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Statement of
Tax Policy

4

Estate and Gift Tax Reform

AICPA

American Institute of
Certified Public Accountants

Statements of Tax Policy of the federal tax division are issued for the general information of those interested in the subject. They present the conclusions of the division, which is the senior technical body of the Institute authorized to speak for the Institute in the area of federal income taxation.

Statements of Tax Policy are intended to aid in the development of federal tax legislation in directions which the division believes are in the public interest.

Statements of Tax Policy do not establish standards enforceable under the Institute's Code of Professional Ethics and are not intended for that purpose.

Statement of Tax Policy **4**

Estate and Gift Tax Reform

Issued by the Federal Taxation Division of the
American Institute of Certified Public Accountants

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Foreword

Statements of Tax Policy represent a conscientious effort by the federal tax division of the American Institute of Certified Public Accountants to explore, comment, and, where appropriate, develop positions on, matters of tax policy covering major areas of taxation in which members of the accounting profession have special competence.

Reform of the present system of estate and gift taxation has been under serious consideration for a number of years, with proposals for change coming from many sources, including Congress, the Treasury Department, and a number of professional organizations. The federal tax division has also been actively advocating changes in this area, and its ideas and proposals are summarized in this statement. It is intended that the formal presentation of this study will assist members of the congressional tax writing committees, members of the executive branch of government, and the public in their consideration of this subject.

Statements of Tax Policy are approved by the executive committee of the federal tax division after they are developed by the division's tax policy subcommittee. Other division subcommittees may develop a policy statement if requested to do so. This statement was developed by the 1972-73 financial and estate planning subcommittee and approved by the 1973-74 executive committee.

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Synopsis of AICPA Position

The American Institute of Certified Public Accountants supports estate and gift tax reform legislation in the following key areas.

Generation-Skipping Transfers

Under current law, an individual can make a transfer of property to a descendant two generations removed and, so long as intervening generations are limited to a mere economic interest (that is, an income interest), no estate or gift tax is imposed on the intervening generation. We recommend the following:

- No imposition of tax on outright transfers benefitting a "skipped" generation.
- Imposition of a tax on creation of inter vivos and testamentary trusts which benefit a skipped generation.
- Basing such tax on actuarially determined values.
- Imposing such tax on the estate of the skipped generation and making it payable from trust corpus.
- A liberal disclaimer provision and extension of the previously taxed property tax credit for a period of up to twenty-five years.

The Marital Deduction

Under present law a decedent may transfer up to one half of his estate to his spouse free of tax so long as the interest trans-

ferred does not lapse because of the passage of time or occurrence of certain events ("terminable interest rule"). We recommend the following:

- Retention of the 50 percent marital deduction limitation.
- Retention of the terminable interest rule.
- As stated below, an exemption level of $150,000, which would permit a $300,000 estate to pass free of tax.

Appreciated Assets Transferred at Death

At present, when a decedent owning appreciated assets dies, the appreciation is not subject to the income tax, and the beneficiaries take a basis in the property received equal to its fair market value. We recommend retention of our present system in this area.

Unified Transfer Tax

There currently exists an exemption from the estate tax of $60,000, and a lifetime gift tax exemption of $30,000 per donor. In addition, there is an annual exclusion of $3,000 for each donee for gifts of present interests. We recommend the following:

- Unification of these two systems of transfer taxes.
- Retention of the present estate and gift tax rates.
- That upon death, there be included in the estate tax computation 75 percent of the fair market value of inter vivos gifts made.
- Allowance of a credit for gift taxes paid on inter vivos gifts.
- Retention of the $3,000 annual gift tax exclusion.
- Increasing to $150,000 the current combined $90,000 exemption for estate and gift taxes.

Liberalization of Deferred Payment of Federal Estate Tax

Under present law, an extension of time to pay the federal estate tax may be granted in two situations: (1) where payment of the tax would result in "undue hardship" to the estate (Section 6161) and (2) where the estate consists largely of an interest in a closely held business (Section 6166). In addition, Section

303 permits certain redemption distributions to be made to help in paying the estate tax, without certain adverse income tax consequences. We recommend the following:

- Treatment as a single corporation, for both Sections 303 and 6166 purposes, a decedent's interest in two or more corporations if the estate owns more than 50 percent of each.
- No change in the amount of redemption proceeds qualifying under Section 303.
- Liberalization of ownership requirements in connection with the payment of estate taxes where an estate consists largely of an interest in a closely held business.
- Liberalization of Section 6161 with regard to extensions of time for payment of the tax.

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Generation-Skipping Transfers

Background

Under current law, a person may transfer property by gift or bequest to a lineal descendent more than one generation removed from himself (for example, a grandchild), and, as a result, the transfer tax is not paid by the intervening generation. In addition to outright transfers, a settlor may make a taxable transfer of property and not have the property subject to transfer tax again for several generations with the use of trust instruments which satisfy the rule against perpetuities. This is true although some elements of beneficial enjoyment of the property accrue to the intervening (or "skipped") generations.

Discussion

The U.S. Treasury Department *Tax Reform Studies and Proposals* dated February 5, 1969,[1] pertaining to estate tax, recommended a tax upon generation-skipping transfers. It was proposed to levy a "substitute" tax, in addition to the present transfer taxes, if property is transferred to a grandchild or more re-

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[1] U.S. Treasury Department, *"Tax Reform Studies and Proposals,"* A Treasury Tax Study (Washington, D.C., Feb. 5, 1969), hereinafter referred to as 1969 Treasury Proposals. All subsequent direct citations of this report will be indicated by page number within the body of the text.

mote generation. This tax upon generation-skipping (GST) would apply to outright transfers as well as transfers in trust. The tax would be 60 percent of the basic transfer tax, unless the member of the skipped generation elected to treat the transfer as a gift or bequest to him and a simultaneous gift to the next generation.

Position of Other Professional Groups

On April 30, 1968, the American Law Institute (ALI) issued a report entitled *Federal Estate and Gift Tax Project.*[2] It was therein reported that the Council to the Members of the ALI approved a resolution to recommend a GST only upon a very limited class of transfers. Basically, the ALI proposal was to have a GST only upon transfers in trust that would vest in a younger generation at a time subsequent to the time of death of the immediately succeeding generation. In other words, if the trust provided for income for benefit of a child and the remainder to a grandchild upon the death of the child, there would be no additional tax. If, however, the trust continued after the death of the child with the remainder to a great-grandchild upon the grandchild's death, there would be an additional tax.

The American Bankers Association (ABA) would also limit the GST solely to transfers in trust. The ABA, in general, would impose a GST only if the transfer skips more than one generation.

AICPA Proposals

The AICPA's position is that there should be a tax upon transfers in trust that skip a generation; the Institute favors a limited inclusion in the estate of the member of the skipped generation, provided such person had a beneficial interest in the trust. The AICPA, therefore, makes the following proposals.

No Separate Generation-Skipping Tax on Testator or Settlor. To the extent that there would be a tax on the property passing to a grandchild or later generation, such tax would be computed

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[2] Published as *Federal Estate and Gift Taxation: Recommendations Adopted by the American Law Institute at Washington, D.C., May 23-4, 1968.*

by including a value in the gross estate of the skipped person. The tax would be due at the time that person's estate tax is due. Thus, no additional tax would be due from the settlor of an inter vivos gift in trust nor from the estate of the creator of a testamentary trust. The tax would be payable from the corpus of the trust. If a generation obtains its interest in the trust or the property in a manner other than by death of the skipped generation (such as after a certain term), the tax would be payable at the time of transfer of interest as though the generation whose interest had terminated had made a gift.

No Additional Tax on Outright Gifts or Bequests. Only gifts in trust would be included in the gross estate of the skipped person. Also, only to the extent that the skipped person had a beneficial interest would there be an inclusion.

Inclusion in Gross Estate Based Upon Actuarial Values. If a person's beneficial interest in a trust expires and if a more remote generation from the grantor than such person will obtain an interest (for example, if the son of a grantor dies and the corpus goes to the grantor's grandchild), then a computation would be made of an amount to be included in the estate (or taxable gifts) of such a person. The fair market value of the corpus at the date of such termination would be calculated. A pro rata portion of this fair market value would be included in the calculation of his gift tax. The portion included would be based upon an actuarial computation of the interest so terminated. This computation would be made as of the date the trust is created (or at the date it became irrevocable if this is later). If the decedent was solely an income beneficiary, the actuarial value would be based upon present value tables of a life-income interest using the age of the beneficiary as of the date of the commencement of his income interest in the trust. If his interest was only for a term of years, then the calculation would be based upon that period. The AICPA believes, however, that the present 6 percent table is too high for this purpose. A table based upon a 4.5 percent or 5 percent return would appear to be more equitable.

Example—Assume that a father dies at a time when his son is age forty-five. Father leaves $1 million in trust with income to his son, and upon the son's death, the remainder to his grandchil-

dren. When the son dies, the corpus has a fair market value of $2 million. The present value at 5 percent of the right to use $1 for the life of a forty-five-year-old person is about 62 percent. Thus, 62 percent of the $2 million date-of-death value would be subject to estate tax upon the death of the life beneficiary. The amount subject to tax would be limited to the interest passing to the next generation. The estate tax would be paid out of the trust corpus unless the life beneficiary provided by will or otherwise that the tax should come from his estate.

The tax charged to the corpus would be from the top brackets. Thus, the personal estate of the life beneficiary would not be affected by the inclusion of the life interest in the tax computation.

