acknowledged a Notice of Intention to Elect and stated that an Amended Notice should be filed by January 15, 1979, which Amended Notice was filed on January 10, 1979. Thereafter, on January 26, 1979 the IRS estate tax examiner notified the attorney by telephone that IRS had determined that the 2032A(d)(1) election should have been made when the original return was filed (October 28, 1977); and, therefore, that the election was too late and was not effective.

Both estate tax returns were assigned for audit to the same estate tax examiner. One was assigned in June, 1978 and the other in July, 1978. In a conference before the proposed regulations were issued, the question was raised whether the farm land in each of the estates would qualify for the 2032A special use valuation. No conclusion was reached. The examiner, however, agreed to send the attorney the proposed regulations when he received them. The examiner furnished the proposed regulations to the attorney on September 8, 1978, which was after the attorney had filed the amended return for The May, 1977 Estate on August 31, 1978, but before he filed the amended return for The April, 1977 Estate on

September 14, 1978. The attorney had obtained the proposed 2032A regulations elsewhere before the examiner furnished them to him.

This attorney, who prepared the estate tax returns, is engaged in general practice in a town, the 1980 population of which was less than 4,400. Although the attorney has for many years handled the administration of estates and the preparation of estate tax returns, he does not purport to be a tax specialist.

The proposed regulations, Section 20.2032A-8, which deal with the manner of making the 1954 I.R.C. Section 2032A(d)(1) election, were published on July 13, 1978. Therein it was provided that they may be relied on, even though not final, to the extent they relate to the procedure for making the 2032A, etc. elections, for those which are ". . . made before the date which is 30 days after publication of final regulations detailing the procedures for making these elections." Section 20.2032A-8 was partially amended on December 21, 1978 by Section 20.2032A-8(a)(1) and was expanded, also on December 21, 1978, by Section 20.2032A-8(d). The proposed regulations, Sections 20.2032A-3 and -4(a)-(e), inclusive, which deal with other 2032A matters (material participation requirements, methods of valuing farm property, determination of gross cash rental, determination of state and local real estate taxes, definition of comparable real property, and definition of effective interest rates) were published on July 19, 1978. On September 10, 1979 Section 20.2032A-4(b) which was published on July 19, 1978 was withdrawn and replaced by a new Section 20.2032A-4(b), proposing a more restrictive method for determining gross cash rentals. The

pre-final reliance provision was included only in Section 20.2032A-8, -8(a)(1) and -8(d). It was not included in Sections 20.2032A-3, -4(a), -4(b) (as proposed on July 19, 1978 and as re-proposed on September 10, 1979), -4(c), -4(d) and -4(e); and, therefore, they could not be relied on until they were finally adopted.* Thus, representatives of estates, for which the time prescribed for filing estate tax returns expired before the publication of the first Section 2032A proposed regulation on July 13, 1978 had no guidance with regard to the election of Code section 2032A special use valuation, and IRS had not issued any interim instructions during the intervening one and one-half year period from January 1, 1976.

The overall question is whether the section 2032A(d)(1) estate tax special use valuation election for certain farm, etc. real property, if not made on an estate tax return for which the time prescribed for filing (determined without regard to extensions) expired before July 13, 1978 may be made for the first time under that section at a later date within a reasonable time after the section 2032A proposed regulations become final.

The Treasury and the Service have taken the position that the 2032A election may not be made in any way after the due date of the estate tax return (including extensions thereof). In support of their position: (1) they cite their interpretation of the phrase in section 2032A(d)(1), and (2) the interpretation by the

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*The proposed regulations have been finally adopted; and the regulations are now effective for estates of decedents dying after December 31, 1976.

courts of what they contend is a similar phrase in section 2032(c) (which pertains to the alternate valuation date). They contend that the concluding phrase in section 2032A(d)(1), ". . . and shall be made in such manner as the Secretary or his delegate shall by regulations prescribe" does not make these cited precedents inapplicable, because they contend that such concluding phrase requires the publication of regulations only as to the "manner" or procedure or method by which the 2032A election itself should be made, that this concluding phrase was not intended to provide that the election could be postponed until regulations dealing with other 2032A questions than the "manner" in which the election should be made, should be published, and that the requirements of the concluding phrase were satisfied by the provisions made in item 12 of the federal estate tax return Form 706, when it was revised in June, 1977, and in the three paragraphs on the form, which followed the item 12 question: "Is the special valuation authorized in Section 2032A elected for certain farm, etc., real property? . . . _____Yes _____No."

In addition, some Service representatives have said that since there is no provision in the Code permitting the filing of amended estate tax returns (even though they are frequently filed by taxpayers and accepted by the Service), no amended return may be filed and, therefore, an election on an amended return is a nullity. Those who have made this point, however, have not dealt with the question of whether the election may be made by a claim for refund and whether the election made on the amended estate tax

return will be treated as a claim for refund of the amount by which the estate taxes previously paid with the original estate tax return are reduced as a result of the 2032A election.

The Service issued Private Letter Ruling 8029009 on April 14, 1980 and officially ruled that a 2032A election could not be made subsequent to the due date (including extensions) of the estate tax return.

The above described problem in each instance involves not only the estate tax liability of the estate but it also involves the professional adviser who prepared or advised as to the original estate tax return on which the 2032A election was not made, because it raises a very real question of malpractice.

Due to the Treasury and the Service being so dilatory in issuing regulations, and the total absence of guidance from them for over one and one-half years, many attorneys during this period refused to make estate tax returns involving farmlands, giving this responsibility (and presumably any potential professional malpractice) to the estates' C.P.A.s and accountants, many of whom were unaware of the benefits of 2032A and thus, needlessly costing otherwise qualifying estates unnecessary estate tax.

Myself and another attorney in our law firm, Warren V. Ludlam, Jr., have talked with many attorneys and accountants from other states to see if they have encountered similar problems with regard to the 2032A(d)(1) election and, what the Service has done with regard to them.

One attorney reported that in his state the Service's official

position is that when an amended return elects 2032A initially, the 2032A election is barred on the following ground: (1) Such election was not timely made on the original return, under the express terms of 2032A. (2) There is no provision in the Code specifically allowing or authorizing an amended estate tax return, Form 706. He further stated that unofficially, since there is a very real question of malpractice on the part of an attorney filing a 706 without a proper 2032A election during the interim period prior to the publishing of proposed regulations on July 13, 1978, Service supervisors did not discount the possibility that an examining agent might have, in certain instances, allowed a subsequent 2032A election to be considered as a valid election, or stretched the election procedure to a point where they were interpreting that there had been a valid election even though the same might have been only a cover letter inquiring about 2032A, in order to prevent an attorney from being sued for malpractice, for what the Service personnel considered to be an obvious error. This attorney also related to me that he had been told by another attorney of a situation where the other attorney was permitted to make the 2032A election for the first time, when the audit of the estate tax return was begun.

An accountant in an international accounting firm stated that his office, in a large mid-West city, is handling a matter where a 2032A election was made on an amended return sometime after the original estate tax return had been prepared and filed by the attorney for the estate. When the accounting firm saw the return

with no 2032A election, it filed an amended return making the 2032A election. This accountant stated that the decedent died in 1977, and the estate tax return was required to be filed before the first proposed 2032A regulations were published on July 13, 1978.

Another attorney has stated that he knows of many estates facing problems similar to those of our two estates. He particularly mentioned that in several instances he contacted IRS for information about various aspects of 2032A and what the proposed regulations might or might not contain with regard to his questions, and was given information by Service representatives which caused him to believe that his particular estates, whose estate tax returns had to be filed before the 2032A proposed regulations were published, would not qualify for the 2032A election, whereupon he did not make the election when the returns were filed; and that under the provisions of the proposed 2032A regulations his estate would have indeed qualified for 2032A.

A preparer of the 2032A proposed regulations has stated that as late as the first of May, 1979 no estate tax return, as to which the 2032A election was made, either with the return or after the return was filed, had been closed. He stated that early in 1979 a directive was sent to Service personnel throughout the country, ordering them to pull and review all such estate tax returns.

The positions of the Treasury and Service representatives and the information obtained by Warren V. Ludlam, Jr., and myself

from other attorneys and accountants raise the following questions:

(1) Have phrases in other Code provisions, similar to the first phrase in section 2032A(d)(1), been interpreted by Treasury, the Service or the courts over a long period of time to require that the election must be made in all events not later than the time prescribed for filing the return to which the election relates, including any extension thereof?

(2) If it is assumed that the answer to (1) is "Yes," do any of the surrounding circumstances make such interpretation of the first phrase inapplicable to section 2032A(d)(1) or justify some sort of exception from the long standing interpretation with regard to the section 2032A(d)(1) election for estates as to which estate tax returns were required by law to be filed before the publication of the first section 2032A regulations or justify this proposed legislation to permit a late election of 2032A? Some of the surrounding circumstances which may be considered are:

(a) Unlike other Code provisions, which contain phrases similar to the first phrase, section 2032A(d)(1) contains a second phrase, to-wit: ". . . and shall be made in such manner as the Secretary or his delegate shall by regulations prescribe . . ." (italics ours), which may be interpreted to mean that the time for the making of the election, specified in the first phrase, shall be postponed until the first regulations were published. This second phrase, if so interpreted, makes it impossible to comply with the statute in the situation where the time for filing the return expired before the publication of the proposed regulations.

