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Rhodes, Transfer Tax

INDIVIDUAL, COUPLE OR FAMILY? THE UNIT OF TAXATION FOR TRANSFER TAX PURPOSES: A SHIFTING FOCUS

by

ANNE-MARIE RHODES*

MUCH HAS BEEN written recently on the estate, gift and generation-skipping taxes.¹ Indeed much has been needed, with the recent flurry of legislative enactments ranging from minor definitional clarification to major structural revision.² This literature often expresses uncertainty as to what the future will bring in the way of "reform." While uncertainty in tax law is unsettling,³ uncertainty in the estate tax area is especially so, given the uncontrollable vagaries of death. One cannot merely delay or hasten the "transaction" to the appropriate tax year.

Much of this uncertainty stems from the current lack of a clearly defined

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¹Most of the literature is technical. See, e.g., Trapp, *Construction of Marital Deduction Formulas and the Tax Effects of Funding Formula Bequests*, 17 INST. ON EST. PLAN. (1983).

²In the last seven years, Congress has enacted, *inter alia*, the following major tax legislation: Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324; Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 92 Stat. 172; Energy Tax Act of 1978, Pub. L. No. 95-618, 92 Stat. 3174; Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. 2763; Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520. Additionally, there have been various Technical Corrections Acts refining prior Congressional enactments, such as the Technical Correction Act of 1982, Pub. L. No. 97-448, 96 Stat. 2365, which made amendments to the Economic Recovery Tax Act of 1981, Pub. L. No. 97-362, 96 Stat. 1726; Subchapter S Revision Act of 1982, Pub. L. No. 97-354, 96 Stat. 1669; Bankruptcy Tax Act of 1980, Pub. L. No. 96-589, 94 Stat. 3389; Installment Sales Revision Act of 1980, Pub. L. No. 96-471, 94 Stat. 2247; Crude Oil Windfall Profits Tax of 1980, Pub. L. No. 96-223, 94 State. 229; Revenue Act of 1978, Pub. L. No. 95-600, 92 State. 2763.

³ [I]n the tax professional community, whatever the rules are, and however much you like them or dislike them, there's a certain importance attached to stability — an understanding of what the ground rules are, to applying them over a period of time, consistently, and the problem is that, when you have major legislation every year, as we've been having . . . we don't have the time, we don't have the ability, to reflect upon how these changes affect the financial decisions that need to be made . . . by individuals in getting their financial houses and futures in order. We don't have regulations yet . . . for the '76, '78, and, certainly the '81 and '82 laws. And yet, our current decisions are subject to these laws. But we don't have the guidance, direction, and stability that these regulations should give . . . It is of great concern to all tax professionals . . .

Shapiro, *Cooper & Lybrand's Ira Shapiro Discusses Current Trends in Tax Policy*, 122 TR. & EST., 18-19 (June 1983).

and articulated purpose for the entire transfer tax structure,⁴ against which it various components may be judged.⁵ If one searches for purpose by examining the tax structure, one will inevitably have a sense of cross-purposes. It also appears that just as the reason or reasons for taxing gratuitous transfers are no longer clear, it is similarly unclear as to who should be taxed.

This paper examines the shifting focus of the transfer tax system from the perspectives of the articulated primary purpose for the taxes and the appropriate unit of taxation given that purpose. The historical progression shows that as a sense of purpose became less clear, the unit of taxation similarly became less focused.

The current result of this progression is an enormously complicated transfer tax structure. It generates less than 2% of federal revenues,⁶ and actually contributes to the concentration of wealth. This is a rather dispiriting assessment considering the traditional historical motives for the tax: revenue raising and avoidance of the undue concentration of wealth.

I. 1916-1941: ESTABLISHING THE PRIMARY STRUCTURE

A. 1916-1926

The current estate tax can be traced without interruption to 1916.⁷ It was not, however, the first federal death tax.⁸ Before 1916, the federal government

⁴See, e.g., *Major Estate and Gift Tax Issues: Hearing on S. 23, S. 395, S. 404, S. 557, S. 574, S. 858 and S. 995 Before the Subcomm. on Est. and Gift Taxation of the Senate Comm. on Finance, 97th Cong., 1st Sess. 95-99 (1981)* (statement of Prof. Gerald Moran). See also, *Federal Estate & Gift Taxes: Public Hearings and Panel Discussions Before the House Comm. on Ways and Means, 94th Cong., 2d Sess., Part 1, 761-762 (1976)*:

Mr. Moran: I think it is incumbent on . . . Congress to define the purpose of estate and gift tax structure

Mr. Steigler: Would the other members of the panel comment on professor Moran's view of the purpose of the estate and gift tax?

Mr. Canwell: I would like to believe it is a revenue-raising measure . . . but that it be antidynastic gives me very serious underlying policy questions

Mr. Dodge: I don't know if I would put it in terms of revenue versus antidynastic purpose, but I do believe that the estate and gift taxes are potentially the most progressive taxes

Mr. Melvoin: I think we would emphasize that certainty in this area has such value that even the act of excessive period review of the area, simply to determine if the existing system should continue is itself disruptive of certainty

Mr. Burleson: Actually I have never thought there was a real contention or serious argument that this was not for distribution of wealth. I can't conceive of it being anything else, and I thought the whole history of the concept from the beginning showed it was really for that purpose.

⁵See also *Federal Estate and Gift Taxes: Public Hearings and Panel Discussions Before the House Comm. on Ways and Means, 94th Cong., 2d Sess., Part 2, 1175 (1976)* (statement of Charles M. Walker, Assistant Secretary for Tax Policy, Department of the Treasury. "It is thus time to reexamine whether the existing estate-tax structure is harmonious with the basis objectives of the tax." *Id.* at 1176.

⁶Treasury Department Statistics. STAFF OF JOINT COMM. ON TAXATION, 97th Cong., 1st Sess., BACKGROUND AND DESCRIPTION OF ADMINISTRATION PROPOSAL RELATING TO ESTATE AND GIFT TAXES 32 (Jt. Com. Print. 1981).

⁷Revenue Act, 1916, ch. 463, 39 Stat. 756.

⁸In April, 1794 a special House Committee on Revenue suggested a system of stamp duties on legacies and distributive shares. Two years later the House Ways and Means Committee proposed a 2% collateral tax. The first such federal tax enacted, however, was a stamp tax imposed by Act of July 6, 1797, ch. 11, 1 Stat. 527, on the receipt of a legacy or intestate share of personal property. The tax was not applicable to a surviving spouse or lineal descendants of the decedent. The stamp tax went into effect on July 1, 1798 and was repealed on April 6, 1802. Act of April 6, 1802, ch. 19, 2 Stat. 148.