With Sprinkling Trust, Taxation of Corpus Upon Death of Last Beneficiary to Die. The question arises as to the best method of taxing the corpus when the income may be paid to any member of a class that includes more than one member of the skipped generation through the use of a sprinkling trust. The AICPA recognizes that arguments could be made for taxing a portion of the corpus as each beneficiary dies or when the last member dies, basing the tax in either case upon the rates applicable as if the pro rata part had been included in each beneficiary's estate at the time he died. Yet again, arguments could be made for granting various elections to the trustee. Each of these various approaches has certain advantages. They all, however, lack the characteristics of simplicity and ease of administration. Because it would work without putting an unreasonable burden upon the IRS or the trustees, the AICPA has determined that the best approach would be to tax the corpus upon the death of the last beneficiary to die, based upon the facts applicable to such last member of the generation. Thus, if the last to die had an actuarial interest of 60 percent, that percentage of the fair market value of the corpus on the date of his death would be included and taxed in his estate.

In this regard, it is important to note the need for the enactment of a very liberal disclaimer provision. The AICPA recommends that the Internal Revenue Code provide that a beneficiary may be permitted to waive his income rights at any time within a two-year period commencing with the date of death of the testator or with the date that an inter vivos trust is created. Such

a disclaimer would result in *no* tax. There would be tax neither at the date of disclaimer nor at the date of the beneficiary's subsequent death. Thus, the possibility is reduced that the corpus would be taxed at rates applicable to the wealthiest members of the generation.

With Power to Invade the Corpus, Taxation of Corpus Based on Value at Time of Beneficiary's Death. The trustee may have the power to invade the corpus for the benefit of a member of the skipped generation, or the beneficiary may have the power to demand the corpus. If the beneficiary does not disclaim his right to receive the corpus pursuant to such power, the AICPA would have the tax on the corpus based upon values at the time of his death. There would not be any reduction based upon actuarial computations unless the invasion power is less than complete. Thus, assuming that a person has a limited power to request corpus (for example, a right to $5,000 or 5 percent of the corpus per year), the value of such right would be included in his estate tax computation. If, therefore, a forty-five-year-old person received a life interest and a "5-and-5" power, the AICPA would actuarially compute the value of the power plus the value of an income interest upon the remaining corpus. The tax on this amount would be based upon fair market values at the time of his death. If he actually draws down corpus each year, the AICPA would not have the remaining corpus subjected to a tax based upon this power. If the power is partially used, the computed amount would be reduced by the amount previously withdrawn.

Even in a case where there is more than one member of the generation for whom there can be an invasion, the AICPA would not recommend a tax until the last member dies. At such time, the full fair market value would be included and taxed in such last person's estate. In other words, the facts and circumstances applicable to the last surviving member would be used for the tax computation. An obvious exception would be those cases where a portion of the trust's corpus terminates as each skipped person dies. In such a case, there would be a tax on such a portion at the time of termination.

More Liberal Credits for Tax Paid on Prior Transfers. An injustice can occur if the skipped person dies shortly after the trust

is created. The severity of this problem can be greatly reduced, however, by the AICPA proposal for more liberal credits for tax paid on prior transfers. For this purpose, a liberal credit would be allowed not only for estate tax on prior transfers, but also for gift tax paid in the case of an inter vivos trust. (This logically follows as a result of the proposed integration of the gift and estate taxes.)

With Two Skipped Generations, Taxation Based Upon Actuarial Computations. There would be a tax upon the death of each skipped generation based upon actuarial computations. The actuarial interest of a child who had an income interest would be taxed upon his death. The actuarial interest of a member of the next, skipped, generation would be taxed upon that member's death. Assuming, for example, a life income to a son and then to a grandson with remainder to great grandchildren, the tax upon the death of the son would be as described above. The tax upon death of the grandchild would be based upon his age at the time his income interest vested (that is, at the death of the son). If the grandchild should predecease the son, there would be no tax upon the grandchild's death. If the grandchild dies shortly after the son, there would be a liberal credit for the tax paid upon the son's death.

Extension of Availability of Previously Taxed Property Credit. Under present law, if a gross estate includes property recently inherited from a prior decedent and the prior decedent's estate paid a tax with respect to the property, a credit is available to the second estate. A full credit is available if less than two years has elapsed between the two deaths. The credit is reduced by 20 percent every two years, until no credit is available if the second death occurs more than ten years after the first.

Estate and gift tax reforms have been proposed that will generate additional tax revenue. The generation-skipping proposals, in particular, can result in a tax for each generation rather than for every second or third generation, as is presently the case with large accumulations of wealth. Because of the greater and more frequent incidence of tax, the AICPA has concluded that the previously taxed property credit should be available for a longer period of time than the present ten years.

The AICPA favors extending the availability of the previously taxed property credit. For the first five years after death a 100 percent credit for prior estate taxes would be granted. The percentage of the credit available would be reduced by 5 percent per year thereafter. When a period of twenty-five years has elapsed, no credit would be available.

Example—Assume that *A* dies in 1974 leaving his entire estate to *B*, and *B* dies in 1978. *B*'s estate will have an available credit equal to the entire estate tax paid by the estate of *A*.

If *B* dies in 1984, ten years after *A* dies, the credit would be reduced to 75 percent of the taxes paid by *A*'s estate, that is, 100 percent less 25 percent (five years at 5 percent). If *B* dies after 1999, no credit from *A's* estate would be available.

The period of twenty-five years was selected as representative of a customary period between generations. The gradual reduction in credit between five and twenty-five years was considered to be logical inasmuch as the second decedent would have enjoyed the inherited assets for some period of time. The transfer at his death should, therefore, be at least partially taxed.

This liberalization becomes logical if generation skipping is adopted. If a member of a skipped generation dies prior to his actuarial expectancy, his estate, under the AICPA proposals, must nevertheless include an actuarially computed amount. The liberalized credit results in fairer treatment in such cases of premature death.

Summary

The AICPA is opposed to a tax upon outright generation-skipping transfers because the member of the skipped generation has no economic interest in the property. Further, the AICPA finds nothing socially or economically wrong with gifts or bequests that totally skip a generation. If a person has an economic interest, that interest should be subject to a tax at the time the interest terminates. The tax should be measured by the value of the person's estate as well as the value of the interest. An additional tax on the original settlor or on his estate is unfavorable, since this would cause an incorrect timing of the tax. Nor should taxpayers be required to make an election as to when the tax is payable or as to when the trust property should be valued. The AICPA is

opposed to the IRS proposals because it does not believe that a new tax should be enacted. Rather, it is thought that the situation can be corrected by redefining the criteria that will result in inclusions in a gross estate or in taxable gifts. The IRS proposals may result in excessive complexity, lack of relationship of the tax to the economic interest subject to tax, and incorrect timing of the tax.

There are many situations not covered in this presentation. Only a basic concept necessary to solve a basic problem has been set forth. This basic problem is that, at present, a generation may have the benefit of corpus which is not subject to transfer tax when it is passed on to the next generation. To subject such corpus fully to tax when the generation has only a limited interest is, in the opinion of the AICPA, inappropriate. The foregoing proposals attempt to find a fair and equitable solution to a very real problem.

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The Marital Deduction

Background

Current law allows a deduction to a donor or decedent for part of the value of property transferred to a spouse. Such a deduction, referred to as the "marital deduction," is limited in the case of a gift to one-half of the value of the gift and in the case of an estate to one-half of the "adjusted gross estate." As a result of the marital deduction, an individual may transfer one-half of his separate property to his spouse, tax free.

To qualify for the marital deduction, outright ownership of the property transferred generally must pass to the spouse so that, unless it is consumed or again given away, it will eventually be included in the estate of the surviving spouse. Such provision is referred to as the "terminable interest rule."

Discussion

Many practitioners and professional groups believe that the present structure of the marital deduction works a hardship on small to moderate-sized estates, especially those estates where all the assets are bequeathed to a widow who must provide for herself and her children. Treasury Department studies indicate that, on the average, a widow survives her husband by ten years, and it is felt that when property passes to a widow, a tax imposes a difficult burden at a time when other significant income sources often disappear.

While it is generally agreed that adequate protection for widows and a reduction in estate tax on moderate estates is a necessary part of estate tax reform, there does not appear to be any reason for the deferral of estate taxes when property transferred to a surviving spouse is more than sufficient to satisfy her needs. An unlimited marital deduction, advocated by some groups, goes far beyond the objective of providing relief to a surviving spouse and would be of greater benefit to larger estates than smaller estates.

Studies indicate that the adoption of an unlimited marital deduction would result in a permanent reduction of 7 percent of the revenue from federal estate and gift taxes and an immediate revenue loss of as high as 17 percent since there would be a tax deferral until such time as the surviving spouse dies. Most of the other estate and gift tax reform proposals would result in an increase in revenue. Accordingly, a retention of the existing 50 percent marital deduction (with a modification for modest estates) would allow for an adjustment in the rate structure and exemption level which would not be dependent on the enactment of a provision for taxing appreciation at death.

An unlimited marital deduction would tend to distort proper estate planning. In order to minimize the tax on the first to die, there would be a tendency to transfer all of the property to the surviving spouse. In estates of any substance, the transfer of all property to a surviving spouse, particularly when there are children, should not be encouraged. Under an unlimited marital deduction, deferral possibilities resulting from remarriages can be carried to ludicrous extremes.

Adoption of an unlimited marital deduction appears to make the adoption of a beneficial enjoyment theory essential. Under an unlimited marital deduction, the beneficial enjoyment test would be the only means available for a decedent to have control over the ultimate disposition of property and yet for such property to qualify for the marital deduction. Such a provision would be a necessity where there are children involved or in situations of second marriages where the tax deferral opportunity under an unlimited marital deduction would encourage outright transfers of all property to surviving spouses.

While the adoption of a beneficial enjoyment rule would allow a decedent to qualify property for the marital deduction and still

retain control over its ultimate disposition, it would appear that an unlimited marital deduction would still tend to encourage the transfer of all property to a surviving spouse.