(b) Congress intended section 2032A to be a relief provision for certain classes of estates. There is nothing in the statute or its history to indicate that Congress intended a harsh, literal interpretation of any part of the statute, particularly the election provisions. There is no policy or administrative reason which justifies requiring the election to be made before publication of the first proposed regulations.

(c) The particular situation which justifies the making of the election after the return has been filed, can easily be limited so that it will not occur again. Permission to make the election after the filing of the return will be limited to those situations, where the return was required to be filed before the July 13, 1978 publication date of the first proposed 2032A regulations.

(d) Section 2032A introduced into the estate tax law an entirely new concept of property valuation. It contained many new and difficult-to-understand provisions, e.g., the estate tax recapture provisions. It involved certain old farming tax principles, which are difficult to understand, such as "material participation." It was adopted simultaneously with other major tax reformations, e.g., (1) unification of the previously separate gift and estate tax systems into a unified tax system and (2) changing the at-death-stepped-up-basis for estate property to the new carryover basis system which was repealed. There were many questions about situations where 2032A could be used--e.g., (1) whether it could be used in situations, where the real properties had no higher and better use than farming, etc.; (2) whether it

could be used where there were no comparable properties being rented for cash in the vicinity, from which the average rentals factor for the farm valuation formula could be derived. Only recently has the Service answered those questions. Many estate representatives and professionals thought or had been led to believe that the answers would be "no," with the result that 2032A was not elected; and Treasury and the Service now contend that it is too late to elect it. They have vacillated on the second question as evidenced by withdrawal on September 10, 1979 of then proposed regulation section 20.2032A-4(b) and the new proposal on the same date of a replacement regulation on the same subject. There was and still is much controversy about the desirability of electing 2032A. In the absence of proposed regulations and adequate official information releases, for the year 1977 and the first half of 1978, it was difficult for even experienced tax practitioners to advise estates pertaining to the election of 2032A. The situation resulted in blind advice being given with the real possibility that making the 2032A election could possibly cause irrevocable damage or problems to the estate and its heirs later on. Failure to issue the 2032A regulations and vacillation by Treasury and the Service on many 2032A questions caused this uncertainty to become even more burdensome for estates and their representatives and professional advisers. An inherently complicated subject was made more so by the failure of Treasury and the Service before July 28, 1980 to provide firm guidance which could be relied on.

(e) It is reasonable to assume that a substantial number of estate tax returns are prepared by persons who are not professionals or who are not experienced in tax matters. Certainly, 2032A is even more of a mystery to them. In addition, such persons could be expected (1) to interpret the second phrase of 2032A(d)(1) as providing for the delay of the making of the election until the proposed 2032A regulations become final, and (2) to overlook the 2032A provisions placed on Form 706 in June, 1977.

(f) The publication of the proposed 2032A regulations was delayed for an extraordinarily long period of time after enactment of Code section 2032A, in view of the facts, that 2032A embodied a new and novel concept in estate tax property valuation and was very complicated.* Even the preparers of the proposed regulations have had difficulty in understanding many of its provisions and in resolving many problems with regard to same. Other IRS personnel have had similar difficulties with it. This has resulted in the dispensation of much information and many personal observations about 2032A which were either inaccurate, or which were not later confirmed by, or included in, the proposed regulations. Occasionally, tax practitioners were told that particular provisions of 2032A would be interpreted in certain ways when the proposed regulations were issued, which advice caused some practitioners to advise their clients that 2032A could not be elected. Subsequently,

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*Section 2032A became effective on December 31, 1976. The first proposed 2032A regulation was issued over a year and a half later on July 13, 1978. Another two years elapsed before the proposed 2032A regulations became final on July 28, 1980.

the interpretation adopted in the proposed regulations was such that 2032A could have been elected by these estates but the Service now takes the position that an election should have been made on the returns when originally filed and that it is too late to make it.

(g) A preparer of the proposed 2032A regulations stated to Warren V. Ludlam, Jr. early in 1979 that no estate tax return, as to which 2032A was elected, had been closed and that certain IRS personnel were directed to pull and review all such returns. Thus, as to such estates which were not closed before the proposed 2032A regulations beame final on July 28, 1980, the Service could deny them 2032A because of failure to comply with the provisions of the final regulations. Conversely, estates of decedents dying after December 31, 1976, for which returns were required to be filed (determined without regard to extensions) before the publication of the first proposed regulations, should be permitted a reasonable time after the regulations became final, to elect initially 2032A where they qualify for same under the final regulations.

(h) In the past, with regard to other elections provided by the Code, the Service initially has been lenient as to the time and manner of making them. If it was not going to be lenient with regard to the 2032A election, it should have immediately after December 31, 1976 published something to that effect, and publicly advised that protective elections could be made, and that elections made before the proposed regulations were issued could be subse-

quently revoked. Service representatives, nevertheless, up until July 13, 1978 continually dispensed information about 2032A which was confusing, and in some cases inaccurate. Experienced tax practitioners and Service personnel have stated in lectures that they believed the Service should be lenient in permitting 2032A elections by amended returns for a reasonable period of time. The proposed regulations themselves confused the matter: Section 20.2032A-8 (the proposed regulations relating to elections allowed under sections 2032A) never stated that the election must be made at the time the estate tax return is filed. Instead, in section 20.2032A-8(a)(2) the following appears: "Time and manner of making election. An election under this section is exercised by attaching to a timely filed estate tax return . . ." Note the use of the word "is" instead of such words as "shall be," "must be" or "is exercised only." Also section 20.2032A-8(b) which contains the provisions for Protective Elections, provides: "If it is subsequently determined that the estate qualifies for special use valuation or that estate tax is due, an additional notice of election must be filed within 60 days after the date of such determination if the executor desires to use the special use valuation under section 2032A." Persons other than skilled tax practitioners are apt to read such provisions out of context and to conclude that the proposed regulations thus provide for the filing of a late 2032A election at a time substantially after the original estate tax return has been filed. In the instance of the two estates, represented by our law firm, the Mississippi District

Director sent out letters in December, 1978, advising the attorney who prepared the estate tax returns that the 2032A elections previously made in August and September, 1978 by amended returns should be refiled, with the result that the attorney for the two estates spent approximately a week of time and much out-of-pocket money in repreparing and refiling the elections to conform to the proposed regulations, which the Mississippi District Director's office rejected. Possibly the representatives of other estates have been similarly misled.

(i) In other Internal Revenue Service Districts, as indicated above, Service personnel are reported to have permitted late 2032A elections.

(j) The proposed 2032A regulations took the approach of providing for protective elections, which could be subsequently revoked. The proposed regulations preparers should have assumed that many persons who were in doubt about 2032A in the absence of proposed regulations, would not think of the possibility of making a protective election which could subsequently be revoked, if desired. On the basis of this assumption, the proposed regulations, should have included, a provision for a late election within a reasonable time after the proposed regulations become final.

(k) We have talked to a number of people in the Service and the Treasury about the question of permitting a 2032A election to be made after the estate tax return is filed. Several recognized the harshness of the Service's position, recognized the malpractice

risk to attorneys and other tax advisers who prepared the original returns, and expressed sympathy with the executors of the estates, their heirs and their tax advisers.

(1) The proposed 2032A regulations published on July 13, 1978, same being section 20.2032A-8, were particularly misleading and in the instance of the two estates, represented by our law firm, probably caused the attorney involved to think that the elections could be made even though they had not been made when the original estate tax returns were filed. Subsection (d) reads as follows:

> "Special rule fo estates for which elections under section 2032A are made before September 15, 1978. An election to specially value real property under section 2032A that is made before September 15, 1978 will be treated as a notice of intention to elect under the provisions of this section. For the election to be effective the executor must file an amended notice of election which meets the requirements of this section before January 15, 1979. The amended notice of election is to be attached to an amended estate tax return and is to be filed with the Internal Revenue Service Office where the original estate tax return was filed. If no action to conform the election to the requirements of this section is taken by the executor before the prescribed date, the election will be deemed never to have been made and the payment of any additional tax will be due upon notice and demand."

This paragraph was probably misleading to personnel in the Mississippi District Director's office. In the case of the attorney, it probably caused him to file an amended return for one of the estates in August, 1978 and for the other estate on September 14, 1978. In the case of the District Director's personnel, it may have caused them to send in December, 1978 notices to the two estates that the elections made with the amended returns, filed in

August and September, 1978, should be refiled. In addition, with regard to the contention of some Service personnel that amended estate tax returns are not permitted and that elections made on or with amended estate tax returns are, therefore, a nullity, note the provision for "an amended estate tax return" in this proposed regulation.