See also W. SCHULTZ, THE TAXATION OF INHERITANCE 150-56 (1926); H. Zaritsky, *Federal Estate, Gift*

had imposed various modest death taxes in times of military crisis.⁹ Each of these duties was generally repealed as the particular prompting crisis passed.¹⁰ The Revenue Act of 1916 was itself a response to the growing revenue needs of the impending World War. When the federal estate tax was introduced, there was no confusion as to its primary origins.¹¹ The House Report indicated that “[t]he necessity for this legislation grows out of the extraordinary increase in the appropriations for the Army and Navy and the fortification of our country.”¹²

In choosing an estate tax, a balance was struck between federalism and states’ rights, the traditional argument advanced in opposition to any form of federal death duty:¹³

Thirty States have laws imposing inheritance or share taxes both upon direct and collateral heirs. Twelve other States have laws imposing inheritance taxes upon collateral heirs. Your committee deemed it advisable to

and Generation-Stepping Taxes: A Legislative History and a Description of Current Law, C.R.S. Rep. No. 80-76A (1980); A. J. CASNER, REPORTER’S STUDY OF DUAL TAX SYSTEM AND UNIFIED TAX (A.L.I.: FEDERAL ESTATE AND GIFT TAXATION RECOMMENDATIONS OF THE AMERICAN LAW INSTITUTE AND REPORTERS’ STUDIES) 59 (1969) [hereinafter cited as ALI PROPOSAL].

⁹In 1862, for example, the Federal government for the second time enacted a death duty. It was in the form of an inheritance tax; and once again exempted the surviving spouse. Act of July 1, 1862, ch. 119, § 111, 12 Stat. 432, 485-86. As the revenue yield was less than expected, adjustments were made. In the 1864 Revenue Act the surviving spouse was no longer exempted. Act of June 30, 1864, ch. 173, 13 Stat. 223. By a retroactive amendment in 1865, a surviving widow was exempted but not a widower. Act of March 3, 1865, ch. 78, 13 Stat. 469. In 1866, a decedent’s minor children received a \$1,000 exemption. Act of July 13, 1866, ch. 184, 14 Stat. 98, 140. The constitutionality of this tax was upheld in *Scholey v. Rew*, 90 U.S. 331 (1874).

The Spanish American War prompted, in 1898, the third federal death duty. This time it was a graduated progressive tax with rates ranging from $\frac{3}{4}$ of 1% to 15% depending on the beneficiary’s class and the total amount going to that class. Once again the surviving spouse was totally exempt. This tax was declared constitutional by the Supreme Court in *Knowlton v. Moore*, 178 U.S. 41 (1900).

¹⁰The Civil War taxes were repealed in 1870, Act of July 14, 1870, ch. 255, 16 Stat. 256, and the Spanish American War tax was repealed in 1902. Act of April 12, 1902, ch. 500, 32 Stat. 96.

¹¹It is not suggested that there were no other motives behind the tax, but that the catalyst was the war. In the period after 1900, there was interest in the imposition of some sort of federal death tax, perhaps sparked by A. CARNEGIE, *THE GOSPEL OF WEALTH* (1962), as a means of “checking untoward concentration of wealth.” W. SCHULTZ, *supra* note 8, at 155. In 1906, President Theodore Roosevelt advocated a progressive federal inheritance tax; “the adoption of some such scheme as that of the progressive tax on all fortunes, beyond a certain amount either given in life or devised or bequeathed upon death to any individual — a tax so framed as to put it out of the power of the owner of one of these enormous fortunes to hand down more than a certain amount to any one individual; the tax, of course, to be imposed by the National and not the State Government.” (cited in S. RATNER, *AMERICAN TAXATION* 260 (1942)). On the other hand, conservatives generally successfully argued against such suggestions on the ground that a federal inheritance tax would encroach on the states’ prerogative. W. SCHULTZ, *supra* note 8, at 155.

¹²H. R. REP. NO. 922, 64th Cong., 1st Sess. 1 (1916) (reprinted in 1939-1 (Part 2) C.B. 22).

¹³For example, the National Tax Association, in its first conference, adopted a resolution squarely opposed to a federal inheritance tax:

WHEREAS, the several states are now taxing inheritances with marked success and need all the revenue that can properly be drawn from this source; and

WHEREAS, the Federal Government can readily raise additional revenue when required from other sources:

RESOLVED, that it is the sense of this conference that inheritance taxes should be reserved wholly for the use of the several states.

Quoted in W. SCHULTZ, *supra* note 8, at 156.

recommend a Federal estate tax upon the transfer of the net estate rather than upon the shares passing to heirs

. . . The Federal estate tax recommended forms a well-balanced system of inheritance taxation as between the Federal Government and the various States, and the same can be readily administered with less conflict than a tax based upon the shares.¹⁴

The original structure of the federal estate tax was straightforward:

1. the determination of the decedent's gross estate, which consisted of three items;¹⁵ then
2. the subtraction of the \$50,000 exemption¹⁶ and the deductions for debts, claims, and expenses,¹⁷ which yielded the net estate; and finally
3. the computation of the estate tax on the net estate by rates which started at 1% and reached a maximum of 10% on the estate in excess of \$5 million.¹⁸

In simplest terms, most of the history of the transfer taxation can be seen as a tinkering with this basic structure — a redefinition of the inclusions in the tax base, a revamping of the allowable deductions, exemptions and credits, and a readjustment of the rate structure. The tinkering began almost immediately.

With the increasing revenue need due to war expenditures, the estate tax rates were increased twice in 1917; thus, rates ranged from a minimum of 2% to a maximum of 25% on estates over \$10 million.¹⁹ The first increase had no significant legislative opposition; the second, however, engendered a great deal of debate.²⁰ The Senate opposed any further increase in the estate tax rates on the basis that the House's proposed increase would seriously encroach on

¹⁴H. R. REP. NO. 922, *supra* note 12, at 5. (*reprinted in* 1939-1 (Part 2) C. B. at 25).

¹⁵Section 202 of The Revenue Act of 1916 included in the gross estate all property, real or personal, to the extent of the interest therein of the decedent (1) which was subject to the payment of charges and expenses against his estate and which was distributable as part of his estate, (2) which was given in contemplation of or intended to take effect in possession or enjoyment at or after his death; or (3) which was held jointly or as tenants by the entirety by the decedent and another, except such part as was shown to have never belonged to the decedent. Revenue Act, ch. 463, § 202, 39 Stat. 756, 777 (1916). These three provisions roughly correspond to current I.R.C. §§ 2033, 2035-38, 2040 (1982).

¹⁶Revenue Act, ch. 463, § 203(a)(2), 39 Stat. 756, 778 (1916).

¹⁷Revenue Act, ch. 463, § 203(a)(1), 39 Stat. 756, 778 (1916).