Position of Other Professional Groups

In their studies for estate and gift tax reform, the U.S. Treasury Department, the American Law Institute, and the American Bankers Association all propose liberalization of the current marital deduction with respect to both the amount of the deduction and the type of interest which will qualify.

Recommendations of the Treasury and of the ALI propose that the present 50 percent marital deduction be removed entirely and replaced by an unlimited 100 percent marital deduction. The ABA favors a retention of the existing 50 percent marital deduction, coupled with a deduction for the first $250,000 of property transferred to the surviving spouse regardless of the 50 percent limitation.

With respect to the type of interest which will qualify for the marital deduction, the Treasury, the ALI, and the ABA, in general agree that the present terminable interest rule should be eliminated and replaced by a concept referred to as the "current beneficial enjoyment rule," whereby a mere income interest to the surviving spouse may qualify for the marital deduction. Under the current beneficial enjoyment rule, an interest will qualify for the marital deduction whether or not the surviving spouse controls the underlying property, as long as it is agreed that the property will be taxed at the death of the spouse.

AICPA Proposals

Retention of the 50 Percent Marital Deduction. The AICPA believes that the current incidence of gift and estate taxation imposes a disproportionate burden on small and medium-sized estates. The AICPA's unified transfer tax proposal recommends an exemption level of $150,000. Assuming an exemption level of $150,000, it is felt that a 50 percent marital deduction will provide adequate relief for a surviving spouse in moderate-sized estates. Accordingly, the AICPA recommends a retention of the 50 percent marital deduction as currently provided in IRC Sec. 2056.

Retention of the Existing Terminable Interest Rules. The AICPA also recommends a retention of the existing terminable interest rules. Advocates of change in the existing terminable interest rule point to the complex and technical requirements necessary for an interest other than outright ownership to qualify for the marital deduction. The existing terminable interest rule has resulted in an inequity for those unaware of its restrictive provisions. To replace such rule with a beneficial enjoyment theory would likewise cause inequity to the unwary. While a beneficial enjoyment rule would allow for greater flexibility in estate planning, introduction into the Internal Revenue Code of an entirely new concept permitting a mere income interest to qualify for the marital deduction would add additional complexity to the law probably causing considerable new litigation.

Summary

The AICPA is opposed to a change in the federal estate and gift tax laws that would permit an unlimited marital deduction and the addition of a beneficial enjoyment rule. While estate tax reform should provide adequate protection to a surviving spouse in moderate estates, the AICPA feels that the increase in the existing exemption level to $150,000 from $60,000, along with retention of the existing marital deduction and terminable interest rules, will accomplish such a result. A change to an unlimited marital deduction and a beneficial enjoyment concept would be of greater benefit to larger estates, resulting in substantial revenue loss and adding further complexity to the existing tax laws.

4

Appreciated Assets Transferred at Death

Background

Under current law, the federal estate tax is imposed upon the fair market value of assets includable in the decedent's gross estate determined at the date of death or alternate valuation date (after taking into account allowable deductions and credits). The basis of the property in the hands of the recipient beneficiaries then generally becomes its value for estate tax purposes. If, however, the property represents the right to "income in respect of a decedent"—such as wages receivable after death, or obligations derived from a sale reported by the decedent under the installment method—the beneficiary must carry over the decedent's basis, if any.

Asset appreciation is not subject to income tax, although it is included in the post-death basis of the asset, under the general rule stated above. Appreciated property transferred by inter vivos gift normally retains the same basis in the hands of the donee as it had in the hands of the donor, plus gift tax paid on the full value of the transfer.

The 1969 Treasury Proposals contended that the current law permits vast portions of capital gains to escape income taxation. It charged that the law fails to recognize the separate characters

of estate and income taxation. It further claimed that accumulations derived from appreciation are favored over accumulations from annually assessed dividends, interest, and wages. In addition, the Treasury Department also stated that "unnatural holding patterns" develop because older investors become locked into appreciated assets to avoid paying income taxes on recognized gains. The Treasury Department drew up statistical tables based upon data gleaned from returns of the 1960's and concluded that $15 billion a year of capital gains fall outside the income tax system.

Under the 1969 Treasury Proposals' capital gain tax concept, the appreciation on capital assets held at death would be taxed in the final income tax return of the decedent as if the assets had been held for more than six months and sold just prior to death. "Income in respect of a decedent" would no longer be taxed as the income is received. It too would be "bunched" into the decedent's final return and taxed as capital gain or ordinary income, depending upon its nature. Only appreciation that accumulates after enactment of the proposals would be subject to the tax. Thus, the provisions would not have retroactive effect, but establishing valuations on the enactment date would be necessary.

The income tax attributable to such capital gains and "income in respect of a decedent" would be deductible from the gross estate of the decedent and would reduce the taxable estate and, accordingly, reduce the estate tax (if any) otherwise payable. The taxed property would acquire a stepped-up basis in the hands of the beneficiaries as under current law.

Property transferred to a surviving spouse and to charity would be exempted from the tax. The decedent's basis for the property would carry over to the spouse. Every decedent would have a minimum basis entitlement of $60,000 to preclude taxation below that level. All losses on capital assets held at death would be considered long-term and applied against capital gains in the year of death; then, under special rules, applied in the following order: against capital gains in the three prior years; against ordinary income for the year of death; and, lastly, against ordinary income of the three prior years. When losses are carried back, they would be applied first to the most recent preceding year. Only 50 percent of the capital loss would be deductible when

applied against ordinary income. Any losses not applied during the four-year period would expire unused.

Under the 1969 Treasury Proposals, since appreciation on property passing to widows and charity—and to a limited extent, to orphans—would not be taxed, the basis would be allocated arithmetically among the assets other than cash, in proportion to their respective fair market values. The objective of this rule would be to discourage transfers to particular beneficiaries principally to accomplish tax objectives.

Income taxes generated by the foregoing proposals would be payable, along with the estate tax, under broadened tax deferral provisions. The 1969 Treasury Proposals also held out the prospect of lowering transfer taxes to the extent that revenues are expected to be produced by this new capital gains tax.

Discussion

Some insight into the rationale underlying the 1969 Treasury Proposals can be gained by reflecting upon certain statements contained therein, and upon a lecture given by their chief advocate, Professor Stanley S. Surrey. The proposals assert: "*For administrative reasons* the tax system does not every year make the taxpayer [whose assets have appreciated] calculate how much his holdings have appreciated in value." (P. 332; emphasis and bracketed matter supplied.) Professor Surrey elaborated upon this theme during his portion of the Third Hess Memorial Lecture delivered to the Association of the Bar of the City of New York on November 18, 1971. Among other things, he stated:

> We could, and probably in equity we should, tax gains as they accrue currently year by year. But, we don't and the income tax system stays its hand as the asset increases in value, partly for administrative reasons and partly for policy reasons, such as, for example, that money may not be at hand to pay the tax.[1]

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[1] Richard B. Covey, Stanley S. Surrey, David B. Westfall, "Perspectives on Suggested Revisions in Federal Estate and Gift Taxation," in *The Record of the Association of the Bar of the City of New York*, Vol. 28, no. 1 (1973), p. 49. All subsequent citations of this article will be made by page number within the body of the text.

This argument could lead to the conclusion that if the administrative procedures could be made somewhat easier, then nothing would stand in the way of a periodic, perhaps year-by-year, tax on unrealized appreciation. Another factor is the philosophical view of the economist Gardiner Ackley, which was quoted with apparent approval by Professor Surrey during the Hess Lecture and introduced by his comment that these words do not come from a radical economist:

> In my judgment the time has now come to move steadily and rapidly toward the virtual abolition of the unequal start in economic life that accrues to one who is born rich. . . .
> The vehicle is at hand to do this in the radical revision of our estate and gift tax laws. I should hope that within a decade or two we could place a virtual ceiling on the transmission of more than the most minimal property income from members of one generation to members of the next. (pp. 45-6)

If one starts with a predilection for the income taxation of unrealized gains and is inclined to seek the eradication of disparities of wealth, these factors would tend to support a tax system containing the technical complexities and burdens inherent in the capital gain tax proposals. While this report does not take a position with respect to such goals, the AICPA feels however, that Congress ought to be fully aware that they may be the springboard of the 1969 Treasury Proposals.

The 1969 Treasury Proposals place great weight on statistics to stimulate Congress to action. It should also be noted, however, that the Treasury Department drafted the proposals in the context of an active stock market and used examples of investors who experienced 50 percent appreciation in one year. Shortly after the proposals were issued, the stock market began a precipitous plunge. More recent statistics indicate the probability that severe inequities could result from the arbitrary taxation of appreciation at a date prior to the realization of capital gains.

While those in favor of a tax on appreciation at death often argue that it eliminates the lock-in problem, changing economic conditions are a far stronger force to that end. We have recently

witnessed significant changes in investment philosophies, and traditional practices of indefinitely holding on to "blue chip" investments are now being challenged. Untouched investments in many basic industries—rails, automobiles, chemicals, basic metals, electronics, and so forth—over extended periods of time would have produced little gain and some notable financial disasters. Tomorrow's "blue chip" investments will be different from today's, and the elemental urge to preserve capital will dictate changes in security portfolios.

There is one type of investment, however, where a tax on appreciation is certain to forcibly unlock long-standing ownerships —small businesses. The problem here is that the unlocking process may be ruinous. The prospect of the conjunction of income and estate taxes on the value of the business would probably accelerate the trend to merge or sell out to avert forced sales when the owners of closely-held companies die. This consequence should not be overlooked by Congress when it considers the advisability of imposing a capital gain tax on appreciation.