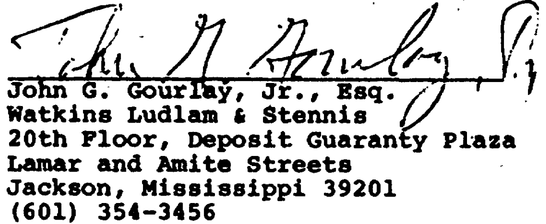
(m) Relatively few persons outside the government knew in October, 1977 and January, 1978, when the estate tax returns for the two estates we are representing were filed, that the regulations to be proposed would include provisions for "protective elections," which could be revoked, and for "notices of intention to elect." Neither section 2032A of the Code nor Form 706 (rev. 6-77), the estate tax return, or the instructions issued for preparation of Form 706, gave any indication that this would be provided.

Senator Cochran of Mississippi has introduced S. 557 which would make Section 2032A available to estates which were required to file their estate tax return prior to the issuance of the proposed regulations. S. 557 would allow estates for which the time prescribed for filing the estate tax return (determined without regard to extensions) expired before July 13, 1978 to make the election within 90 days after the date of enactment of S. 557. The bill also provides for refunds to be claimed within this 90 day period.

The enactment of S. 557 is necessary to insure that the Congressional intent expressed by Section 2032A is implemented by the Treasury and the Service. If S. 557 is not enacted, many

estates which would have elected Section 2032A if adequate guidance by regulations or otherwise had been available, will not be allowed to elect the special use valuation and will be forced to liquidate their farms and small business to pay the estate tax.

The American Farm Bureau Federation, the National Cattlemen's Association, and the National Association of Realtors support S. 557.



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Senate SYMMS. I think the Chair will keep the record open until we have a hearing. We are going to continue on with a series of hearings on the subject. This chairman is not going to rest easily until we totally abolish the inheritance tax, because the gentleman, Mr. Gourlay, is just pointing out another gross inequity and disparity which has come about because of this tax law which is just a bad law all around.

It doesn't create a lot of revenue. It does a great deal of damage to the accumulation of capital for jobs and the future of the country. It destroys the family unit, as well as family farm, family business.

The sooner the better this law will be done away with.

Having said that, the committee stands adjourned until the call of the Chair.

[Whereupon, at 1:20 p.m., the hearing adjourned, subject to the call of the Chair.]

[By direction of the chairman the following communications were made a part of the hearing record:]

RICHARD G. LUGAR
INDIANA

[illegible]
WASHINGTON, D.C. [illegible]

INDIANA OFFICE:
[illegible] EAST OHIO STREET, ROOM [illegible]
INDIANAPOLIS, INDIANA [illegible]

**United States Senate**

WASHINGTON, D.C. [illegible]

COMMITTEES:
AGRICULTURE, NUTRITION, AND FORESTRY
BANKING, HOUSING, AND URBAN AFFAIRS
FOREIGN RELATIONS
SELECT COMMITTEE ON INTELLIGENCE

April 29, 1981

The Honorable Robert Dole
Chairman
Senate Finance Committee

Dear Mr. Chairman:

The Special Use Valuation provisions of Section 2032 A, and regulations issued pursuant thereto, are of considerable interest to me and many of my constituents in agricultural areas of Indiana. William J. Caron, a CPA from Indianapolis, Indiana, has prepared an excellent memorandum concerning the practical difficulties involving the regulations implementing Section 2032 A.

I am aware that hearings have been scheduled in the Senate Finance Committee concerning the various proposals relative to estate tax issues. I would appreciate having Mr. Caron's memorandum included in the hearing record of these hearings.

I thank you, in advance, for this request.

Sincerely,

Richard G. Lugar

RGL:bkf

Enclosure

**Family Farms and Small Business**
**Federal Estate Tax**
**Special Use Valuation Under Sec. 2032 A**
**Deferred Payment of Federal Estate Tax Under Sec. 6166**

**Background:**

In the President's State of the Union Message of January 19, 1976 the following statement was made:

> . . . also for the sake of future generations we must preserve the family farm and family-owned small businesses. Both strengthen America and give stability to our economy.
>
> I will propose estate tax changes so that family businesses and family farms can be handed down from generation to generation without having to be sold to pay taxes.

The 94th Congress did in fact enact legislation in the Tax Reform Act of 1976 to carry out the above objectives. Sec. 2032 A provides in general that, if certain conditions are met, the executor of an estate may elect to value qualified real property on the basis of such property's value in its current use rather than on the basis of its highest and best use. The special valuation in any event may not be used to decrease the value of an estate by more than $500,000. Based on experience in Indiana, this has produced special use values on farm land in the range of $1,000 to $1,500 per acre rather than the higher investment values ranging as high as from $3,000 to $4,000.

Since enactment, the Internal Revenue Service has adopted an extremely limited interpretation of the law. While exact percentages are not generally available to tax practitioners, there are very few estates who elected special use valuation who are able to retain this election on examination. It is believed the primary difficulty is that Congress did not give proper consideration to the time required for advance planning to meet certain of the tests

which requires a look back for as many as eight years prior to death. Most of the estates that are being denied these benefits are those where the decedent farmer had retired prior to death and could not have been aware of the pre-planning required.

In a typical situation, a farmer who has attained age 65 and who has decided to quit active farming will thereafter either cash rent and sharecrop the land with a tenant. If he desires to draw Social Security benefits, he will either (1) cash rent only, (2) share crop without furnishing any material participation on his part, or (3) keep his earned income under the Social Security limits set at $5,500 in 1980. It is believed that most farmers who have retired have followed one of the above plans.

Sec. 2032 A (b)(1)(c) provides in part that property may qualify for special use if during an eight year period prior to death the decedent or a member of his family owned the property and there was material participation by the decedent or a member of his family. Clearly, this concept adopted a theory that the qualifying test related to a farm family as a unit and was not limited to the decedent's activity at the time of death. However, Sec. 2032 (b)(2)(A) provides that "qualified use" means the devotion of the property to the use as a farm for farming purposes, but does not mention whether this particular test related to the family unit or the decedents use at the time of death.

In the General Explanation of the Tax Reform Act of 1976 prepared by the Staff of the Joint Committee on Taxation on December 26, 1976, this question of use was examined in more detail. A statement was made that "Congress intended that there must be a trade or business use of qualifying property. The mere passive rental of property will not qualify. However, where a related party leases the property and conducts farming or other business activities on the property, the real property may qualify for special use valuation.

For example, if A, the decedent, owned real property which he leased for use as a farm to the ABC partnership in which he and his sons, B and C, each had a one-third interest in profits and capital, the real property could qualify for special use valuation."

Final regulations were adopted by the Internal Revenue Service on July 28, 1980 in T.D. 7710. Reg. 20 2032 A-3(b) is quoted in part:

> . . . all specially valued property must be used in a trade or business. Directly owned real property that is leased by a decedent to a separate closely held business is considered to be qualified real property, but only if the separate business qualifies as a closely held business under section 6166 (b)(1) with respect to the decedent on the date of his or her death and for sufficient other time (combined with periods during which the property was operated as a proprietorship) to equal at least 5 years of the 8 year period preceding death. For example, real property owned by the decedent and leased to a farming corporation or partnership owned and operated entirely by the decedent and fewer than 15 members of the decedent's family is eligible for special use valuation.---The mere passive rental of property will not qualify. The decedent must own an equity interest in the farm operation.

The Internal Revenue Service therefore recognizes that leased property may qualify, but limits qualification to situations where farm property is leased to farming entities solely of family members and the decedent must have an equity interest in the farming operations. The Service doesn't indicate what percentage of equity ownership is required although the Staff of the

Joint Committee indicated a one-third partnership interest by the decedent would qualify. This hard line leads to a definite inequity. For example, assume Farmer A had retired in 1971 and cash rented his farm to his two sons until his death in 1979. Also assume the sons actually farmed the leased property individually as a trade or business for the entire eight years. Under the regulations, the property would not qualify since the decedent did not have an equity interest in the farming operations. If the sons had formed a partnership prior to their father's death and included him in the partnership for a five percent interest, the property would apparently qualify. No justification for this requirement appears reasonable. Of course, with proper planning the regulations can be complied with in the future, but not for taxpayers dying after 12/31/76 and prior to 7/28/80 who had failed to establish partnerships with their family members.

Assuming that an estate can overcome the cash rent problem, the farm may still not qualify if there is a possibility that the qualified property will pass to a trust under the decedent's will. Sec. 2032 A (b) provides in part that property must pass to a qualified heir. The Conference Committee on the 1976 Tax Reform Act further amplified this rule by stating that if an interest in property is transferred to a trust the qualified heir must have a present interest in the trust. The Internal Revenue Service then took the position in Reg. 20 2032 A-3 (b)(1) that the definition of a present interest for this purpose would be the same as used for gift tax purposes under Reg. 25 2503-3(b). For gift tax purposes, only present interests qualify for the annual $3,000 exclusion. Otherwise the question of whether an interest is a "present interest" or a future interest has no affect on estate tax liability.