¹⁸Revenue Act, ch. 463, § 201, 39 Stat. 756, 777 (1916).

¹⁹The first of these, Act of March 3, 1917, ch. 159, 39 Stat. 1000 (1917), raised the estate tax rates by 50%, to 1½% to a maximum of 15% on the excess over \$5 million. "This . . . is made necessary because of the urgent need of funds with which to meet the extraordinarily large appropriations for the military" H.R. REP. NO. 1366, 64th Cong., 2d Sess. 1 (1917) (*reprinted in* 1939-1 (Part 2) C.B. 43).

The second, the War Revenue Act, ch. 63, § 900, 40 Stat. 300, 324-25 (1917), increased the rates to 2% to a maximum of 25% on the excess over \$10 million. These rates reflect a compromise between the House (which originally proposed increasing the estate tax rates to 2½% to 30% and lowering the exemption to \$25,000 from \$50,000) and the Senate (which was opposed to any increase in rates).

²⁰S. REP. NO. 103, 65th Cong., 1st Sess. 1 (1917) (*reprinted in* 1939-1 (Part 2) C.B. 56).

the states' initiative in inheritance taxation.²¹ Compromise, however, was achieved and the second increase was effected.

In 1918, while Congress was in the midst of tax revision, "came the sudden and dramatic victory," and hence the "opportunity [and] necessity of reducing the large tax budget."²² Thus, within two years of enactment, some of the tinkering began to reduce the scope of the tax.

The House bill in 1918 made some general tightening changes and increased the estate tax rates by a bout 50%.²³ The Senate, having received the sweet news of victory, decided to substitute an inheritance tax for the estate tax. It believed that an "inheritance tax plan is fairer and more equitable in its operation than the estate tax plan."²⁴ Its proposed inheritance tax made "no difference in the rate . . . because of the relationship of the beneficiary" to the decedent.²⁵ The plan, however, did exempt completely the estates of those decedents "dying during the . . . present war while serving in the military" (or dying within one year after the war from injuries received or disease contracted during military service) as well as all transfers for charitable purposes.²⁶ In conference, the estate tax structure was retained; however, the charitable deduction was added,²⁷ and the rates were lowered for estates under \$1½ million.²⁸ Hence, this injection of an inheritance tax notion — a tax based on the status of the recipient, rather than the ability to pay — into the estate tax structure apparently occurred as a result of legislative compromise and without much specific debate.²⁹ In addition, the 1918 legislation provided an injection of asset inequality by exempting up to \$40,000 of life insurance proceeds paid to a named beneficiary other than the decedent's estate,³⁰ again without debate.

²¹ More than 40 of the States of the Union are now imposing some form of inheritance taxes and in some of the States these taxes are very high. There was a strong protest presented . . . against any further increases in the inheritance tax levied by the National Government, and . . . these protests should not be overlooked. After careful consideration . . . your committee [concluded] it would be wiser not to increase the inheritance tax . . . and that it would be more equitable and economically better to supply the comparatively small loss in revenue . . . from sources which would not so interfere with the revenues of the States.

Such a tax, when used as an emergency measure is necessarily unequal in operation. Only if continued at the same rate for many years — the period of a generation — does it become equal for all persons in like situations On the other hand, as a permanent measure, such a tax, even at the rates already fixed by existing law, trenches in considerable degree on a sphere which should be reserved to the States.

Id. at 14 (reprinted in 1939-1 (Part 2) C.B. at 65).

²²S. REP. NO. 617, 65th Cong., 3d Sess. 1-3 (1918) (reprinted in 1939-1 (Part 2) C.B. 117-18).

²³H.R. REP. NO. 767, 65th Cong., 2d Sess. 1, 21-24 (1918) (reprinted in 1939-1 (Part 2) C.B. 86, 101-03).

²⁴S. REP. NO. 617, *supra* note 22, at 15 (reprinted in 1939-1 (Part 2) C.B. at 127).

²⁵*Id.*

²⁶*Id.*

²⁷Revenue Act of 1918, ch. 18, § 403(a)(3), 40 Stat. 1057, 1098. For a concise history of the charitable deduction, see Bittker, *Charitable Bequests and the Federal Estate Tax: Proposed Restrictions on Deductibility*, 31 *Rec. A.B. City New York* 159-163 (1976).

²⁸Revenue Act of 1918, ch. 18, § 401, 40 Stat. 1057, 1096.

²⁹Dean Griswold characterized this addition as occurring "almost by accident." E. GRISWOLD, *CASE AND MATERIALS ON FEDERAL TAXATION* 1075 (6th ed. 1966).

³⁰Revenue Act of 1918, ch. 18, § 402(f), 40 Stat. 1057, 1098; H.R. REP. NO. 767, *supra* note 23, at 21-24 (reprinted in 1939-1 (Part 2) C.B. 101-02).

Three years later in 1921, the revenue mood was for tax reduction and simplification, which was deemed "essential to business recovery" after the feverish activity of World War I.³¹ Therefore, the Revenue Act of 1921 merely made some clarifying changes in the estate tax,³² although a Senate bill had unsuccessfully proposed a gift tax "at graduated rates on gifts of property amounting to \$20,000 or more in a year."³³

By 1924, the prevailing mood was still for tax reduction, with the Treasury Department estimating surpluses of over \$300 million a year.³⁴ The House Ways and Means Committee version of the Revenue Act of 1924 thus made only administrative changes in the estate taxes.³⁵ Despite the "imperative" need³⁶ for tax reduction and simplification, a combination of "Democratic and insurgent Republican votes"³⁷ added floor amendments that raised the maximum estate tax rate to 40% on estates over \$10 million, allowed a 25% credit for state death taxes and imposed a gift tax.³⁸ The Senate Committee on Finance objected to all three changes. It quoted Secretary Mellon's statement: "Inheritance taxes are properly sources of revenue for the States."³⁹ At the same time, however, the Senate offered an inheritance tax plan and a gift tax proposal.⁴⁰ In conference, it was the House version as amended by floor vote that substantially passed.⁴¹

Two years later in 1926, with the continuing Treasury estimates of significant surpluses, legislative sentiment on the estate and gift tax had changed somewhat. The maximum estate tax rate was lowered to 20% on estates over \$10 million, the exemption was increased from \$50,000 to \$100,000, the 25% credit for state death taxes became an 80% credit and the gift tax was repealed.⁴² The monetary extent of this reduction was uncertain but the hope was expressed that the loss, due primarily to the 80% credit, would "be postponed for so long a period that the natural increase" in other federal revenues would make

³¹H.R. REP. NO. 350, 67th Cong., 1st Sess. 1 (1921) (reprinted in 1939-1 (Part 1) C.B. 168); See also Blakey, *The Revenue Act of 1921*, 12 AM. ECON. REV. 7577 (1922) ("It was generally understood by everybody even before the elections of 1920 that federal . . . tax burdens were to be reduced." *Id.*

³²*E.g.*, an attempt was made to prevent taxing the estates of American missionaries at a higher rate merely because of their foreign service residences. Revenue Act of 1921, ch. 136, 42 Stat. 227 (1921). See also, I.R.C. § 2202, repealed by Tax Reform Act of 1976, § 1902(a)(8).