The 1969 Treasury Proposals repeatedly refer to the advantages held by a taxpayer who accumulates wealth through untaxed appreciation of his capital assets over one who earns ordinary income. While there is no doubt that one who is subject annually to a tax upon his ordinary income is at a comparative disadvantage, that disadvantage exists whether or not the investor is taxed on his capital gains, because the capital gain tax applies only when the investor chooses to realize the gain, and the tax is at lower effective rates. Probity dictates that the effects of current law be evaluated by comparing persons who are similarly situated to measure fairly the advantages that one may have over the other.

The two exhibits that follow contradict the implications of the 1969 Treasury Proposals that the current law permits high-bracket taxpayers to elude paying their fair share of taxes forever. They disclose that the estate tax, assuming other proposals in this report for a unitary tax structure and for the prevention of generation skipping are enacted, effectively balances the tax impact in the two situations.

Exhibit 1, page 22, compares two taxpayers, *A-1* and *B-1*. At the

beginning of a 20-year period ended by their deaths, both held $2 million worth of capital assets. During the 20 years, the assets appreciate 30 percent (compounded) every five years. *A-1* sells his property at five-year intervals and pays the capital gain taxes. When he died, the last five years of appreciation remained untaxed. *B-1* does not sell any appreciated assets, so that the appreciation arrives unreduced by income taxes into his estate. The Treasury Department's commentary indicates that, under current law, *B-1* has enormous advantages over *A-1*, but it disregards the effects of the estate tax in this situation. For example, the Treasury Department states: "The estate tax will fall on both [*A-1*

EXHIBIT 1

Taxpayer A-1		*Assets*	*Taxes Paid*
		(000 Omitted)	
Cost basis		$2,000	
Appreciation—first 5 years—30%	$600		
Tax—35%	210	390	$ 210
		$2,390	
Appreciation—second 5 years—30%	$717		
Tax—35%	251	466	251
		$2,856	
Appreciation—third 5 years—30%	$857		
Tax—35%	300	557	300
		$3,413	
Appreciation—fourth 5 years—30% Not taxed, taxpayer dies		1,024	
		$4,437	
Federal gross estate tax		2,076	2,076
		$2,361	$2,837
Ratios of assets and taxes paid to combined amount		45%	55%

Taxpayer B-1	*Assets*	*Taxes Paid*
	(000 Omitted)	
Cost basis	$2,000	
Appreciation—first 5 years—30%	600	
	$2,600	
Appreciation—second 5 years—30%	780	
	$3,380	
Appreciation—third 5 years—30%	1,014	
	$4,394	
Appreciation—fourth 5 years—30%	1,318	
	$5,712	
Federal gross estate tax	2,905	
	$2,807	$2,905
Ratios of assets and taxes paid to combined amount	49%	51%

and *B-1*] *so it is not relevant* to say that [B-1] ought not to pay any income tax on his accumulation of wealth 'because he pays an estate tax.' " (P. 332; emphasis and bracketed matter added.) In Exhibit 1, A-1, the repeatedly taxed investor would have paid or had paid by his estate cumulative taxes of $2,837,000. *B-1,* who avoided the capital gain tax would have paid federal estate taxes aggregating $2,905,000—$68,000 more than *A-1.*

Exhibit 2 employs the same assumptions with respect to sales and growth rates, except that taxpayers *A-2* and *B-2* each held $4 million worth of capital assets at the beginning of a 20-year period ending with their deaths. *B-2,* who deferred payment of tax until his death and thereby obtained a stepped-up basis free of income taxes, would have paid taxes aggregating

$7,138,000, or $429,000 more than the cumulative taxes paid by *A-2*. The taxable estates of *A-1* and *A-2* would have been reduced, of course, by both the taxes paid and the appreciation on the tax money no longer available for investment. The higher estate tax brackets reached by *B-1* and *B-2* brings the percentage of assets of the four estates paid into the federal treasury into comparable alignment. The computations for these two exhibits are as follows.

Exhibits 1 and 2 assume that the taxpayer is not married at date of death and is therefore unable to utilize the marital deduction. In the following two supplementary illustrations, the facts are identical except that the taxpayer takes advantage,

EXHIBIT 2

Taxpayer A-2		*Assets* (000 Omitted)	*Taxes Paid* (000 Omitted)
Cost basis		$ 4,000	
Appreciation—first 5 years—30%	$1,200		
Tax—35%	420	780	$ 420
		$ 4,780	
Appreciation—second 5 years—30%	$1,434		
Tax—35%	502	932	502
		$ 5,712	
Appreciation—third 5 years—30%	$1,714		
Tax—35%	600	1,114	600
		$ 6,826	
Appreciation—fourth 5 years—30% Not taxed, taxpayer dies		2,048	
		$ 8,874	
Federal gross estate tax		5,187	5,187
		$ 3,687	$6,709
Ratios of assets and taxes paid to combined amount		35%	65%

EXHIBIT 2 continued

Taxpayer B-2	*Assets* (000 Omitted)	*Taxes Paid* (000 Omitted)
Cost basis	$ 4,000	
Appreciation—first 5 years—30%	1,200	
	$ 5,200	
Appreciation—second 5 years—30%	1,560	
	$ 6,760	
Appreciation—third 5 years—30%	2,028	
	$ 8,788	
Appreciation—fourth 5 years—30%	2,636	
	$11,424	
Federal gross estate tax	7,138	
	$ 4,286	$7,138
Ratios of assets and taxes paid to combined amount	38%	62%

EXHIBIT 3

Taxpayer A-1 and Spouse	*Assets* (000 Omitted)		*Taxes Paid*
At time of death	$4,437		$ 761
Marital	(2,218)	$2,218	
	2,219	2,218	
Federal gross estate tax	831	830	1,661
	1,388	$1,388	$2,422
	1,388		
Assets transferred	$2,776		
Assets transferred versus taxes paid	53%		47%

EXHIBIT 3 continued

Taxpayer B-1 and Spouse		*Assets*	*Taxes Paid*
	(000 Omitted)		
At time of death	$5,712		
Marital	(2,856)	$2,856	None
	2,856	2,856	
Federal gross estate tax	1,155	1,155	$2,310
	1,701	$1,701	$2,310
	1,701		
Assets transferred	$3,402		
Assets transferred versus taxes paid	60%		40%

through transferring one-half of his property to his spouse, of the maximum marital deduction.

In Exhibit 3, the total taxes paid by A-1 and spouse (the taxpayers who recognized gains and paid the capital gains tax) now

EXHIBIT 4

Taxpayer A-2 and Spouse		*Assets*	*Taxes Paid*
	(000 Omitted)		
At time of death	$ 8,874		$1,522
Marital	(4,437)	$4,437	
	4,437	4,437	
Federal gross estate tax	2,076	2,076	4,152
	2,361	$2,361	$5,674
	2,361		
Assets transferred	$ 4,722		
Assets transferred versus taxes paid	45%		55%

EXHIBIT 4 continued

Taxpayer B-2 and Spouse	*Assets* (000 Omitted)		*Taxes Paid*
At time of death	$11,424		None
Marital	(5,712)	$5,712	
	5,712	5,712	
Federal gross estate tax	2,905	2,905	$5,810
	2,807	$2,807	$5,810
	2,807		
Assets transferred	$ 5,614		
Assets transferred versus taxes paid	49%		51%

exceeds by a minor amount ($2,422,000 versus $2,310,000) the estate taxes paid by B-1 and spouse. However, in Exhibit 4, the estate taxes paid by B-2 and spouse continue to exceed ($5,810,000 versus $5,674,000) the combination of capital gains and estate taxes paid by A-2 and spouse.

The AICPA believes that Professor Surrey was erroneous in these remarks concerning the present system during the Hess Lecture:

> This *complete forgiveness* is totally unfair to people who have built up their estate from after-tax income, whether it derives from dividends, salary or capital gains upon which tax has already been paid. It is a *complete windfall* to those who are building up their estates out of before-tax income, the *untaxed appreciation* in value. (p. 49; emphasis added)

Certainly the terms "complete forgiveness," "complete windfall," and "untaxed appreciation" are grossly deceptive and do not properly describe the tax situations of the hypothetical taxpayers *B-1* and *B-2* in the above illustrations.

**Position of Another Professional Group—
American Bankers Association**

In its commentary on the 1969 Treasury Proposals, the ABA contends that the capital gain tax on appreciation at death is regressive and unfair. Large estates would have the lowest net rate of capital gain tax since the tax would be allowed as a deduction at the highest transfer tax bracket. At present rates, 77 percent of the capital gain tax could be recouped from the estate tax. Whatever progressive rate scale is adopted, the capital gain tax must bite more deeply into estates in the lower brackets.

Undue complexity is another charge levelled against the Treasury Proposals by the ABA. Complications stem from the exclusion from the capital gain tax of property qualifying for the marital, charitable, and orphans deductions. Such exclusions would make the basis of any particular asset unknown until all assets are finally allocated among the beneficiaries, and sales of assets and funding of bequests of pecuniary amounts would have long uncertain tax consequences.

The ABA further points out that the 1969 Treasury Proposals contain a specter of interdependent tax computations with multiple variables. The amount of the marital and charitable deductions depends on the capital gain tax; that tax is dependent on the amount of property qualifying for the deductions; and the estate tax depends on, and often is interwoven with, the equation in fractional share deduction computations.

The brusque discarding by the 1969 Treasury Proposals of the present deferred tax treatment of "income in respect of a decedent" in IRC Sec. 691 is challenged by the ABA. The Treasury Department proposed to bunch all "income in respect of a decedent," whenever it is to be received, in the final return of the decedent, leaving the amelioration of the tax consequences to the income-averaging provisions. The ABA points out that the proposal complicates rather than simplifies the taxation of such income. Generally, "income in respect of a decedent" is not readily marketable and not readily subject to accurate valuation. Therefore, it will necessarily be reported at values below the full amounts to be collected. The discount would be reported over the same period, in the same fashion, and by the same taxpayers

as under current law. Moreover, anticipatory taxation would create serious liquidity problems for the estate.