As a general rule a good estate plan will provide for a distribution of up to 50% of an estate to a surviving spouse which is the maximum marital deduction. The remaining assets of the estate will pass to a trust over which

the surviving spouse will have no control to avoid having the trust property taxed in the surviving spouse's estate. In order to provide full protection for the surviving spouse, an independent Trustee will be given powers to distribute income and or principal to the surviving spouse if needed to maintain proper support. If the Trustee decides he or she does not need additional income he is usually given the power to accumulate income or distribute the income to other trust beneficiaries. For gift tax purposes, only, this power to accumulate income would constitute a future interest.

Under the regulations adopted, this common provision for a Trustee to accumulate income will disqualify farm property from special use valuation even though the only beneficiaries of the trust are qualified heirs and even though qualified heirs may continue to cash rent or sharecrop any farm property held by the trust. Again, this position fails to look at the farm family as a unit and negates the original intent to preserve the family farm by providing relief from estate tax. Prior to the issuance of the regulations, it would not have been reasonable to suspect the IRS would adopt this position so that trusts could be amended. The power of a Trustee to accumulate income has no effect on the calculation of estate tax other than for a determination as to whether farm property qualifies for special use valuation.

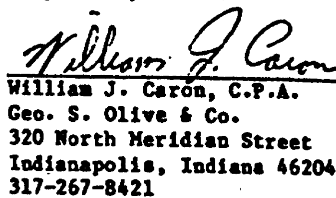
In addition to the special use valuation provision, an estate may also qualify for an election to pay estate over an extended period of time up to fifteen years. This was intended to provide relief for estates consisting primarily of interests in a closely held business, including farms. Sec. 6166 (a)(7) indicates that only property used in a trade or business will qualify for deferred payment of tax. There is no statutory definition of a farm or a trade or business for this purpose. However, the Internal Revenue Service in Rev. Rul. 75-365 and Rev. Rul. 75-366 took a position that Sec. 6166 was

intended to apply only to a business such as manufacturing, mercantile or service enterprise, as distinguished from management of investment assets. Thus farm land which was cash rented would not qualify, but farm land which was sharecropped and with which the owner participated in the management would qualify. Unlike Sec. 2032 A there is no provision in Sec. 6166 relating to a farm family for qualifying purposes except where interests are held in partnership or corporate farms. The position of the Service was further amplified in private letter rulings 8020101 where farm land was rented on a fixed basis without management participation.

The purpose of this memo is to indicate that relief from estate taxes is not being provided to a large proportion of farm estates. If family farms are to be preserved, both Sec. 2032 A and Sec. 6166 should be amended retroactively to permit profit sharing arrangements among family members, including cash or fixed rentals, as long as at least one family member is materially participating in the operation and/or management of the farm. Also, the definition of a present interest in a trust should be codified to permit accumulation of income in a trust as long as the eventual beneficiary or beneficiaries of the trust are qualified heirs. Unless the law is amended most retired farmers and family members will be unaware of the steps that must be taken to preserve the family farm or business.

Also attached to this memo is a copy of recent Internal Revenue Service National Office Technical Advice Memorandum, dated December 31, 1980, which indicates the strict interpretations adopted under section 2032 A.

Prepared by:



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Index No. 2032.40-00

INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

DEC 31 1980

District Director
Indianapolis, District Office

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's SSN:

Date of Death: December 14, 1978

No Conference held.

Issues:

1. Is property which is leased by a decedent to his or her children pursuant to a net cash lease used in a "qualified use" as required under section 2032A(b)?

2. Can property which passes to a trust under the terms of which, the trustee has discretion over payment of trust income to the beneficiaries, be specially valued under section 2032A?

3. If the decedent's executor has discretion to decide the beneficiary to which farm real property will be distributed, and one possible distributee is a trust in which no qualified heir has a present interest (determined under section 2503), can the property be specially valued under section 2032A?

4. If the executor has discretion to distribute specially valued property to a surviving spouse in partial or complete satisfaction of a pecuniary marital bequest, how is the marital deduction under section 2056 determined?

Facts:

The decedent died testate on December 14, 1978, owning a one-half interest in farm real estate located in Indiana. The decedent and her husband owned the property as tenants in common and had been active in the operation of the farm. However, at the time of her death, the decedent and her husband were net cash renting the property to their children who were actively engaged in the business of farming.

Under the terms of the decedent's will, all farm real property will pass either to the dececent's husband or to their children or lineal descendants. All potential heirs are qualified heirs.

Article IV of the decedent's will provides, in pertinent part that:

> "If my husband survives me, I give to him an amount equal to fifty percent (50%) of the value of my adjusted gross estate as finally determined for federal estate tax purposes, less the aggregate amount of marital deductions, if any, allowed for property or interests in property passing or which have passed to my husband otherwise than by the terms of this article.
>
> My executor shall select and distribute to him the cash, securities and other property, including real estate and interest therein, . which shall constitute the bequest, employing for the purpose values current at the time or times of distribution. No asset or proceeds of any asset shall be used as to which the marital deduction is not allowable if included. This bequest shall carry with it a proportionate part of the income of my estate from the date of my death to the date of satisfaction."

Article II of the decedents will provides that if decedent's husband should survive her, the residue of her estate shall be placed in trust for the benefit of her husband and children.

Section I of Article V provides that:

> "Commencing with my death, the trustee shall pay the income from the trust estate in convenient installments, at least quarterly, to my husband during his lifetime; but if the income so payable to my husband at any time or times exceeds the amount which the trustee deems to be for his needs, best interests and welfare (considering his other income and means of support known to the trustee, the desirability of augmenting his separate income

or estate, and any other circumstances and factors deemed pertinent), the trustee may pay any part or all of the excess income to any one or more of my descendants from time to time living, in equal or unequal proportions, according to their respective needs, best interests and welfare, or accumulate the same and add it to principal as the trustee deems advisable.

The trustee may also pay to my husband such sumsfrom principal as he deems necessary or advisable from time to time for his medical care, comfortable maintenance and welfare. While it is my desire that my husband receive, from all sources, funds adequate to enable him to maintain a very comfortable standard of living, it is my desire -- but not my direction -- that the trustee make no distributions from principal to him so long as he individually owns any readily marketable assets.

In addition, the trustee may distribute such sums from principal as he deems necessary or advisable from time to time to any one or more of my descendants from time to time living, in equal or unequal portions, for their medical care, support and education (including college and post graduate). Whether the necessity exists for such purposes, and the amount of said trust assets to be used for such purposes shall rest in the sound discretion of my trustee. No advancement shall be made that will prevent an equal distribution of the assets of this trust at its termination."

The decedent's executor elected to specially value the decedent's one-half interest in the farm real property. The decedent's husband, two children and grandchildren consented to the election and signed the agreement required under section 2032A(d)(2) of the Code.

The fair market value of the farm real property at the date of death (1/2 interest) is $942,950. The special use value of the value of the real property, as computed for 2032A purposes, is $279,482.50 (for a 1/2 interest). Since the difference between the fair market value and special use value exceeds the $500,000 limitation as provided in 2032A(a)(2) the election results in a 2032A special use value of $442,950.

Law and Analysis - Issue 1:

Section 2032A of the Internal Revenue Code provides that if certain conditions are met, the executor may elect to value qualified real property on the basis of such property's value at its current use rather than its fair market value.

Only property that is used for a qualified use is eligible for special use valuation. A qualified use is a use as a farm for farming purposes or in a trade or business other than the trade or business of farming. The legislative history (H.R. Rep. 94-1380) indicates that the trade or business in which the qualified property is used must be the property owner's trade or business.

The Estate Tax Regulations in section 20.2032A-3(b)(1) adopt a position consistent with this legislative history. The regulation states that "Under section 2032A, the term trade or business applies only to an active business such as a manufacturing, mercantile, or service enterprise, or to the raising of agricultural or horticultural commodities, as distinguished from passive investment activities. The mere passive rental of property will not qualify. The decedent must own an equity interest in the farm operation." Therefore, property which is leased by the decedent for an amount of rent that is not contingent upon production is not normally considered to be used in a qualified use since the mere passive rental of property is not a trade or business use. At a minimum, the decedent must in some way be at risk (i.e., have an "equity interest") in the farming operation before he or she considered to be engaged in a trade or business.

The "active business" and "at risk" requirements of a qualified use are determined independently of any personal involvement in the busniess operation by the decedent or members of his family. That involvement addresses another statutory requirement - that the decedent or a member of his family materially participate in the operation of the farm business for certain specified periods. Activities of family members are by statute considered only for purposes of satisfying the material participation requirements. Therefore, even though a family member operates the farm, the qualified use test is not satisfied unless the owner of the property has an equity interest in the farming operation.

Because the decedent and her husband leased the farm real property to their children for an amount of rent that was not contingent upon production, the property was not used for a qualified use. Accordingly, the farm real property is not eligible for special use valuation under section 2032A of the Code.

Law and Analysis Issue 2:

Section 2032A(b) establishes certain threshold criteria for availability of special use valuation. One of the basic requirements is that all property valued pursuant to section 2032A or considered in determining the estate's eligibility for the election be acquired from or pass from the decedent by or to a qualified heir.

A qualified heir is defined in section 2032A(e)(1) as a member of the decedent's family. This term includes ancestors, lineal descendants of grandparents, spouses of such descendants, and the decedent's spouse.