³³See H.R. REP. NO. 486, 67th Cong., 1st Sess. 47, Am. #622 (1921) (reprinted in 1939-1 (Part 2) C.B. 206, 231); See also Blakey, *supra* note 31, at 98.

³⁴H.R. REP. NO. 179, 68th Cong., 1st Sess. 1 (1924) (reprinted in 1939-1 (Part 2) C.B. 241).

³⁵*Id.* at 28-32 (reprinted in 1939-1 (Part 2) C.B. at 261-63).

³⁶*Id.* at 1 (reprinted in 1939-1 (Part 2) C.B. at 241).

³⁷W. SCHULTZ, *supra* note 8, at 161.

³⁸*Id.*

³⁹S. REP. NO. 398, 68th Cong., 1st Sess. 1, 6-7 (1924) (reprinted in 1939-1 (Part 2) C.B. 266, 270).

⁴⁰H.R. REP. NO. 844, 68th Cong., 1st Sess. 1, 5-7, Am. #122 (1924) (reprinted in 1939-1 (Part 2) C.B. 300, 308).

⁴¹Revenue Act of 1924, ch. 234, §§ 300-24, 43 Stat. 253, 303-316.

up for it.⁴³ The Senate Committee on Finance advocated repeal of the estate tax by arguing that the House's 80% credit was an "admission" that the estate tax was "peculiarly a form of tax which should be within the province of the states."⁴⁴ The Senate also argued unsuccessfully for a retroactive reduction in the estate tax rates.⁴⁵

The first ten years of the estate tax was a period of great activity for the tax. Its traditional origins as a revenue-raiser in time of military conflict inevitably led to the traditional requests for its repeal once the conflict ended.⁴⁶ The mere survival of the estate tax structure against these traditional attacks is remarkable and may be due to the purity of that structure. The original political reasons for choosing a federal estate tax over an inheritance tax may have dictated a single structural focus of an individual-decedent, thereby minimizing structural references to the states rights arguments. The structure itself was sufficiently flexible, however, to repel the traditional attacks by incorporating, when necessary, various politically convenient alliances of ideals and practicality.⁴⁷ At the end of its first ten years, the existence of the structure served the more liberal politicians who could point to it, if not with pride, at least as evidence of the democratic federal process, as well as the more conservative politicians who could look directly at the bottom line without much fiscal pain.

B. 1932-1941

With the stock market crash, the ensuing depression, and current as well as projected federal deficits, public and Congressional sentiment inevitably and necessarily shifted towards a stricter tax. The Revenue Act of 1932, via the imposition of an additional estate tax, essentially increased the maximum estate tax rate to 45% on estates in excess of \$10 million and decreased the exemption to the original \$50,000 amount from \$100,000.⁴⁸ In addition, it expressly provided that the 80% credit for state death taxes was not applicable to this additional estate tax (so that the increase would go exclusively to the federal coffers)⁴⁹ and reintroduced the gift tax. The gift tax, whose purpose was "to

⁴³H.R. REP. NO. 1, 69th Cong., 1st Sess. 1, 15 (1925) (reprinted in 1939-1 (Part 2) C.B. 315, 325).

⁴⁴S. REP. NO. 52, 69th Cong., 1st Sess. 1, 8 (1926) (reprinted in 1939-1 (Part 2) C.B. 332, 338).

⁴⁵*Id.* at 8. (reprinted in 1939-1 (Part 2) C.B. at 338).

⁴⁶*E.g., Id.* (reprinted in 1939-1 (Part 2) C.B. at 338).

⁴⁷ There had been much propoganda against the estate tax. The Secretary of the Treasury did everything he could to have the tax repealed. Chairman Green of the Ways and Means Committee opposed the Secretary of the Treasury and, with the help of public opinion and Mr. Garner, put up a successful fight to retain the tax. Chairman Green knew that the members of Congress from states with wealthy constituents, especially New York, Pennsylvania, and Massachusetts, wanted the tax repealed. His strategy to keep the tax was a concession to the states by increasing the credit for state death taxes paid from 25 percent to 80 percent of the amount of the federal tax.

R. PAUL, 1 FEDERAL ESTATE AND GIFT TAXATION 11 n.35 (1942).

⁴⁸Revenue Act of 1932, ch. 209, §§ 401-532, 47 Stat. 169, 243-259.

⁴⁹*Id.* at 402(a), 47 Stat. at 245. H.R. REP. NO. 708, 72d Cong., 1st Sess. 27 (1932) (reprinted in 1939-1 (Part 2) C.B. 457, 476).

assist in the collection of the income and estate taxes, and prevent their avoidance through the splitting up of estates during the lifetime of a taxpayer,"⁵⁰ had rates set at three-fourths of the estate tax, a \$5,000 annual per donee exclusion, and a \$50,000 per donor lifetime exemption.⁵¹ This estate and gift revision was viewed as an emergency measure, complete with a hope that by June 1934 a reduction could be effected.⁵²

In 1934, however, economic conditions were unimproved and the maximum estate tax rate was increased to 60% on estates over \$10 million:⁵³

These increases will raise about \$7,000,000 of additional revenue in a full year of operation, and moreover, will tend to prevent undue accumulation of wealth. This objective is more properly reached by estate tax than by income-tax increases. Moreover, the drastic increases made in the income-tax rates by the Revenue Act of 1932 have been most disappointing from a revenue standpoint, and it appears that further income-tax rate increases would have an unfavorable effect on business recovery.⁵⁴

Thus, although the catalyst of the increased tax was the need for revenue, Congress also articulated an anticoncentration motive. President Franklin Roosevelt⁵⁵ in turn placed great importance on the anticoncentration motive:

Our revenue laws have operated in many ways to the unfair advantage of the few, and they have done little to prevent an unjust concentration of wealth and economic power

The transmission from generation to generation of vast fortunes by will, inheritance, or gift is not consistent with the ideals and sentiments of the American people.

The desire to provide security for one's self and one's family is natural and wholesome, but it is adequately served by a reasonable inheritance. Great accumulations of wealth cannot be justified on the basis of personal and family security. In the last analysis such accumulations amount to the perpetuation of great and undesirable concentration of control in a relatively few individuals over the employment and welfare of many, many others.⁵⁶

⁵⁰H.R. REP. NO. 708, *supra* note 49, at 8 (*reprinted in* 1939-1 (Part 2) C.B. at 462).