The ABA further points out that taxpayers with identical amounts of losses would be treated differently, depending upon the existence of gains and losses in the year of death and in the three prior years. Furthermore, while losses would be allowed on lifetime gifts, they would be disallowed on transfers to related parties. The ABA rhetorically asks, "To whom does one ordinarily make lifetime gifts, if not to related parties?"

In other areas of criticism, the ABA takes issue with the Treasury Department's proposed allowance of basis at the higher of actual basis or enactment date value, with the minimum basis, with the absence of an exemption for life insurance, and with the triggering of added taxes where the decedent's state of residence conforms its income taxes to those of the federal government. The ABA shies away from the obligation to prove cost basis, asserting that many taxpayers maintain inadequate records, in reliance upon the stepped-up bases rules under the current estate tax law.

The ABA originally advocated carryover of basis as its alternative to the present system. It reconsidered, and now is in favor of the Additional Estate Tax (AET). Under the carryover of basis concept, the transferor's tax basis for all properties included in the decedent's estate would carry over to the transferee, as is the case at present when property is transferred by inter vivos gift. The federal estate tax before state death tax credit would be added to the bases of assets transferred, but limited to the extent that the fair market value of the estate's assets exceed their bases. Tangible property held for personal use by the decedent would be allowed a step-up of basis within the limits of $5,000 per item and $25,000 in total.

The carryover-of-basis proposal was attractive for the following reasons:

- It has proved to be operative under present gift tax rules;
- The tax burden would fall on the parties who realize income on a voluntary sale of the property, and at a time when funds become available to pay the tax;
- Death is not the moment of realization of income;
- Carryover of basis meets the objection to the escape from in-

come tax of appreciation on a decedent's assets;

- The inequity of imposition of tax before realization of income cannot be eliminated by averaging devices; and
- Relief measures for deferring the tax will not be necessary under the carryover-of-basis concept.

Yet in its commentary on the carryover-of-basis proposal, the ABA presented its reconsideration of the matter.

The ABA is deeply concerned with proposals that would require the establishment of historical cost basis for federal income tax purposes after property passes through an estate. It contends in its commentary, that many people have not maintained adequate records in reliance on current law which makes cost basis irrelevant when the property owner dies.

The carryover-of-basis proposal also allows the addition of federal estate taxes to the bases of items of property. The ABA is concerned that sales of property by the executor of an estate prior to the final determination of the estate tax liability will involve guesswork as to the income tax consequences of such sales and will necessitate the filing of amended fiduciary and beneficiary income tax returns as a matter of burdensome routine. Further, with carryover of basis the period over which taxpayers tend to refrain from the sale of property to postpone the incidence of taxation would be indefinitely extended, thus creating a lock-in problem.

The ABA also considers it manifestly unfair for estate taxes to be allocated under the carryover-of-basis proposal to property qualifying for the marital or charitable deductions. Yet, if certain property is to receive a basis adjustment, and other property is not, the entire process of administration would be beset by the indefiniteness of the bases of specific items.

Sales soon after the date of death are often obligatory to pay death taxes, debts, expenses, and bequests. Under the carryover-of-basis proposal, the ABA concluded, these sales may result in substantial capital gains, and the need to pay taxes thereon may require further sales which in turn may add to additional capital gain taxes—a compound "mushroom" effect. In light of this interaction, the ABA contends that the carryover-of-basis proposal

bears a close resemblance to the capital gains tax-at-death proposal—without the advantages of the latter (that is, the capital gains tax liability would reduce the estate tax).

The ABA believes that a carryover-of-basis rule would bring with it the practical elimination of the utilitarian pecuniary marital bequest. Draftsmen would be wary because the funding of such bequests might involve recognition of prohibitive amounts of capital gain.

Finally, if a carryover-of-basis rule is enacted, the ABA envisions firm resistance by Congress to meaningful transfer tax reductions. The ABA believes that the tax revenues eventually to be derived from adoption of a carryover-of-basis rule cannot be accurately measured.

While the ABA favors retention of the current taxing system, it urges only as the least problem-filled alternative the adoption of the "Additional Estate Tax" (AET). The ABA devised the AET as an alternative to the capital gains tax after deciding to reject support for the carryover-of-basis concept which it had previously favored.

The AET would be imposed at the fixed rate of 14 percent on net appreciation of assets upon death and upon transfers made within the two years preceding death. Property transferred earlier would take a carryover basis as under current law. The 14 percent rate was arrived at by multiplying the complement of a postulated highest transfer tax bracket (60 percent) by the highest capital gains tax rate (35 percent). The tax would apply even upon property qualifying for the marital and charitable deductions.

Losses at death would not be rebated to any extent by the AET. The ABA considers their proposed reduced rate structure a sufficient compensation for estates holding depreciated assets. Only appreciation after the enactment of the AET would be subject to the tax. Accordingly, the proposed rate reductions of the transfer tax to a ceiling of 60 percent would be phased in over a five-year period as the revenues generated by the AET would presumably increase.

The AET is advocated by the ABA in lieu of the Treasury Proposals on three broad grounds: (1) it would be progressive, and therefore fair; (2) it would be simple because it would avoid

complex refinements, and would be collected along with the basic transfer tax; and (3) it would be constitutional because it would be an excise tax, a classification which might not apply to the capital gains tax. Each of these claimed attributes of the AET is evaluated below.

AICPA Proposals

Retention of Current Law. After carefully studying each of the proposals for taxing, directly or indirectly, the unrealized appreciation of assets at death, the AICPA concluded that the objectionable features of each proposal were compelling and beyond recasting. It has further concluded that the AICPA should not temper its strong belief that the current law should not be abandoned, or by expressing a qualified preference for one proposed change over the others. The following discussion serves to support the AICPA's conclusions.

The ABA's proposed tax is called an "Additional Estate Tax," but it is not that; it is an income tax. It is measured by gains—unrealized gains—and that is its fundamental defect. The AICPA, as a general observation, takes the position that the claimed advantages of the AET are not valid. It does not agree that the tax is fair, progressive, simple, and constitutional beyond debate.

The Correlation of Death and Gain. The focal point of the problem with both the AET and the 1969 Treasury Proposals is their turn from the heretofore well-established principle that taxes on appreciation should be imposed only when gains are realized and when cash to pay the taxes is generated. The AICPA believes that the view of death as a moment of realization of gain is philosophically unsound. Paper profits at any point in time are so ephemeral that, if they are to be taxed, only an immensely complex system involving alternate valuation dates, liberal tax deferrals, credits, averaging, and quick-refund procedures could possibly provide for fairness.

Double Tax. The AET would be in effect a double tax. This is acknowledged by the ABA. No deduction would be allowed for the basic estate tax for AET purposes. The resultant double tax is embraced by the ABA so that the AET would be progressive, when viewed in combination with the basic estate tax.

Rate of Tax. The AET would not be on a graduated scale, yet it is labeled "progressive" by the ABA. It is not convincing to contend that the AET is progressive when (but only when) it is combined with the basic estate tax rate schedule. It is obvious that a taxpayer who has accumulated a modest amount of taxable appreciation over many years would be taxed at the same rate as one who has accumulated substantial appreciation over a short-term period. By contrast, the income tax rules do ease the burden upon lower-bracket taxpayers. In addition, the inclusion of only one-half of net long-term gain in taxable income, the exemption from the minimum tax, and the income averaging provisions operate in favor of the individual who recognizes relatively small amounts of gain on an annual basis.

The AET rate would be tied directly to the highest capital gain tax rates. There have been many proposals to increase or otherwise modify the capital gains tax. If the tax is increased, as it has been in recent years, it has been assumed that an increase in the rate of the AET would follow. Such a change would magnify the problems associated with the AET, not the least of which would be the liquidity crisis in prospect for estates.

Basis Problems. The ABA is concerned with the requirement, especially under the carryover-of-basis proposal, to prove actual cost basis. The AICPA does not share that concern—at least not to an extent that would justify so complicating the estate tax structure. The current recordkeeping requirements should be observed by all taxpayers; and no taxpayer should be entitled to ignore these requirements based on the highly speculative assumption that he will hold his property until his death.

The ABA's concern with proof of basis, however, does not extend to several areas in which carryover of basis is adopted under the AET. For example, there is apparently no concern with the present gift tax basis rules. Nevertheless, to avoid proof of basis it proposes to adopt a start-up date rule. The AICPA sees a serious problem in the choice of fair market value on the enactment date as the basis of property for AET purposes.

The enactment date rule would create a nationwide appraisal obligation which would be a substantial administrative burden. Estates are not necessarily made up primarily of listed securities, and the valuation problems at the time of death could be enor-

mous. Disputes between examining agents and taxpayers' representatives often involve the valuation of real estate, partnership interests, closely held corporations, loans receivable, copyrights and patents, valuable art work, large blocks of securities, and present and future interests in trusts. These disputes often reach the courts. A start-up date would bring another set of subjective valuations into the transfer tax picture, and the AICPA believes that the accompanying distortions and inaccuracies would be an unfortunate consequence of this approach. Moreover, the development of self-serving records to support valuations for the types of assets listed above could become a widespread practice. The prospects of an informed and fair review of the accuracy of these records would likely be inversely proportional to the interval between their preparation and review.