The Report of the Conference Committee on the Tax Reform Act of 1976, which enacted section 2032A further defines the circumstances under which property is considered to pass to a qualified heir. The Report states that special use valuation under section 2032A is available for property passing in trust. Trust property is considered to have passed from the decedent to a qualified heir to the extent that a qualified heir receives a present interest in the property. S.R. No. 94-1236, 94th Cong., 2nd. Sess. 3 (1976); Vol. 1976-3 C.B. 807,960.

Section 20.2032A-3(b)(1) of the Estate Tax Regulations indicates that for purposes of Section 2032A, the distinction between present and future interest is found in Section 2503 of the Code. Any property (or portion thereof) in which a qualified heir does not have a present interest is not eligible for special valuation under section 2032A.

Section 25.2503-3(b) of the regulations defines a present interest as follows:

> An unrestricted right to the immediate use, possession, or enjoyment of property or the income from property (such as a life estate or term certain) is a present interest in property....

Section 25.2503-3(a) of the regulations defines a future interest as follows:

> 'Future interest' is a legal term, and includes reversions, remainders, and other interests or estates, whether vested or contingent, and whether or not supported by a particular interest or estate, which are limited to commence in use, possession, or enjoyment at some future date or time....

Example (1) contained in section 25.2503-3(c) illustrates the application of these definitions of present and future interests to facts such as those considered in this memorandum:

> Example (1)-Under the terms of a trust created by A, the trustee is directed to pay the net income to B, so long as B shall live. The trustee is authorized in his discretion to withhold payments of income during any period he deems advisable and add such income to the trust corpus. Since B's right to receive the income payments is subject to the trustee's discretion, it is not a present interest...

In example (1) B, the income beneficiary, received a future interest because B's income interest could be abated by the trustee's ability to withhold payments of income as the trustee deemed advisable. Any income so withheld would be retained in the trust and would accrue to the benefit of the holders of the remainder interest. Discretionary life estates where the trustee has discretion over what distributions are made are future interests.

Accordingly, because the decedent's husband did not receive a present interest, the farm real property is not considered as having passed to a qualified heir. The property is not qualified real property within the meaning of Section 2032A(b), and an election to use special use valuation is not available to the decedent's estate.

Additionally, since the property did not pass from the decedent to a qualified heir within the meaning of section 2032A(b)(1), it cannot be used for purposes of satisfying the threshold tests of sections 2032A(b)(1)(A) and (b)(1)(B).

Law and Analysis Issue 3:

Section 2032A(b)(1) requires that all property valued pursuant to a Section 2032A election be "acquired from or pass from the decedent by or to a qualified heir." Section 20.2032A-3(b)(1) of the Estate Tax Regulations states that only property in which a qualified heir receives a present interest (determined under section 2503) is considered to be so received from the decedent by a qualified heir for purposes of section 2032A.

In the instant case, the decedent's will gives the executor the discretion to distribute farm property to the trust created under Article V, section 1 of that instrument. Because the trustee under the trust has the discretion over what distributions are made, no qualified heir has a present interest in that trust. See Section 25.2503-3(c)(example 1). Based upon facts existing as of the decedent's death, it cannot be determined whether the property will be distributed to this trust in which no qualified heir has a present interest. Therefore, it cannot be determined with certainty

that the property will be acquired from or pass from the decedent by or to a qualified heir as is required by section 20.2032A-3(b)(1).

Accordingly, any farm personal property subject to this discretion in the executor cannot be used to satisfy the threshold requirement of section 2032A(b)(1)(A). Likewise, any farm real property subject to this discretion in the executor is not eligible for special use valuation, or for consideration in determining whether the threshold requirements of sections 2032A(b)(1)(A) and (b)(1)(B) are satisfied.

Law and Analysis: Issue 4

Because we have concluded that the estate may not elect special use valuation under section 2032A, we need not consider the effect of a section 2032A election on the allowance of the marital deduction in this case.

Conclusion

Because the decedent and her husband leased the farm real property to their children for an amount of rent that was not contingent upon production, the property is not eligible for special use valuation. Additionally, because the farm real and personal property may be distributed to a trust in which no qualified heir has a present interest, such property may not be considered in determining whether the threshold requirements of sections 2032A(b)(1)(A) and (b)(1)(B) are satisfied.

A copy of this technical advice memorandum is to be given to the taxpayer. Section 6110(j)(3) of the Internal Revenue Code provides that it may not be used or cited as precedent.

-END-

testimony of

LEN R. SMALL
publisher and editor
Moline (Ill.) Daily Dispatch

and chairman of the newspaper
TAX LAW ACTION GROUP

jointly supported by the
AMERICAN NEWSPAPER PUBLISHERS ASSOCIATION
and the
NATIONAL NEWSPAPER ASSOCIATION

submitted for the hearing record of
May 1, 1981

before the

Subcommittee on Estate and Gift Taxation
Committee on Finance
United States Senate

We believe that federal estate tax laws should be changed to assure that no family business must be sold to pay federal estate taxes.

I am Len R. (Rob) Small, publisher and editor of the Moline (Ill.) Daily Dispatch, and chairman of the newspaper Tax Law Action Group. This informal committee represents the interests of family-owned newspapers nationwide and enjoys the support of the American Newspaper Publishers Association, the National Newspaper Association and other national, regional and state newspaper organizations in the United States. As you may know, ANPA is a non-profit trade association representing more than 1400 daily and non-daily newspaper members. Membership accounts for more than 90 percent of U.S. daily and Sunday newspaper circulation. NNA represents some 5,000 weekly and some 500 smaller-city daily newspapers throughout the nation.

The Tax Law Action Group was formed late in 1979 to seek to implement the recommendations of an ANPA Tax Law Task Force which made a year-long study of the effect of federal estate tax laws upon newspaper sales. NNA formed a similar study group. Both organizations concluded that burdensome, some would say "punitive," federal estate tax laws are one of the reasons that owners of independent, locally-owned newspapers sell their properties. Believing the tax laws should be neutral on an owner's decision regarding sale, ANPA and NNA agreed that broad-based legislation affecting all family-owned businesses would be preferable to specialized legislation addressed only to estate taxes applied to newspaper assets.

Preserving individual and family ownership of businesses will help increase the productivity, competition and diversity of the nation's economy.

Independent businesses produce more jobs, invest more in research and development, and bring into the marketplace more innovations than do their giant corporate counter-parts. An M.I.T. study, "The Job Generation Process," by David L. Birch, produced in 1979 under contract for the Economic Development Administration, found that independent firms with 20 or fewer employees generated 66 percent of all new jobs created in the U.S. The figure was based on data collected from 5.6 million business establishments, encompassing about 82 percent of all private sector employment, and covering four different points in time: 1969, 1972, 1974 and 1976.

In the newspaper business, and in a number of other businesses, valuations based on sales of business properties at many times earnings result in a heavy estate tax burden on heirs who desire to continue a business which enjoys only modest earning power. In many cases, earnings over the next several years would fall far short of the federal estate taxes levied upon the market value of the business. The business cannot realize its taxable value in such cases short of actual sale. The result can be detrimental to the community and to the nation's economy.

The Tax Law Action Group stands ready to assist the subcommittee, if it desires, in developing the record regarding newspaper business sales and demonstrating the effect of federal estate taxes on such sales. We believe our business is not alone in the problem faced by heirs who would prefer to continue to run the family business but have inadequate liquidity to pay estate taxes based on potential sale value. We believe this situation is detrimental not only to the heirs, but also to the nation's economy and the public generally.

The 1980 White House Conference on Small Business recommended a prioritized list of suggestions aimed at improving the climate for the continuation of

independent business ownership. The recommendation receiving the fourth-highest number of delegate votes (799) was: "Revise estate tax laws to ease the burden on family-owned businesses and encourage the continuity of family ownership."

The Tax Law Action Group recommends four specific changes in federal estate tax laws which could help to achieve this worthy goal:

1 -- The approach used by the Internal Revenue Service in valuing a company in an estate on its potential sale or merger value should be changed so as to value the property on its going-concern value as a business. A recapture clause would be appropriate to assure that such optional valuation reflects the honest intent of the heirs to continue operation of the business.

2 -- The accumulated earnings penalty tax should be amended so that an independent business can prepare in advance to redeem stock to pay estate taxes upon the death of an owner. Sec. 531 of the tax code requires that accumulations in excess of $150,000 be justified as a reasonable business need. The Action Group recommends elimination of the penalty tax on advance accumulations to pay death taxes (Sec. 303 redemptions) by designating such accumulations as "reasonable business needs" for Sec. 531 purposes.

3 -- The qualifications test for Sec. 303 stock redemptions to pay death taxes should be eased. The section currently allows capital gains treatment of such redemptions instead of treating them as ordinary income. However, this is allowed only if the value of the closely-held stock being redeemed is at least 50 percent of the decedent's adjusted gross estate and if the estate owns stock in two or more corporations. In such a case these interests can be combined for purposes of meeting the 50 percent test only if at least 75 percent of the value of the stock of each corporation is owned by the estate. The Tax Law Action Group recommends lowering both of these tests, particularly

the 75 percent test for estates owning stock in more than one corporation. We also believe that redemptions allowed in Sec. 302 (disproportionate redemptions) and Sec. 306 (stock recapitalization) could be valuable tools to help closely-held farms and businesses remain closely-held. The Action Group further recommends that the two principal requirements for using Sec. 302 be eased. Sec. 306 stock should again be subject to capital gains treatment.