⁵¹Revenue Act of 1932, ch. 209, §§ 502, 504(b), 505(a)(1), 47 Stat. 169, 246-47.

⁵²H.R. REP. NO. 708, *supra* note 49, at 8 (*reprinted in* 1939-1 (Part 2) C.B. at 463).

⁵³Revenue Act of 1934, ch. 277, 48 Stat. 680.

⁵⁴S. REP. NO. 558, 73d Cong., 2d Sess. 1, 7 (1934) (*reprinted in* (Part 2) C.B. 586, 591).

⁵⁵President Roosevelt may have been aided in his belief by Mr. Justice Frankfurter. See B. MURPHY, *THE BRANDEIS/FRANKFURTER CONNECTION: THE SECRET POLITICAL ACTIVITIES OF TWO SUPREME COURT JUSTICES 159-162* (1982).

⁵⁶Message from President Franklin D. Roosevelt to the Congress of the United States (June 19, 1935), *reprinted in* H.R. REP. NO. 1681, 74th Cong., 1st Sess. 1, 2 (1935) (*reprinted in* 1939-1 (Part 2) C.B. 642-643).

The President proposed, in addition to the estate tax, a federal inheritance tax "in respect to all very large amounts received by any one legatee or beneficiary."⁵⁷ There was one rate table with "recognition to the principle of consanguinity":⁵⁸ a spouse and near relatives received a \$50,000 specific exemption, while all others received a \$10,000 specific exemption. Charities were completely exempt.⁵⁹ The President also proposed a donee's gift tax.⁶⁰ Once again, the inheritance tax plan was rejected,⁶¹ but this time in favor of a stricter estate tax. The rates were increased to a maximum of 70% on estates over \$50 million and the exemption was reduced from \$50,000 to \$40,000.⁶²

While it is recognized that the inheritance tax, in a number of respects, is more equitable than an estate tax, nevertheless, the difficulties encountered in designing an inheritance tax even reasonably free from serious administrative difficulties are very numerous. Your committee believes, therefore, that, in view of the short time available for the study of an inheritance tax, it is safer to accomplish the same general purposes by an increase in estate-tax rates.⁶³

Five years later, with the 1940 revenue act, the original emergency revenue-raising purpose of the estate and gift tax surfaced one again when an additional "Defense Tax for Five Years" was imposed.⁶⁴ Decedents dying within five years of its enactment were to pay a tax "10 percentum greater than the amount of tax which would be payable if computed without regard to this section."⁶⁵ In 1941, the temporary increase was made permanent in a new rate schedule with a maximum rate of 77% on estates in excess of \$10 million.⁶⁶

During the 1930's, the estate tax took on increased political importance. The 1932 estate tax measure had traditional revenue-raising origins, complete with an expressed hope for reduction by 1934. By the mid-1930's, however, with a depressed economy and an uncertain recovery, political concern grew beyond revenue to social and economic concerns regarding the undue concentration of wealth.⁶⁷ This call for a redistribution of wealth resulted in higher

⁵⁷Message, reprinted in H.R. REP. NO. 1681, 74th Cong., 1 Sess. 1, 2 (1935) (reprinted in 1939-1 (Part 2) C.B. 642, 643).

⁵⁸H.R. REP. NO. 1681, 74th Cong., 1st Sess. 1, 9 (1935) (reprinted in 1939-1 (Part 2) C.B. 642, 649).

⁵⁹*Id.* (reprinted in 1939-1 (Part 2) C.B. at 649).

⁶⁰"[T]o prevent, so far as possible, evasions of this [inheritance] tax, I recommend further the imposition of gift taxes suited to this end." Message, reprinted in H.R. REP. NO. 1681, 74th Cong., 1st Sess. 1, 2 (1935) (reprinted in 1939-1 (Part 2) C.B. 642, 643).

⁶¹See *supra* notes 24-28 and accompanying text.

⁶²Revenue Act of 1935, ch. 829, § 201, 49 Stat. 1014, 1021-22.

⁶³S. REP. NO. 1240, 74th Cong., 1st Sess. 1, 8 (1935) (reprinted in 1939-1 (Part 2) C.B. 651, 655).

⁶⁴Revenue Act of 1940, ch. 419, § 206, 54 Stat. 516, 521.

⁶⁵*Id.*

⁶⁶Revenue Act of 1941, ch. 412, § 401, 55 Stat. 687, 704-05.

⁶⁷ The real justification for the taxes is no longer a dire need for the revenue they produce but a realization that in the current climate of public opinion it is necessary to have some device to counteract the tendency of wealth to concentrate . . . In other words, death duties in this generation are an implement of social, not fiscal, legislation.

tax rates, lower exemptions and a more stringent transfer taxing structure; yet throughout its twenty-five year fluid history, the individual as the unit of taxation in the estate and gift tax was a constant. The next ten year period, however, indirectly introduced the topic of an expanded unit of taxation.

II. 1942-1948: THE COMMUNITY PROPERTY DILEMMA

In 1942, the country was in the midst of World War II and the federal government's need for revenue was extreme. The legislative goal was to increase revenues without placing an "unbearable burden upon any taxpayer."⁶⁸ At least one change enacted by the Revenue Act of 1942⁶⁹ in the estate and gift tax laws was in this spirit of revenue-raising equity.

Property acquired by a husband or wife after marriage in a community property state is considered to be half owned by each, whereas in a common law property state it is owned totally⁷⁰ by the acquirer. Thus, if at death the community property decedent spouse had acquired an estate of \$100,000 in 1942, the estate tax would be based on a gross estate of \$50,000, with a total tax of \$500. In the common law state, on the other hand, the decedent spouse would have paid a tax of \$9,500 based on a gross estate of the entire \$100,000.⁷¹ This "preferential treatment"⁷² was remedied by requiring the inclusion of community property in the decedent's gross estate, except for the part which was "economically attributable"⁷³ to the surviving spouse. Thus the "special estate tax privileges enjoyed by residents of community property jurisdictions"⁷⁴ were eliminated and the estate tax burden was equally shouldered.

Two further changes were made to reduce the inequities in tax treatment due to the asset composition of the estate. The 1918 legislation had provided a \$40,000 exemption from estate taxes for proceeds of life insurance payable to a beneficiary other than the estate.⁷⁵ In 1942, Congress decided that "[t]his treatment favors estates in which life insurance is present by, in effect, allowing such estates an exemption of \$80,000, while estates in which there is no life insurance are allowed only a \$40,000 exemption."⁷⁶ This asset inequity was corrected by repealing the life insurance exemption.⁷⁷ The taxpayer's loss, however, was "in some measure" compensated for by increasing the specific

⁶⁸H.R. REP. NO. 2333, 77th Cong., 1st Sess. 1, 2 (1942) (reprinted in 1942-2 C.B. 372, 373).