If a start-up date is adopted, enormous numbers of persons will be obliged to price an inconceivably large number of assets. Relatively few estates now must file federal estate tax returns because of the exemption under current law. Consequently, the assets of relatively few estates undergo professional appraisal. But it is difficult—if not impossible—for a taxpayer to know that he will not have a taxable estate in the uncertain future. He, therefore, cannot safely assume that he need not determine his start-up date values. Under these conditions, the appraisal of property as of the start-up date would be an immediate major burden, and valuation controversies in the settlement of estate tax liabilities would be many times more frequent than is presently the case.

Marital and Charitable Deductions. The AET makes no allowance for transfers that qualify for the marital and charitable deductions. In connection with the 100 percent marital deduction proposal, the 1969 Treasury Proposals appropriately state:

> It does not appear, then, that transfer of property between husband and wife are appropriate occasions for imposing tax. An especially difficult burden may be imposed by the tax when property passes to a widow, particularly if there are minor children. The present system of taxing transfers between spouses does not accord with common understanding of most husbands and wives that the property they have accumulated is 'ours.' (p. 358)

This view should be compared with the ABA's view that "as a matter of theory, imposition of a tax on appreciation should not turn upon the destination or use of the appreciation." As a matter of practice and public policy, the marital deduction has been allowed in valid recognition of the nature of the marital relationship and to equate the tax consequences of taxpayers living in jurisdictions having different property law concepts. Moreover, deductions for income tax purposes generally have been allowed for the value of assets transferred to charity, and no gain need be reported if the transferred assets have appreciated.

The ABA's overriding consideration in suggesting these tax provisions is revealed in the following statement.

> Further, if exemptions from the AET based upon the recipients of the property subjected to the tax or adjustments to it are introduced, *simplicity is lost,* and administration becomes complex. *It is time that simplicity and ease of administration, whether it works 'for' or 'against' the taxpayer, be considered as priority objectives in the enactment of tax laws.* (pp. 2-43, 44, emphasis supplied)

If we substitute for the words "for" and "against" in the foregoing quotation the words "equitably" and "inequitably"—or "fairly" and "unfairly"—the consequence of the selection of simplicity as the overriding priority may be more clearly apparent.

Simplicity and Unfairness—The Correlatives. Although the AET conceivably could be modified to achieve greater equity, the ABA apparently prefers not to do this on the grounds of an overriding need for simplicity. The following observations seem appropriate in this connection.

- Appreciation would be taxed, but there would be no tax rebate for a net loss at death. The investor may have paid capital gains taxes throughout his life, but no carryback of a net loss position would be available, and no transfer tax reduction is suggested. The ABA suggests that the investor would have some relief with its proposed lower tax rate schedule. The AICPA believes that in an effort to simplify this proposal, the fundamental income tax

character of the AET is ignored, and thus the normal income tax equitable safeguards are omitted.

- The AET is at a flat rate. A graduated rate, providing lower rates for insubstantial amounts of appreciation, is rejected—in the interest of simplicity.
- Properties qualifying for the marital and charitable deductions are subjected to the AET—in the interest of simplicity.
- The AET proposal incorporates a mandatory start-up date basis rule, although the ABA recognizes that inequities would occur between and among individuals, that there would be advantages for taxpayers holding highly appreciated property at the enactment date, and that there would be hardship for taxpayers who have a provable basis for property greater than its value on that date—in the interest of simplicity.
- Tangible personal property generally is exempted from the AET; neither gain nor loss would be considered; and no dollar ceiling would be imposed upon the exemption, even though inequities could result—in the interest of simplicity.

Constitutionality. The ABA states that the capital gain tax on net unrealized appreciation at death has been attacked as unconstitutional. It further asserts: "Any problem in this regard is avoided by the AET, which is an excise tax as contrasted to an income tax." Regarding the nature of its proposed tax, the ABA admits, "Some people will say that the AET is nothing more than a capital gains tax at death. They are obviously correct in the sense that *the result is the same*—the taxation of net unrealized appreciation at death." In view of the foregoing, a layman might wonder why an AET at death should be considered any more or less constitutional than a capital gain tax at death. Would not the courts, in evaluating the constitutionality of the AET, look hard at the acknowledged similarity of the *result,* and not be unduly swayed by the label "excise tax"?

Summary

The proposals that would purportedly prevent any tax reduction opportunities under the current system are melanges of complexities and inequities bound to cause extreme difficulties for taxpayers and government alike. If there is merit to the positions

of both the 1969 Treasury Proposals and the ABA that proof of actual basis over the years would be a hardship, then carryover of basis is impractical and, as a matter of equity, we should then resort to a new start-up basis under any new taxing proposal. If, however, there is—as the AICPA contends—a host of inherent inequities in the new start-up basis, then it should be rejected. It is believed also that the notion that the occasion of death is an appropriate time for the recognition of unrealized gain is unsound and that it should not be acceptable to Congress.

The asserted imperatives for a change of current law are not absolutely compelling. It is at least debatable that a shift of problems from one tax system (for example, the income tax system) to another (for example, the estate tax system) is progress. Estates which pay as much tax as did our illustrative taxpayers *B-1* and *B-2* on pages 23–27 do not escape the taxing system. Furthermore, there should be no extensive opportunities for transfer tax avoidance if the AICPA's other recommendations—a unified transfer tax; restrictions on generation skipping; and rejection of an increased marital deduction—are adopted. The present rules do not confuse the separate roles of the income and estate taxes. The estate tax complements the income tax. The estate tax is equitably progressive; at least, it has such high rates that Congress should continue to permit the beneficiaries to take bases equal to the full values subject to such heavy tax assessments.

The AICPA knows and experienced practitioners will attest that the present system is workable. The ease of reference to finally determined estate tax values to prove the bases of assets subsequently sold is manifest. If simplicity of administration of the tax law has merit, as is so often asserted by members of Congress and professional groups, the AICPA believes that where the law has this attribute with respect to taxation at death, it should not be discarded.

A practical and equitable exchange of a tax on appreciation cannot be made for an appreciable rate reduction. A new start-up date necessitates a phase-in of any rate reduction, as is apparent in the AET proposal. The new start-up date also requires speculation as to the amount of tax which would be derived from appreciation over the years ahead as shown by the previous discussion of the ups and downs of the securities markets. Congress would have to gamble that appreciation during that period would

be enough to permit a considerably lower top tax bracket. Moreover, whatever the rate concessions might be, these intended benefits might be more than counterbalanced by the new proposed tax system to which estates would be subject. Reasonable opportunities for rate reduction exist in the AICPA's several other recommendations.

5

Unified Transfer Tax

Background

Current law imposes an estate tax on certain transfers at death and a gift tax on certain transfers during life. Each tax has a separate rate schedule with the gift tax rates representing three-quarters of the estate tax rates at comparable levels. The estate tax exemption is $60,000 while the gift tax has a lifetime exemption of $30,000 for each donor and an annual exclusion of $3,000 for gifts of present interests to each of any number of donees. The gift tax is imposed on the value of the gift but the gift tax itself is not treated as an additional transfer subject to tax. Under the estate tax law, the tax itself is subjected to tax because the estate tax is imposed on the gross estate reduced only by deductions and not by the estate tax.

Statistics repeatedly issued by the Treasury indicate that despite the substantial tax incentives for lifetime giving, only a small percentage of individuals for whom estate tax returns are filed make such gifts in amounts exceeding the lifetime gift exemption and the annual gift tax exclusions.

Discussion

The primary policy question involved in determining whether there should be a single rate structure applicable to lifetime transfers and to transfers at death is the extent to which lifetime giving should be encouraged. The general consensus appears to be that such giving should be encouraged because it is socially desirable to have property transferred to or for the benefit of

younger generations where there is usually a greater need and a greater willingness to make the property productive. Thus, the issue becomes whether the present dual rate structure strikes a proper balance between creating incentives for lifetime giving and being fair to different taxpayers.

The 1969 Treasury Proposals take the position that current law grants an undue preference to lifetime gifts because it benefits the relatively wealthy individual who can afford to make significant lifetime gifts compared to the less well-to-do individual who cannot afford to do so.

Position of Other Professional Groups

The ABA favors a single rate structure for all transfers, whether made during life or at death. The ABA's acceptance of a single rate structure is subject to the qualification that the rates will be lowered to offset the additional transfer taxes that will be payable at death by persons who make taxable transfers during life.

"Grossing up" the amount of lifetime gifts to be included in a single rate structure for all transfers has also been proposed. This concept has been explained to require that the single-rate-schedule transfer tax would be imposed upon the fair market value of the property transferred, including, in the case of lifetime transfers, the amount of the federal transfer tax incurred on the transfer, which is an integral part of the making of the gift. Under present law, the tax on lifetime gifts is based on the fair market value of the property transferred exclusive of any gift tax. In the case of testamentary transfers, however, the present estate tax is imposed on the full value of the property in the estate, including that portion used to pay the estate tax imposed. Under the unified transfer tax, this difference in treatment between lifetime gifts and testamentary transfers would be eliminated by grossing up the fair market value of lifetime gifts, thus causing the transfer tax in effect, to be paid out of the property taxed, as is the case with testamentary transfers. A table would be provided showing the amount of the grossed-up transfer so that taxpayers would not be burdened with complex calculations.

The ABA opposes the use of grossing up for all lifetime transfers on two grounds. First, it discourages lifetime gifts because the payment of the additional transfer tax imposed on the

tax results in the loss of subsequent earnings on that amount during the remaining life of the transferor. Second, it is complicated and would not be understood by transferors, particularly when, as is possible, the tax is greater than the amount of the gift itself.

A majority of the members comprising various bodies within the ALI appear to prefer a unified transfer tax. In October 1967, however, the Council of the ALI voted 12 to 11 in favor of the retention of the dual tax system.

At the present time, there appears to be no official ALI recommendation on the choice between a dual tax system and a unified tax system. The ALI does appear to favor grossing up all lifetime transfers and the retention of the present $3,000 annual gift tax exclusions.