4 -- The qualifications for extended time payments of estate taxes should be eased. Sec. 6166 and related sections allow 10- and 15-year installment payments if stringent qualifications are met concerning the portion of an estate which contains closely-held business or farm stock. These sections also concern the number of stockholders in a business. In the case of newspapers and other businesses which may now be in their fourth or fifth generation of family ownership, a large number of family members may be involved -- yet the business remains family-owned or closely-held in the view of the owners. The Tax Law Action Group recommends reduction of the percentage of the estate tests, removal of the limits on the number of stockholders and elimination of voting stock tests as qualifications for the extended payment provisions.

Mr. Chairman and members of the subcommittee, family business owners do not seek to avoid their fair share of tax, but federal estate tax laws should not force sales of independent businesses in order to pay those taxes.

The subcommittee has specifically asked for comment on the amount of the combined estate and gift tax exclusion; the size of the marital deduction, and the amount of the annual gift tax exclusion and treatment of spouses who contribute substantially to a family enterprise.

The members of the Tax Law Action Group see no reason why unlimited inter-spousal transfers should not be allowed, or why unlimited gifts of business ownership also should not be allowed when the recipient is a family member

who has chosen to continue operations of the business. Continuation of the business is in the public interest and its economic viability contributes not only to the economy but to its taxable revenues. Estate taxes comprise only about 1.35 percent of federal tax revenues annually. The portion of those taxes collected on spousal transfers and gifts of business property to other family members seems a small price to forfeit for the encouragement of economic viability and business competition which have historically been offered our nation by independent family businesses.

Only the Congress can determine the proper size of the combined estate and gift tax exclusion, but legislation increasing the exclusion to $600,000, although helpful, still seems inadequate when newspaper and other family-owned businesses are being valued for estate tax purposes at $50 and $60 millions -- some 20 to 30 times earnings. Even with an expanded exclusion, many such businesses have not the liquidity to enable continuation.

A more direct solution would be a direction from Congress that family business properties are to be valued as going concerns without regard to potential sale prices. In the alternative, a simple statement that accumulations to pay death taxes is a reasonable business expense, together with easing the qualifications for Sec. 303 stock redemptions and for extended time payments, would constitute direct and necessary assistance in the public interest to help to assure the continuation of many family-owned businesses which mean so much to small and large communities nationwide.

# # #

President's Club

Phone 325-7351

J. A. SIEFFERT, C.L.U.
908 FIRST NATIONAL BANK BUILDING
SPRINGFIELD, OHIO 45502

April 28, 1981

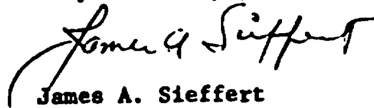
Mr. Robert E. Lightizer, Chief Counsel
Committee on Finance
Room 2227
Dirksen Senate Office Building
Washington D.C. 20510

Re: The Senate Finance Subcommittee on Estate and Gift Taxation

Dear Mr. Lightizer:

As an individual who has spent the past 13 years working financially with the small and medium sized corporation, I can think of no other tax that is relatively small in tax consequences to the government but has done so much harm to small business and property owners as the estate tax. The examples in my files would be too numerous to mention. Suffice it to say that any reduction in the estate tax to its complete elimination would do more economic good to this country in its present situation than any other single thing based upon what would have to be given up to gain the benefits.

Very sincerely yours,



James A. Sieffert

JAS/pe

cc/

413 Junewood Drive
Cherry Hill, New Jersey 08003

Robert E. Lightizer, Chief Counsel
Committee on Finance
Room 2227
Dirksen Senate Office Building
Washington, D.C. 20510

April 29, 1981

RE: Estate and Gift Tax Legislation

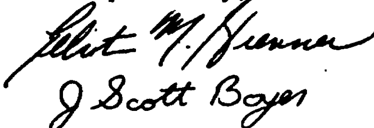
Dear Sir:

Our purpose in writing to you is to express our enthusiastic support for the abolishment of the Federal Estate and Gift Tax as proposed in Senate Bill 404. Other bills introduced in Congress recently to reduce the burden of estate and gift taxation are simply preposterous. They would leave a complex set of laws and regulations on the books, not to mention, a mass of federal bureaucrats intact in Washington to administer them. These mere revisions in the present law could not possibly justify the diminutive amount of estate and gift taxes to be collected by the government.

The principal reason for the existence of any type of tax is to raise revenue for government purposes. The Federal Estate and Gift Tax has never been and cannot now be supported as a meaningful source of government revenue. Its continued existence, however, is devastating to the present business climate in this country. At a time when capital formation is so vitally important to the improvement of our economic situation, the estate and gift tax laws are causing the depletion of needed investment capital. As tax attorneys, it has been our experience that taxpayers are now more than ever willing to engage in legalistic schemes of tax avoidance in this area. More often than not, these schemes are economically unsound and unproductive. The elimination of the Federal Estate and Gift Tax is the only rational and sensible solution to the problem. To recapitulate, the revenue loss to the government would be insignificant; IRS employees administering these laws would be able to turn their attention to collecting other taxes otherwise not collected; and private practitioners in the estate and gift tax field could devote their time to more productive enterprise.

Now is the time to look beyond the political convenience of maintaining the status quo. It is time for a bold change-a sensible change. We urge you to support the passage of Senate Bill 404.

Respectfully,



Elliot M. Brenner, Esq.
J. Scott Boyer, Esq.

JOHN M. HANLEY
Attorney at Law
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Phone: (408) 245-0352

April 22, 1981

Mr. Robert E. Lighthizer, Chief Counsel
Committee on Finance
Room 2227
Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Lighthizer:

I welcome this opportunity to express my views on proposed changes to the estate and gift tax laws.

It has always been my understanding that the original intention of the drafters of the estate tax was to prevent large concentrations of wealth and economic power.

Many years ago the amount which would pass free of the estate tax was set at $60,000. That amount, when set, was proper to accomplish the purposes of the tax -- not to tax every estate but, instead, to break up large concentrations of wealth and economic power. Later the amount, in effect, was increased to $175,000.

However, it should be obvious to everyone that the ravages of inflation have greatly diluted the value of that exclusion.

Now, because of inflation, many modest estates have been made subject to the tax.

Further, the tax has now become so burdensome as to interfere with the transfer of small businesses and farms from one generation to the next.

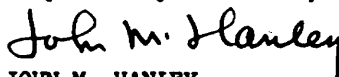
Therefore, I support the provision in S. 395 to increase to $600,000 the amount of property which may pass to heirs free of the tax.

In addition, it also is obvious that the $3,000 gift tax annual exemption is totally inadequate.

That exemption has not been increased in 35 years. During that 35-year period, inflation has more than quadrupled the cost of goods and property.

Therefore, I support legislation to increase the gift tax exclusion to an amount in the neighborhood of $10,000 to $15,000.

Respectfully submitted,



JOHN M. HANLEY

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May 13, 1981

The Honorable Harry F. Byrd, Jr.
United States Senator
Suite 417, Russell Senate Office Building
Washington, D.C.

Dear Senator Byrd,

I have read the J.C.T. Staff pamphlet setting out the background and description of estate and gift tax bills considered at the Senate Finance Subcommittee Hearing on May 1, 1981, and I strongly support your endorsement of S.395.

As an attorney involved to some considerable extent in estate planning and probate I have continuous difficulty explaining to clients the justification for some of the present provisions in the estate and gift tax statutes. For example, married spouses cannot understand why they may not leave property to each other free of estate tax or transfer property between each other free of gift tax. This is a lateral-type transfer which should not carry a tax burden. Indeed, it is preventing many wives from enjoying the responsibilities of property management and ownership which their husbands would like to accord them. The unlimited marital deduction would not result in a significant loss of revenue compared to the total governmental income. It would still leave intact the estate and gift taxation of transfers downstream to lower generations.

The increase in the gift tax annual exclusion to $10,000 per donee is also very justifiable and simply recognizes the inflationary erosion of the old 1942 exclusion of $3,000 per donee. This would legitimize gifts of property to children over the age of majority to enable them to attend colleges and universities. Again, the loss in revenue would not be significant in comparison to the social advantages which would take place.

Increasing the threshhold of taxability of adjusted gross estates to a figure of $600,000 would alleviate the need for elaborate estate planning to those persons having estates in excess of $350,000. While this would curtail my own law practice in this specialized area, I certainly would be willing to give up my personal, rather insignificant benefit in exchange for the simplification of planning of these "middle-type" estates and the need for filing returns for people in this category on death.

For these reasons I commend you on your sponsorship of this legislation and do hope that many other practitioners are joining me in commenting favorably on it.