⁶⁹Ch. 619, 56 Stat. 798.

⁷⁰A spouse may often have some inchoate right in the property such as statutory dower, forced heirship, or other legislative grant. These rights however typically do not interfere with ownership during the lifetime of the owner. *E.g.*, *Johnson v. LaGrange State Bank*, 73 Ill. 2d 342, 383 N.E.2d 185 (1978).

⁷¹H.R. REP. NO. 2333, *supra* note 68, at 35 (reprinted in 1942-2 C.B. at 400-01).

⁷²*Id.* at 35 (reprinted in 1942-2 C.B. at 401).

⁷³*Id.* at 160 (reprinted in 1942-2 C.B. at 489); Revenue Act of 1942, ch. 619, § 402, 56 Stat. 941.

⁷⁴H.R. REP. NO. 2333, *supra* note 68, at 160 (reprinted in 1942 C.B. at 489).

⁷⁵Revenue Act of 1918, ch. 18, § 402(f), 40 Stat. 1057, 1098; *See also supra* note 28 and accompanying text.

⁷⁶H.R. REP. NO. 2333, *supra* note 68, at 35 (reprinted in 1942-2 C.B. at 400-01).

⁷⁷Revenue Act of 1942, ch. 619, § 404, 56 Stat. 798, 944-45.

exemption from \$40,000 to \$60,000.⁷⁸

The second revision focusing on an inequity in asset composition concerned powers of appointment. At the time, powers were included in the donee's gross estate only if property passed pursuant to the donee's exercise of a general power.⁷⁹ This latitude "facilitated the avoidance of estate tax, thus seriously impairing the effectiveness of the tax."⁸⁰ The 1942 legislation provided a strict new rule on inclusion: a general power, whether exercised or not, was includible in the donee's gross estate.⁸¹ Special powers of appointment were not taxable. Special powers, however, were only those powers exercisable in favor of a defined group of appointees, which generally centered on the family members of the donor and those of the donee as well.⁸²

This wartime tax legislation followed the predictable pattern of tightening the structure, this time by expanding the tax base to achieve a more equal and equitable distribution of the tax burden. It deviated, however, from prior emergency revisions by significantly increasing the specific exemption, from \$40,000 to \$60,000.

After World War II, the traditional pressure for a lessening of the tax burden began in earnest.⁸³ The Revenue Act of 1948⁸⁴ responded with both

⁷⁸H.R. REP. NO. 2333, *supra* note 68, at 58 (*reprinted in* 1942-2 C.B. at 418).

⁷⁹Act of February 10, 1939, ch. 3, § 811, 53 Stat. 118, 120-22.

⁸⁰S. REP. NO. 1631, 77th Cong., 2d Sess. 1, 55 (1942) (*reprinted in* 1942-2 C.B. 504, 549).

⁸¹Revenue Act of 1942, ch. 619, 56 Stat. 798, 942-44; § 403; adding Int. Rev. Code of 1939, ch. 3, § 811(f), 53 Stat. 118, 122.

⁸²Act of February 10, 1939, ch. 3 § 811(f), 53 Stat. 118, 122 defines a special power as "as power to appoint within a class which does not include any others than the spouse of the decedent, spouse of the creator of the power, descendants of the decedent or his spouse, descendants (other than the decedent) of the creator of the power or his spouse, spouses of such descendants . . ." This is not necessarily a dynastic picture (if the donee is not a lineal descendant of the grantor) but practically so. In the Powers of Appointment Act of 1951, ch. 165, 65 Stat. 91, Congress revamped the legislation so that special powers were not specifically defined, but general powers were. Only powers to appoint to the donee, the donee's estate, the donee's creditors or creditors of the donee's estate were general powers. Thus by negative implication, special powers (i.e., nontaxable powers) were loosened from their family ties. This was done because the 1942 Act was "artificial and complicated to apply," and forced a "narrow and rigid pattern" of property disposition. S. REP. NO. 382, 82d Cong., 1st Sess. 2 *reprinted in* 1951 U.S. CODE CONG. & AD NEWS 1530.

⁸³ The circumstances surrounding enactment of the Revenue Act of 1921, bear a striking resemblance to our own day. In 1920 it was generally thought that the war time tax structure was too burdensome and that tax revision was needed . . . Tax reduction awaited the election of President Harding whose Secretary of the Treasury, Andrew Mellon, established what may well be the all time record for tax reductions emanating from the Treasury . . .

By 1945 the country . . . had experienced . . . sixteen years of increasing tax burden and the burden had become relatively heavy. With the end of the war in August, the cancellation of war contracts and the task of converting the economy to a peace-time footing . . . were factors exerting considerable pressure in favor of tax reduction. With the support of the President for "some tax reduction" the Treasury in 1945 submitted the first real tax reduction recommendation since Andrew Mellon's day.

Pedrick, *The Revenue Act of 1948, Income, Estate and Gift Taxes — Divided They Fall*, 43 ILL. L. REV. 277-277, 279 (1948).

⁸⁴Ch. 168, 62 Stat. 110.

tax-reduction and tax-equalization. Reduction applied solely to the individual income tax.⁸⁵ A major portion of the 1948 Act, however, dealt with the "geographic equalization" of individual income, estate and gift taxes due to the community property/common law property dichotomy.⁸⁶ The high wartime rates, combined with the Supreme Court-sanctioned split of community property income for federal income tax purposes,⁸⁷ set off a new grassroots effort to revise the income tax system. Five common law property states adopted the community property system in order to secure to their citizens the privilege of automatic income splitting;⁸⁸ other states studied the option.⁸⁹ Clearly, federal action was necessary.⁹⁰

Since Congress had rejected compulsory joint income tax returns for community property couples in 1941⁹¹ and 1942,⁹² when revenue needs were great (at the nominal cost of sacrificing the estate tax community property advantage),⁹³ a different tactic was required now that tax reduction was the new order of the day. In the Revenue Act of 1948, as finally passed over a vigorous Presidential veto⁹⁴ and vocal legislative dissent,⁹⁵ instead of ending

⁸⁵S. REP. NO. 1013, 80th Cong., 2d Sess. 3, *reprinted in* 1948 U.S. CODE CONG. & AD. NEWS 1163, 1164.

⁸⁶*Id.* at 3, *reprinted in* 1948 U.S. CODE CONG. & AD. NEWS at 1164-65.