AICPA Proposals

Since lifetime transfers should continue to be encouraged and further, since the current incidence of taxation on testamentary dispositions is imposed disproportionately and unfairly on low and medium-sized estates, the AICPA proposes a modified unified transfer tax as follows.

Retention of Current Estate Tax Rates. The modified unified transfer tax would utilize the federal estate tax rates as currently established by IRC Sec. 2001. Along with this, the AICPA advocates continuation of the current incentive to make inter vivos gifts by subjecting such gifts to a tax at the rate of 75 percent of that rate.

Inclusion of Lifetime Gifts. Lifetime gifts would be included in the unified rate without grossing up lifetime dispositions except for gifts in contemplation of death. The 75 percent rate would be preserved at death by the inclusion of only 75 percent of the taxable value of property transferred during lifetime and by the granting of credit against the unified transfer tax liability for gift taxes paid on such taxable gifts. Gifts in contemplation of death, as that term is currently defined by Sec. 2035, would be grossed up so that both the value of the property at the date

of death and the amount of gift tax paid would be subject to the unified transfer tax at death. Credit would be granted against the unified transfer tax liability for gift taxes paid on gifts made in contemplation of death.

Annual Exclusion for Gifts. The AICPA advocates the continuation of the $3,000 annual exclusion for gifts of present interests in property as currently provided by Sec. 2503(b).

Unified Transfer Tax Deduction. For the current estate tax exemption in the amount of $60,000, provided by Sec. 2052, and the current specific gift tax exemption in the amount of $30,000, provided by Sec. 2521, the AICPA would substitute a unified transfer tax deduction in the amount of $150,000, available, at the option of the taxpayer, either against inter vivos gift tax liabilities or against the unified transfer tax imposed at death.

Retention of Marital Deduction. The AICPA proposes the retention of the allowance of a marital deduction as currently provided by Sec. 2056.

Summary

The AICPA believes that the recommendations outlined above will continue to encourage lifetime gifts. The continuation of the 75 percent gift tax rates, the availability of annual gift tax exclusions, the continuing possibility of removing asset appreciation from an estate by eliminating from the death transfer tax appreciation from the date of the gift to the date of death, and the income tax considerations often associated with inter vivos transfers can all be cited as continuing reasons to support inter vivos gift transfers.

The current estate exemption of $60,000 and the current specific gift tax exemption of $30,000 are inadequate when considered in light of many years' inflation. Accordingly, the AICPA recommends that the current tax exemptions be replaced by a unified transfer tax deduction of $150,000, available to a taxpayer to reduce either the amounts of inter vivos taxable gifts or to reduce the taxable estate. Also recommended is the continuation of the

two present transfer tax schedules since the availability of two schedules does not create undue administrative problems.

The "gross-up" concept for inter vivos transfers is opposed primarily because such a provision would discourage lifetime gifts. The gross-up concept also appears to be extremely complex in administration.

Exhibits 5, 6 and 7 (p. 44-47) respectively illustrate the AICPA recommendations to retain the current rates, to retain the current concept of a marital deduction, and to substitute a unified transfer tax deduction in the amount of $150,000 for the current $60,000 and $30,000 estate and gift tax exemptions. (Each schedule illustrates four hypothetical estate valuations.) The AICPA believes that these recommendations, when combined with its other recommendations, including our recommendation for severe restrictions on generation skipping, will not adversely affect the total federal revenues derived from these sources. Instead, these recommendations should alleviate substantial inequities currently imposed on low and medium-sized estates. It is noteworthy in the following schedules that total transfer taxes from an estate with net disposable assets aggregating $200,000 would be decreased from $36,100 to $7,000, while for larger estates, total transfer taxes would not be significantly affected. Equally important should be the fact that in the typical situation where the male predeceases the female, no death transfer taxes would be payable at the death of the first decedent until net disposable assets exceed $300,000 where the surviving spouse inherits all of the family's assets. Since the necessities of life often dictate that in low and medium-sized estates the surviving spouse requires all of the family's assets, the AICPA proposed tax structure should permit and strongly encourage such testamentary dispositions by imposing the major portion of death transfer tax liability only at the time of death of the second spouse.

Exhibit 7 (p. 46—47) illustrates the effect of inter vivos gifts (other than gifts in contemplation of death) by the first decedent. Note that substantial savings in total federal unified transfer taxes can be realized by the continued use of inter vivos gifts; such savings are increased where the unified transfer tax deduction of $150,000 is not claimed against earlier gifts taxed at low gift tax rates.

EXHIBIT 5

Current Federal Estate Taxes—No Inter Vivos Gifts

First Death				
Net disposable assets (after reduction by liabilities and expenses)	$200,000	$1,000,000	$5,000,000	$10,000,000
Less:				
Marital deduction	100,000	500,000	2,500,000	5,000,000
Exemption	60,000	60,000	60,000	60,000
Total reductions	160,000	560,000	2,560,000	5,060,000
Taxable estate	$ 40,000	$ 440,000	$2,440,000	$ 4,940,000
Federal estate tax	$ 4,800	$ 126,500	$ 968,800	$ 2,430,400
Second Death				
Net disposable assets	$195,200	$ 500,000	$2,500,000	$ 5,000,000
Less exemption	60,000	60,000	60,000	60,000
Taxable estate	$135,200	$ 440,000	$2,440,000	$ 4,940,000
Federal estate tax	$ 31,300	$ 126,500	$ 968,800	$ 2,430,400
Summary				
Total federal estate taxes	$ 36,100	$ 253,000	$1,937,600	$ 4,860,800
Tax as % of total net disposal assets	18.1%	25.3%	38.8%	48.6%

EXHIBIT 6

Proposed Federal Unified Transfer Tax—No Inter Vivos Gifts

First Death				
Net disposable assets (after reduction by liabilities and expenses)	$200,000	$1,000,000	$5,000,000	$10,000,000
Less:				
Marital deduction	100,000	500,000	2,500,000	5,000,000
Unified transfer tax deduction	150,000	150,000	150,000	150,000
Total reductions	250,000	650,000	2,650,000	5,150,000
Taxable estate	None	$ 350,000	$2,350,000	$ 4,850,000
Federal estate tax	None	$ 97,700	$ 924,700	$ 2,373,700
Second Death				
Net disposable assets	$200,000	$ 500,000	$2,500,000	$ 5,000,000
Less unified transfer tax deduction	150,000	150,000	150,000	150,000
Taxable estate	$ 50,000	$ 350,000	$2,350,000	$ 4,850,000
Federal estate tax	$ 7,000	$ 97,700	$ 924,700	$ 2,373,700
Summary				
Total federal estate taxes	$ 7,000	$ 195,400	$1,849,400	$ 4,747,400
Tax as % of total net disposal assets	3.5%	19.5%	37.0%	47.5%

EXHIBIT 7

Proposed Federal Unified Transfer Tax—With Inter Vivos Gifts

Net disposable assets	$200,000	$1,000,000	$5,000,000	$10,000,000
Inter vivos gifts by first decedent of 20% of net disposable assets (not in contemplation of death)—except in case of $200,000 estate	None	$ 200,000	$1,000,000	$ 2,000,000
Less unified transfer tax deduction	None	(None claimed)	(None claimed)	(None claimed)
Taxable gifts	None	$ 200,000	$1,000,000	$ 2,000,000
Federal gift tax		$ 38,000	$ 244,300	$ 564,900
First Death				
Net disposable assets (reduced by amounts of gifts and gift taxes)	$200,000	$ 762,000	$3,755,700	$ 7,435,100
Plus:				
75% of inter vivos gifts	None	150,000	750,000	1,500,000
Asset balance	200,000	912,000	4,505,700	8,935,100

Less:				
50% marital deduction	100,000	456,000	2,252,850	4,467,550
Unified transfer tax deduction not previously claimed	150,000	150,000	150,000	150,000
Total deductions	250,000	606,000	2,402,850	4,617,550
Taxable estate	None	$ 306,000	$2,102,850	$ 4,317,550
Federal estate tax	None	$ 83,600	$ 803,600	$ 2,038,300
Less credit for gift tax paid	None	38,000	244,300	564,900
Net federal estate tax	None	$ 45,600	$ 559,300	$ 1,473,400
Second Death				
Net disposable assets	$200,000	$ 456,000	$2,252,850	$ 4,467,550
Less unified transfer tax deduction	150,000	150,000	150,000	150,000
Taxable estate	$ 50,000	$ 306,000	$2,102,850	$ 4,317,550
Federal estate tax	$ 7,000	$ 83,600	$ 803,600	$ 2,038,300
Summary				
Total federal unified transfer taxes	$ 7,000	$ 167,200	$1,607,200	$ 4,076,600
Tax as % of total net disposable assets	3.5%	16.7%	32.1%	40.8%

EXHIBIT 8

Summary

Net disposable assets (after reduction by liabilities and expenses)	$200,000	$1,000,000	$5,000,000	$10,000,000
Total current federal estate taxes (no inter vivos gifts)—Exhibit 5	$ 36,100	$ 253,000	$1,937,600	$ 4,860,800
Total tax as % of net disposable assets	18.1%	25.3%	38.8%	48.6%
Total proposed federal unified transfer taxes (no inter vivos gifts)—Exhibit 6	$ 7,000	$ 195,400	$1,849,400	$ 4,747,400
Total tax as % of net disposable assets	3.5%	19.5%	37.0%	47.5%
Total proposed federal unified transfer taxes after inter vivos gifts of 20% of net disposable assets—Exhibit 7	(Not applicable)	$ 167,200	$1,607,200	$ 4,076,600
Total tax as % of total net disposable assets	(Not applicable)	16.7%	32.1%	40.8%

Exhibit 8 (opposite) summarizes the computations in Exhibits 5, 6, and 7.