Very sincerely,

John E. Riecker

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DOROTHY M. DORAN, C.P.A.
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LYNNE E. LUFBOROUGH, C.P.A.
HAZEL J. STABLER, C.P.A.
M. BERL STALLARD, C.P.A.

October 16, 1980

Commissioner of Internal Revenue
1111 Constitution Avenue N. W.
Washington, D. C. 20224

Attention: John G. Schmalz, Office of Chief Counsel
CC:LR:T (LR-221-78)
RE: Comments on proposed Regulations, Sec. 482 & 483.

Dear Sir:

I am 67 years of age, a lifetime resident of Eastern Montana, started public accounting in 1943, Certified in 1954, still active in a CPA firm in Miles City, Montana.

Our clients are largely farmers and ranchers living in a radius of 150 miles of Miles City, Montana, several have moved farther away and retain our services.

My efforts do not include preparing income tax returns, twenty percent of my time is managing our firm with four CPA's as partners and an auxiliary staff of 10 more persons.

Eighty percent of my time is conferring with our clients (also in consultation with the other CPA's) on how to survive in business.

Over half of the eighty percent is with Farmers and Ranchers who are trying to convey property to their family for a continuation of their chosen way of life.

Their biggest problem is the INFLATED PRICES OF LAND, and now your PROPOSED IMPUTED INTEREST RATES.

Land prices are caused by SPECULATORS investing in lands as a HEDGE against inflation.

WHO caused and WHY inflation is not the question.

SURVIVAL of the FARM as A FAMILY unit is a BIG QUESTION, it is imperative that it be given a chance to SURVIVE.

October 16, 1980

Page 2 Continued

In my lifetime of observation, I find that the FARMERS and RANCHERS live comfortably but very few accumulate ENOUGH to retire, EXCEPT if they can get a reasonable amount from their children as payments on the land. When this happens, the same land must support TWO families-a buyer and a seller.

A descendent buying a farm does not intend to resell, continuing a basic way of life.

The IMPOSITION of inflated land prices for GIFT and INHERITANCE purposes causes a hardship on Pa and Ma. The children must buy BELOW market, causing the parents to file a gift return and using up part or all of their lifetime exclusion.

IMPUTED interest as proposed is OUTLANDISH as a practical matter for a buyer to pay, operate the farm and raise a family.

There must be a compromise somewhere to protect the BASE of agriculture which is the FAMILY UNIT.

Farmers and Ranchers as families live poorly (income below wage earner's averages) but die RICH according to IRS standards.

Our office files around 1000 returns for Farms and Ranches and the above amounts can be proven.

I would like to testify at a public hearing.

Very truly yours,

M. Berl Stallard, CPA
Box 549
Miles City, Montana 59301
406-232-1118

STATEMENT OF NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION
BEFORE THE SENATE COMMITTEE ON FINANCE
ON MAJOR ESTATE TAX ISSUES
MAY 1,1981
BY ROBERT D. PARTRIDGE

Mr. Chairman and Members of the Committee, my name is Robert D. Partridge. I am the Executive Vice President and General Manager of the National Rural Electric Cooperative Association (NRECA). NRECA is the national service organization of approximately 1,000 non-profit rural electric cooperatives which provide central station electricity to nearly 25-million farm and rural people in approximately 2,600 of the nation's 3,141 counties and county-type areas of 46 states.

We appreciate the opportunity to submit this statement on the proposals pending before this Committee on major estate tax issues.

I commend the Committee for its concern over this issue which is having such an adverse impact on rural America. Inflation and rapidly increasing land values have made many of the people who are served by and own our member cooperatives appear wealthy on paper. However the earnings generated from farms and small businesses owned by these people are usually quite low in relation to the values attributed to the property.

This creates quite a dilemma when the owner of the property dies. Even the heirs of small property owners find themselves confronted with substantial estate taxes, little liquidity, and low earnings from the land. Such a combination frequently leads to the forced sale of the inheritance.

There appears to be little public policy benefit from these forced sales. To the contrary, a hardship is created for the heirs. Rather than encouraging more diverse land ownership and greater competition a growing concentration of ownership is encouraged resulting in less competition.

NRECA's membership has been particularly concerned about the hardship that estate taxes have created for the widows of owners of farms and small businesses. The burden of proving that the wife contributed "money or monies worth" before any portion of the enterprise can be considered to have been hers is unfair. It is generally acknowledged by all but the law and the IRS that the family farm involves the labors and contributions of every member within the ownership family, particularly the wife.

In January, NRECA concluded its 39th annual meeting. During the course of this meeting the delegates passed a number of resolutions including one entitled "Estate Tax Laws." The resolution criticizes this presumption that property is to be included in the decedent's estate for tax purposes, unless the survivor shows a monetary contribution. This presumption seems particularly difficult for widows to overcome. It further urges that legislation be passed which would end this discriminatory practice.

All of the bills currently before the Committee would greatly improve the situation. S.395 in providing for an unlimited marital deduction and S. 404 repealing the Federal estate and gift tax would,of course, totally resolve the issues raised by our membership.

We respectively urge the Committee to support legislation which will provide relief for the heirs and spouses of family farms and businesses.

We thank you for the opportunity to express our views on this important subject.

HARDIN R. GLASCOCK, JR.
5870 N. W. THRUSH DRIVE
CORVALLIS, OREGON 97330

TO: Senate Subcommittee of Estate and Gift Taxation
FROM: Hardin R. Glascock, Jr., Small Forest Owner
SUBJECT: Statement in Support of S. 395 for Hearing Record
DATE: May 11, 1981

No federal policy is the basis of more frustration and hardship for small forest owners than estate taxation. In practice its effect is so disruptive and at variance with other federal policies as to raise serious doubts about the overall intent of government with respect to encouraging investments in nonindustrial private forestry. As a family forest owner in Lincoln County, Oregon I would like to show committee members how our experience leads to these conclusions and why S.395 is a step in the right direction.

Briefly, my parents acquired our farm forest in 1942 by exchange for a small farm in California. As markets developed for Douglas fir second growth timber in the late 1950's, father began harvesting small quantities each year and replanting immediately. In the 1960's fire roads were constructed for protection. Idle forest land was rehabilitated and planted with choice growing stock. Conservative thinning was started in young timber stands. As the markets improved in the 1970's, emphasis continued to be on harvesting poor quality trees and poorly stocked timber stands; preparing the site for the new crop; planting with seedlings from the proper seed source; protecting the reforestation from damage by wild and domestic animals; maintaining the aesthetics of the property; and making the forestland available to the public for free hunting by permit. The increasingly rigorous state forest practices act and

environme[illegible] [illegible]gulations have b[illegible]n strictly adhered to.

The lar[illegible] [illegible]vestments required for these activities were paid [illegible]or out of tim[illegible] income plowed back into the land. Government subsidies through cost sharing were not taken until the late 1970's when property and income taxes skyrocketed. The costs of reforestation could not be deducted as a business expense under federal income [illegible] law.

[illegible] 1969 my father and mother incorporated the property as a fam- [illegible]oratio[illegible]. They gifted shares of stock to children and grand- [illegible]en, but passed away before a substantial amount had been conveyed. When father died in 1978, his remaining shares of stock in the corporation were bequeathed to me as the offspring most involved and interested in carrying on the family forest enterprise. With this bequest came a staggering load of federal and state death taxes of just under 1/3 of a million dollars for which I am personally responsible. Even after the initial payments made with the tax returns of nearly 1/3 of the total, the yearly installments, including interest, on a 15-year payout range from about $17,000 to over $32,000. To make it all worse, the stifling effect of high interest rates on the construction industry and lumber markets since 1978 has made it difficult to sell timber to pay the death taxes.

The situation is sufficiently frightening to impel my brother and sister, who are also officers of the family corporation, to strongly urge selling a substantial portion of the property to pay the taxes. I have steadfastly resisted selling off any of the land since it is the manufacturing plant for the timber values and an essential part of the forest enterprise. But it's a scary situation even

for a person with an education and faith in forest management--and it remains to see who is right. Certainly many, if not most, heirs in a similar situation would have sold land, most likely to large timber companies. If the family forest were not located in an area of projected timber shortage, holding on to it might be considered downright foolish.

As best, there will be no continuity of forest management since most of the timber growing stock will have to be cut prematurely to pay death taxes. Progress toward sustained yield and income has been curtailed. No one will win in the long run. Future yields of timber have been and will continue to be reduced. This will not only reduce the supply of an increasingly needed raw material as well as reduce owner income; it will reduce future tax revenue to government as well.

As a family forest owner with children and the benefit of hindsight, you can be sure that I am investigating all avenues in forest estate planning to minimize the impact of death taxes next time around. But the real relief must come from more enlightened and equitable tax policies.

The 1975 leaflet Forestry Incentives Program (FIP) for the Forest Landowner distributed to small owners by the Agricultural Stabilization and Conservation Service/USDA states:

> "...The demand for wood in this country is expected to exceed the supply within 30 years unless many more trees are planted each year and much more land is placed under good forest management. Lands owned by the forest industry and by the public are being planted and improved at the fastest rate possible. But smaller private owners, who control the majority of forest lands in the Nation, do not have the funds to make such long-term investments. Therefore, the Forestry Incentives Program is designed to share this expense with these private, eligible owners...."