⁸⁷*Poe v. Seaborn*, 282 U.S. 101 (1930); *Cf. Lucas v. Earl*, 281 U.S. 111 (1930).

⁸⁸"Oklahoma joined the community property group in 1945. Oregon, Michigan, Nebraska and Pennsylvania were added to the list in 1947." S. REP. NO. 1013, *supra* note 85, at 24, *reprinted in* 1948 U.S. CODE & AD. NEWS at 1186.

⁸⁹Illinois, Massachusetts and New York reportedly studied the possibility. Pedrick, *supra* note 83, at 284 n.52.

⁹⁰"Many States are waiting to see what Congress will do about the problem of geographic equalization . . . The impetuous enactment of community-property legislation by States that have long used the common law will be forestalled." S. REP. NO. 1013, *supra* note 85, at 24-25, *reprinted in* 1948 U.S. CODE & AD. NEWS at 1186-87.

⁹¹The proposal was included in the House bill, H.R. REP. NO. 1040, 77th Cong., 1st Sess. 13 (1941) (*reprinted in* 1941-2 C.B. 413, 423):

(It is the opinion of your committee that division of income between husband and wife as a tax-saving device has no equitable basis. It results in an unequal distribution of tax burden as between families similarly situated. The jointed return proposal will overcome the inequities referred to and will result in a more equitable distribution of the tax burden.)

but was defeated in conference. H.R. REP. NO. 1203, 77th Cong., 1st Sess. 1 (1941) (*reprinted in* 1941-2 C.B. 509).

⁹²Similarly, in 1942 the proposal of mandatory joint returns was again defeated. Surrey, *Family Income and Federal Taxation*, 24 TAXES 980, 984 (1946). "Mandatory joint returns met with defeat, which, after all, was to be expected. For did not its opponents charge that it was a device that would reduce women to slavery, break up homes, encourage divorce and promote living in sin?"

⁹³Surrey, *Federal Taxation of the Family — The Revenue Act of 1948*, 61 HARV. L. REV. 1097, 1118 (1948).

⁹⁴Revenue Act of 1948, Message from the President of the United States, H.R. DOC. NO. 589, 80th Cong., 2d Sess. 1 (1948): "I am convinced that to reduce the income of the [g]overnment by \$5,000,000,000 at this time would exhibit a reckless disregard for the soundness of our economy . . ." Moreover, with respect to the new marital deduction, the President indicated his belief that there was no inequity: "[T]he discovery that it is possible to make very substantial savings in the gift and estate taxes by dividing a family's wealth between husband and wife has brought forth much ingenious argument to the effect that the provisions in the bill are needed to equalize the application of these taxes . . . In fact, this equalization was in all essential respects achieved by legislation enacted by the Congress in 1942."

⁹⁵*See, e.g., Views of Minority Members on H.R. 4790*, H.R. REP. NO. 1274, 80th Cong. 2d Sess. 75, *reprinted in* 1948 U.S. CODE CONG. & AD. NEWS 1258, 1295 ("It is utterly unjustifiable that the wealthiest residents (only estates in excess of \$60,000 after deductions are subject to the estate tax) be granted this concession simply because the Congress decides to take action to equalize the application of the Federal income tax upon married persons.').

preferential treatment, the benefits of income splitting were extended to married couples in common law jurisdictions⁹⁶ at a cost which the Treasury Department estimated to be \$800 million.⁹⁷ To complete the task of geographic equalization and Congressional largesse, Congress repealed the burdensome 1942 estate tax amendments on community property⁹⁸ and provided the benefit of estate tax "splitting" to married couples in common law jurisdictions.⁹⁹ The mechanism for this was the introduction of the estate tax marital deduction, which, like the charitable deduction instituted thirty years earlier, focused on the status of the beneficiary. While it may be true that the Revenue Act of 1948 represented "short-run politics,"¹⁰⁰ nevertheless, with the enactment of the estate tax marital deduction Congress may have started the long run shifting of focus on the appropriate unit for transfer taxation.¹⁰¹ Significantly, Congress introduced the estate tax marital deduction mostly as a political afterthought.¹⁰²

⁹⁶Revenue Act of 1948, ch. 168, § 301, 62 Stat. 110.

⁹⁷Hearings on H.R. 4790. Before the House Comm. on Ways and Means, 80. Cong., 2d Sess. 1258 (1948).

⁹⁸Revenue Act of 1948, § 351. "Unfortunately, a number of problems have arisen under the 1942 amendments. Most important of these is the fact that geographic equalization has not been realized . . . Furthermore, the problems of determining the economic contribution of the surviving spouse to the community has resulted in an extremely difficult problem of 'tracing.'" S. REP. NO. 1013, *supra* note 85, at 26. Reprinted in 1948 U.S. CODE CONG. & AD. NEWS 1163, 1188. There had been an unsuccessful campaign to have the 1942 amendments repealed retroactively. See, e.g., *Revenue Revisions, 1947-48, Hearings Before the House Committee on Ways and Means, 80th Cong., 1st Sess. 3362 (1947)* (discussion between Chairman of the House Committee and Allan H. W. Higgins, Chairman of Committee on Equalization of Taxes, Tax Section, American Bar Association):

The Chairman: Are you recommending that anything we do along the line of taxation on the estates be made retroactive to 1942?

Mr. Higgins: Yes. We are recommending that the so-called community property amendments to the Federal estate and gift taxes which were passed in 1942, be repealed retroactively.

The Chairman: How much would that cost?

Mr. Higgins: There have been various estimates . . . somewhere around \$150,000,000.

. . . .

The Chairman: The committee has considered the matter informally. The general impression seems to be that we should make it effective January 1, 1948 . . . I am very doubtful if we can go back to 1942.

⁹⁹Revenue Act of 1948, ch. 168, § 361, 62 Stat. 110, 117-21.

¹⁰⁰Surrey, *supra* note 93, at 1098.

¹⁰¹*Id.* at 1127: "Some may well urge that the federal tax loses its utility when it combines both types of death duties, and may rely on the 1948 changes to support the advocacy of a complete shift to accessions tax principles."

See also Sugarman, *Estate and Gift Tax Equalization — The Marital Deduction*, 36 CAL. L. REV. 223, 279-280 (1948):

The maze of complications inherent in the approach to "equalization" of estate and gift taxes under the Revenue Act of 1948 suggest the necessity for further study of legislative solutions to the equalization problem

. . . .

. . . But in the basic concept of treating husband and wife as a unit lies the hope for ending the complications inherent under the Revenue Act of 1948 in the treatment of interspouse transfers.

¹⁰²Surrey, *supra* note 93, at 1117.

The splitting of marital income . . . represented the culmination of an orderly process of tax revision. But the splitting of estates and gifts simply rode in unheralded and uninspected on the coattails of splitting of income. "Geographic equalization" became the open sesame and the doors of the estate and gift taxes parted.