Assume the following for these schedules:

1. Decedents with net disposal assets of $200,000 or less transfer their total estate to a surviving spouse. Such second estates are reduced only by federal estate taxes imposed at the first death.

2. Decedents with net disposable assets of $1,000,000 or more utilize a full marital deduction and limit testamentary dispositions to a spouse to such amount.

3. Assets transferred at the death of the first decedent neither appreciate nor depreciate in value between the date of transfer and the date of death of the second spouse.

4. Credit for state death taxes are disregarded for the purposes of these computations since they effectively represent a substitution for such death taxes.

5. Annual exclusions are disregarded in determining inter vivos gifts in Exhibit 7.

6

Liberalization of Deferred Payment of Federal Estate Tax

Background

Section 6166 was enacted by Congress in 1958. The House committee report accompanying HR 8381, which added Sec. 6166 to the 1954 code, provided that where the value of an interest in a closely held business represents a significant portion of the base on which the federal estate tax is computed, the federal death tax can be paid in ten annual installments instead of a lump-sum payment fifteen months after the death of the decedent.

For purposes of IRC Sec. 6166 a closely held business includes a proprietorship, or stock or ownership interest in a partnership or corporation of 20 percent or more, or a partnership or corporation in which there are ten or fewer partners or shareholders.

The House committee report explained the purpose was to make it possible to keep together a business enterprise where the death of one of the larger owners of the business results in the imposition of a relatively heavy estate tax. Under existing law, when a decedent has a substantial portion of his estate invested in the business enterprise, the heirs might be confronted with the necessity of either breaking up the business or selling it to a larger enterprise in order to obtain funds to pay the federal estate tax. This is especially unfortunate in the case of small businesses, which traditionally are also closely held businesses. By spreading out the period over which the estate tax may be paid, it would be

possible for the estate tax to be paid out of the earnings of the business, or at least it would provide the heirs with time to obtain funds with which to pay the tax without upsetting the operation of the business. This provision was believed to be particularly important in preventing corporate mergers and in maintaining the free enterprise system.

Section 6166 was deemed necessary because the general provision of Sec. 6161(a)(1) permitting a six-month extension of time for payment of federal taxes, including federal estate taxes by the IRS for reasonable cause, is not an adequate remedy for an executor holding an interest in a closely held business. Section 6161(a)(2), which permits the IRS to grant an extension of time for up to ten years for payment of estate taxes upon a showing that payment of the entire estate tax would result in "undue hardship" to the estate, is also an inadequate relief procedure for an executor holding an interest in a closely held business. For decedents dying after December 31, 1970, an extension of time under Sec. 6161(a)(1) can be granted for up to a year (for reasonable cause). Section 6165 permits the IRS to require that a bond (for up to twice the amount of tax involved) be furnished where an extension of time for payment is granted. The regulations permit the IRS to require such a bond when an extension is granted under Sec. 6161. The bond requirement has not been applied in connection with Sec. 6166 extensions.

Where applicable, Sec. 303 presently permits redemption of stock of closely held corporations, to the extent of the entire amount of estate taxes, administration expenses, and funeral expenses. If there is a profit on the redemption (that is, if the sales price exceeds the estate tax value), the profit is taxed as a capital gain.

Discussion

Reference to the amount of the estate taxes, federal and state, payable at death, indicates that the executor of the estate of a deceased owner of a closely held business interest is faced with a substantial liability for estate taxes. The growth of the value of such an interest during the lifetime of the owner, increases the potential estate tax burden. The greater the growth, the greater the likelihood that the executors will have to sell the

closely held business interest. Inflation serves further to aggravate this problem.

The following chart indicates the estate tax liability of a decedent resident of New York State.

Estate before exemption	*Federal tax*	*New York tax*	*Total*	*Percent on excess*	
				Federal	*New York*
$ 300,000	$ 59,100	$ 10,000	$ 69,100	26.8	5.0
500,000	116,500	20,000	136,500	28.0	6.0
700,000	176,700	32,000	208,700	30.2	7.0
1,060,000	289,140	58,800	347,940	33.4	8.0
2,060,000	649,280	153,000	802,280	41.8	10.0
3,060,000	1,075,920	267,200	1,343,120	47.2	12.0
4,060,000	1,551,560	401,400	1,952,960	52.6	14.0
5,060,000	2,069,880	551,000	2,620,880	55.8	15.0
6,060,000	2,620,200	710,600	3,330,800	58.0	16.0

The owner of a substantial equity in a closely held business needs statutory help, which would permit deferred payment of these substantial tax liabilities. The very size of the tax in relation to the estate should be enough "hardship" to permit relief without the necessity of proving "undue hardship" as presently required by Sec. 6161(a)(2).

The approach of Sec. 6166 in permitting an absolute right for installment payments over a ten-year period of federal estate tax attributable to taxation of a closely held business interest should be extended to provide relief in more instances.

Where there are several closely held business equities in an estate, the yardsticks of Sec. 303 and Sec. 6166 to treat them as one interest should be alike.

Position of Other Professional Groups

Section VIII of the 1969 Treasury Proposals, "Estate and Gift Tax Proposals," contained recommendations for liberalization of the Sec. 6166 payment rules. The proposals indicate that the "voting stock" requirement should be eliminated and that the shareholder limit should be raised from ten to fifteen. Further proposed liberalization would include permitting the installment-payment election (Sec. 6166) where the interest in the closely

held business exceeds 25 percent of the taxable estate. The Treasury Proposals would then limit the application of Sec. 303 to the portion of the estate tax which could qualify under Sec. 6166.

The ABA, in its "Summary of Transfer Act Draft Statute of the American Bankers Association" would permit deferral under Sec. 6166 where the decedent's interest in a closely held business exceeds 20 percent of his transfers at death. The definition of closely held stock would include any stock not traded on a national securities exchange or in an over-the-counter market, or if so traded, if the estate includes 20 percent or more of the voting stock. In the case of partnerships, the required percentage of partnership interest would be reduced from twenty to ten, and the limitation on partners would be increased from ten to twenty.

AICPA Proposals

Section 303 Rules Regarding Treatment of Several Closely Held Business Equities as One Should Take on the Standards of Sec. 6166. Section 303 presently permits two or more corporations to be treated as a single corporation where an estate owns more than 75 percent in value of the outstanding stock in each of the corporations. Section 6166 has a similar provision, except that the ownership requirement is more than 50 percent of the stock. The AICPA recommends that this percentage test be the same for purposes of Secs. 303 and 6166, and that the 50 percent or more test of Sec. 6166 apply for purposes of Secs. 303 and 6166.

Period for Sec. 303 Redemption Should Recognize Litigation in Any Court. The period during which Sec. 303 may be utilized is the period of limitations for assessment of federal estate tax plus ninety days, or, if a petition for redetermination of an estate tax deficiency has been filed with the Tax Court, at any time before the expiration of sixty days after the decision of the Tax Court becomes final. The AICPA feels that there is no reason that taxpayers who litigate in the District Court or Court of Claims should be prejudiced, and the AICPA recommends that the period during which Sec. 303 may be applied be extended to the expiration of ninety days after the conclusion of litigation with regard to the estate tax liability.

Elimination of Voting Stock Requirement of Sec. 6166 and the Raising of the Shareholder Limit. These AICPA proposals are in agreement with those set forth by the Treasury Department.

Reductions in Percentage Ownership of Stock Requirements in Secs. 303 and 6166. This is in agreement with the ABA's proposal. The AICPA favors these reductions in percentage ownership of stock requirements to 20 percent (of transfers at death). It is also felt that Sec. 6166 should be as available to partners as it is to stockholders.

The purpose of Sec. 6166 is to provide additional time to pay estate taxes where the deceased's assets are not readily convertible to cash because such assets consist of an interest in a closely held business. In these instances, an estate which includes a minority interest in a business may be less able to cause a redemption by the business of that interest than a holder of a large interest. Therefore, some holders are in great need of the benefit of Sec. 6166.

The problem with respect to liquidity of partnership interest is similar to that of the liquidity of a stockholder interest and should be subject to the same rules.

Retention of Sec. 303(a). In opposition to the 1969 Treasury Proposals, the AICPA does not feel that Sec. 303 should be restricted to the estate taxes attributable to the inclusion of a closely held business in the gross estate. Section 303 is presently broader in that it permits redemption of amounts representing all estate taxes as well as administrative expenses. The narrowing of Sec. 303 would impose a serious liquidity hardship on estates which have to incur a substantial income tax liability in order to pay the estate taxes.

Eliminate "Undue" Requirement of Hardship Situations. Section 6161(a)(2) should be revised to eliminate the word "undue" from the phrase "undue hardship." The use of the word "undue" has in effect nullified the value of the provision because of the administrative problems of determining what hardship is "undue" hardship.

Section 6166 Should Apply to Partners in a Manner Similar to Stockholders. Section 6166 relief should be as available to partners as to stockholders.

Eliminate Sec. 303's Extension Restriction to Tax Court Cases. A Sec. 303 redemption should be permitted after the conclusion of litigation in any court.

Summary

The AICPA believes that the tax laws should be made as consistent as possible in similar provisions of related sections and in addition that they should not contain provisions which are administratively impractical.

Differences among similar provisions, such as Secs. 6166 and 303, presently cause confusion and inequities among taxpayers, and we feel our recommendations would result in greater fairness.

We believe that the recommendations contained in this section will bring about better results administratively and will be more acceptable to taxpayers in various situations.

Conclusion

The AICPA believes that the recommendations in this report provide a sound basis for federal estate and gift tax reform as far as the five areas reviewed are concerned. The AICPA feels that it has conformed the principles of fairness and simplicity to the extent that these two principles can be combined in this connection.