Is this the same government that once every generation disrupts good forest management and drives small forest ownerships into the hands of large industrial owners? Is the government that wants to share our forestry investment costs due to our insufficiency of funds the same government that aborts these investments periodically with a herculean burden of death taxes? Does the left hand of government policy know what the right hand of government policy is doing? How can family forest owners come to any other conclusion than that the overall net impact of all federal policies is a distinct <u>dis</u>incentive for making investments in forest management?

If the public really wants greater timber outputs from nonindustrial private forests, it has only to change the net impact of all federal policies to a distinct <u>incentive</u> for making investments. Government has only to:

1.) relieve small owners from onerous and disruptive estate taxation;
2.) implement tax credits for owner investments in forestry; and
3.) discontinue wasteful costsharing subsidies whose cost effectiveness has never been documented.

S.395 is a meaningful step in this direction. I support it with the hope that it will be further improved by increasing the exemptions in the Bill. A strong measure is urgently needed to provide relief to owners and to stabilize forest ownership and management of nonindustrial private forests in this country.

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Convalescent Homes, INC.

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April 28, 1981

Mr. Robert E. Lighthizer, Chief Counsel
Committee on Finance
Room 2227
Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Lighthizer:

This letter is in response to your press release regarding the hearing for the Finance Subcommittee on Estate and Gift Taxation.

I sincerely believe legislation should be passed which would postpone estate taxes for husbands and wives who jointly own family farms or small businesses until this estate is passed on to a succeeding generation.

I have seen many instances where small businesses have been destroyed because of the trauma of a survivor having to go through the agony of settling estate taxes while trying to manage a small business and having to liquidate substantial assets to pay estate taxes. It is particularly upsetting when the survivor is faced with the upgraded value of assets under the law which may have cost a fraction of their present value when they were developed many years before.

Personally, my wife and I have worked together for 30 years developing a small company which includes two nursing homes, a small home for the aged and four apartment complexes with a total of 165 rental units. It was only in March of this year that we finally paid off the last of our long term debt. Early in our business career my wife cooked two meals per day and supervised the nursing for a forty-two bed nursing home while I did construction on new facilities doing all of the plumbing and heating myself. The first 18 years we worked seven days a week about 80% of the time and would take 3 or 4 days off to recover every 6 or 7 weeks.

Mr. Robert E. Lighthizer -2- April 28, 1981

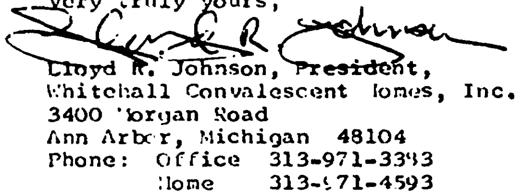
Because of inflation the value of our apartment buildings and nursing homes are far greater than their original cost. In some cases 4 or 5 times greater.

I am aware the purpose of the estate tax law is to prevent the concentration of wealth from one generation to another but, after paying substantial income taxes, trying to build a company out of after tax income, and living on substandard available income for many years, the unkindest cut of all is for a surviving spouse to have to produce a substantial sum for estate tax purposes within fifteen months of suffering the loss of the other person, and in many instances, having to liquidate the business which is the source of income for the surviving spouse, in order to meet government requirements.

It is important for the committee to realize that it is necessary for a company to have several million dollars worth of upgraded assets in order to provide jobs for only 200 employees so that an exclusion of $750,000, or even $1,000,000, would not be adequate to correct the problem. At present about 12% of nursing homes nationally are owned by chain type public corporations. Much of the good nursing care provided our older people comes from family owned nursing homes and I am sure similar services are being provided by family owned businesses throughout the country.

I am enclosing my personal address and phone numbers should any member of your committee want to contact me personally.

Very truly yours,



Lloyd R. Johnson, President,
Whitehall Convalescent Homes, Inc.
3400 Morgan Road
Ann Arbor, Michigan 48104
Phone: Office 313-971-3393
Home 313-971-4593

cc: Senator Carl T. Curtis
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R#1, Box 59B
Arbuckle, CA 95912
April 29, 1981

Robert E. Lighthizer, Chief Council
Committee on Finance
Washington, D.C.

Dear Mr. Lighthizer:

Re: Estate and Gift Tax (for printed testimony)

Yesterday my husband and I visited a tax attorney regarding our estate. Needless to say we were astounded at the federal estate tax which would be mandatory at the death of either of us.

Due to inflation, ranch property we purchased 16 years ago at $180,000 is now worth $1,000,000! The same land raising the same products! This does not mean we would ever realise that much money on a sale, particularly a forced sale and of course we do not wish to sell.

Now for the tax: at the death of one of us, the other would have to pay almost $1000000. At the second death $232,000 would be due.

Because crop payments have not risen with the inflation rate, at our ages the cost of insurance to pay the tax is prohibitive. Ours is not an isolated problem but is the same for farmers and small businessmen. Our worth is only on paper.

Also, a gift of $3000 per person in our area would be a gift of less than 1 acre. You could not even build a house on it as in our county you cannot build on less than 10 acres. Reforms are needed in this area also.

Please consider all this as you deal with the estate and gift tax issue. Thank you.

Yours truly,

Ruth Lehman

Ruth Lehman

115 S. Lake Ave. Apt. 1
Albany, N.Y. 12208
May 11, 1981

Robert E. Lightizer, Esq.
Chief Counsel
Committee on Finance
Room 2227
Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Lightizer,

From Senate Finance Press Release No. 81-122 (4/14/81), I learn the Senate is considering four bills to alter the estate and gift tax.

I am an attorney and financial consultant, and most of my earnings come from counseling the upper middle class on how to structure their affairs to minimize estate taxation. Many of my co-workers are aghast at your proposals, even such moderate ones as S. 395, and take what comfort they can from the thought that chance of passage is slim--they hope. The company I work for, Ayco Corporation, employs seventy-five attorneys, full time, who devote most of their effort to estate planning to minimize taxation. Further, there are dozens, or hundreds, of similar firms and law firms similarly active.

Clearly, this represents a massive waste of national resources. I believe more money is spent each year in an effort to minimize or avoid, or cope with in various ways, estate taxation than is generated for the government's use. This is not an exaggeration, and your hearings should address this specific issue. If my observation is true, then the estate and gift tax is a terribly inefficient means of generating revenue for the government, since the vast sums spent on lawyers, insurance, tax advisors, financial consultants, estate tax books and periodicals, trusts and trustees, accountants, etc. add no quality to our national life. Furthermore, the social goal of breaking up large aggregations of wealth is not served by depleting the resources of the upper middle class (those who work, and work hard in socially responsible positions, to maintain a high--but not luxurious--standard of living).

Few would object to an estate tax levied solely upon the wealthy. In fact, we have all met those whose character would be much improved by a sudden dose of need. But the estate tax as presently structured is a real burden on the middle class: not only in the depletion of their estates at death, but in the onerous planning manuevers that deplete their

wallets during life. And, it is the widows--and sometimes orphans--who must pay the tax--not the resourceful executive. The reduction in standard of living the survivor must undergo is very real and very worrisome. And not a reduction from yachts and caviar, but a big reduction in the ability to live the comfortable life which is the goal of most Americans. It does not further the cause of social justice when a widow must reduce her standard of living from a $60,000 after-tax annual income stream to a $25,000 after-tax annual income stream. Especially, if one adds in the devastating effects of inflation on the purchasing power of a survivor annuity or other source of fixed income. In ten years, ten percent inflation a year erodes this down to $9640; in twenty years, $3700. This is the actual situation many widows find themselves in, since it is not unusual to survive her mate by this length. These are the grim statistics we have to confront our clients with, and you cannot blame them for wanting to minimize the Federal government's share of the estate.

In fact you, yourself, as an attorney, very likely have already implemented the "two-share" testamentary pattern to help preserve that share of your possessions ultimately passing to your children. But such complications are an unneccessary drag on the productivity of our nation. Raising the effective exclusion to $600,000 would be a true "supply-side" tax cut.

There are two other miscellaneous injustices that this tax causes, that need articulation. First, the federal estate tax often greatly slows the closing of an estate (while awaiting audit, etc.), prolonging administration, inconveniencing the objects of the decedent's bounty, and once again siphoning precious funds into an essentially non-productive use. Second, the unfortunate citizens of California, whose modest homes can have a paper value of $1,000,000, but whose life-style is not affluent, are sometimes forced to move as they cannot afford the debt service that would be necessary to re-mortgage their home to pay estate tax. Clearly an injustice. A similar tragedy occurs when a family business must be broken up to pay estate taxes. Assets with high paper value do not necessarily translate into wealth--as many "land poor" farmers will tell you.

Therefore, I strongly urge adoption of S. 395, S. 858, or S. 574. They may cost us our jobs, but as a matter of fairness--and as a way of freeing up a lot of legal talent and other professional skilled workers from non-productive work--I believe such modifications would have a very benevolent effect.

Sincerely,

Ralph Benko

RB:mo

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