There had been warning of the differences between the income tax and the estate and gift taxes. *Oliver*, Published by IdeaExchange@UAKron, 1984

III. 1976: DIFFUSED REFORM

The estate and gift tax lumbered along for another twenty-eight years before Congress made major structural revisions. Although Congressional action may have been wanting, there was no lack of reform proposals, including a major internal study by the Treasury Department¹⁰³ and the ALI proposal.¹⁰⁴ While there was not unanimity on all suggested areas for reform, there was agreement on some. Congress finally agreed to the reexamination and overhaul of the system in 1976.¹⁰⁵ The results were staggering and some proved overwhelming. There were five major estate and gift tax changes enacted by the Tax Reform Act of 1976.¹⁰⁶ Two were clearly tinkering changes, two were major structural changes and one was a hybrid reform that centered on the income tax. While the tinkering changes involved a reduction in revenues, the major structural changes were designed to increase revenues and the overall efficiency and equity of the system.¹⁰⁷

A. Unification

A major structural change of the 1976 program that was recommended by the Treasury Department was the unification of the estate and gift tax rates.¹⁰⁸ Congress saw this "as a matter of equity," in order to remove the "substantial disparity of treatment" between testamentary transfers and inter vivos

Community Property and the Taxation of Family Income, 20 TEX. L. REV. 532, 555 (1942) ("It would seem desirable . . . that legislation concerning the income-tax situation rather pointedly indicate a restriction to the income tax field, lest there be a carry-over to a field not yet fully considered from the standpoint of policy and public opinion.") Nonetheless, "[A] committee amendment will be offered on the floor of the House to provide for estate — and gift-tax "splitting" in common-law States The delay in the preparation of this amendment is due to the inherent difficulties of the subject." See also H.R. REP. NO. 1274, 80th Cong., 2d Sess. 1, 4 (1948), *reprinted in* 1948 U.S. CODE CONG. & AD. NEWS 1258, 1260. See note 95, *supra*, for another explanation.

¹⁰³U.S. TREASURY DEPARTMENT, TAX REFORM STUDIES AND PROPOSALS, JT. PUBLICATION OF HOUSE COMM. ON WAYS AND MEANS AND SENATE COMM. ON FINANCE, 91st Cong., 1st Sess. (1969), [hereinafter cited as 1969 TREASURY STUDY].

¹⁰⁴A.L.I. PROPOSAL, *supra* note 8. The American Bankers Association also provided an extensive reform proposal. *American Bankers Association Discussion Draft of Transfer Tax Statute and Explanatory Comments*, in *General Tax Reform: Public Hearings before the House Comm. on Ways and Means*, 93d Cong., 1st Sess., Part 9, 3747-3958 (1973).

¹⁰⁵"Estate tax revision is long overdue, and this bill undertakes that task." H.R. REP. NO. 1380, 94th Cong., 2d Sess. 5, *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS 3356, 3359.

¹⁰⁶Pub. L. No. 94-455, 90 Stat. 1520 (1976).

¹⁰⁷"The Estate and Gift Tax Reform of 1976, then, provides much-needed tax relief to medium-sized estates These tax cuts are fashioned with long-overdue tax reforms that will go far towards equalizing the tax burdens of similarly situated taxpayers." H.R. REP. NO. 1380, *supra* note 105, at 6, *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS at 3360.

¹⁰⁸1969 TREASURY STUDY, *supra* note 103, at 30-31 ("The Treasury recommends full unification of the estate and gift taxes into a single-transfer tax to accomplish the dual objectives of fairness and reduced complexity.") The ALI Proposal specifically did not make a recommendation on this subject:

[T]he underlying question of the desirability or undesirability of shifting from the present dual tax system . . . to a unified system was extensively considered Given the complexity and difficulty of the problem, the time required for its thorough exploration and the improbability of reaching any clear consensus, the Reporter . . . did not propose a resolution There is, therefore, no ALI recommendation on the choice between a dual tax system and a unified tax.

ALI PROPOSAL 56-57.

transfers, the latter of which were taxed at only three-fourths of the estate tax rates.¹⁰⁹

In addition, a phased in exemption of \$175,000 was provided for the cumulative transfers of a taxpayer¹¹⁰ via a unified credit. This exemption, increased from the \$60,000 limit instituted in 1942, was to counter the effects of inflation.¹¹¹ The credit form was to preserve the progressiveness of the tax.¹¹²

B. Carryover Basis

The 1969 Treasury Study's first recommendation was to repeal step-up in basis at death and to tax as income the appreciation on assets at death.¹¹³ In 1976, Congress introduced carryover basis in order to eliminate the "unwarranted discrimination against those persons who sell their property prior to death as compared with those whose property is not sold until after death," and the "lock-in" effect which often "distort(s) allocation of capital between competing sources."¹¹⁴ In general, step-up in basis was repealed,¹¹⁵ and assets were to receive a "fresh start" in basis measured by their fair market value on December 31, 1976.¹¹⁶ This mechanical "fresh start" rule did not, however, apply to nonmarketable securities for which a special valuation was devised. In essence, it gave the asset an increase in basis equal to a pro rata amount of total appreciation from date of acquisition to date of death.¹¹⁷ Upon sale or exchange of the asset, therefore, the carryover basis rather than step-up would be the appropriate measuring stick.

¹⁰⁹STAFF OF JOINT COMM. ON TAXATION, 94th CONG. 2d SESS., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1976, 526 (reprinted in 1976 C.B. 738, 742 (1976)). [hereinafter cited as JOINT COMM. REPORT].

¹¹⁰Tax Reform Act of 1976, § 2001(a)(2), adding I.R.C. § 2010. The specific exemption was repealed. *Id.*, § 2001(a)(4) (1982).

¹¹¹JOINT COMM. REPORT, *supra* note 109, at 530. "The amount of the estate tax exemption was established in 1942. Since that date, the purchasing power of the dollar has decreased to less than one-third of its value in 1942 . . . [T]he inflation which has occurred means that the estate tax now has a much broader impact than it did originally."

¹¹²*Id.*, at 530-531:

[A] credit in lieu of an exemption has the effect of reducing the estate tax at the lower estate tax brackets since a tax credit is applied as a dollar-for-dollar reduction of the amount otherwise due. Thus, at a given level of revenue cost, a tax credit tends to confer more tax savings on small-and-medium-sized estates, whereas a deduction or exemption tends to confer more tax savings on larger estates.

Id.

¹¹³1969 TREASURY STUDY, *supra* note 103, at 28-29.

The Treasury recommends taxation under the income tax, in a manner similar to that of other capital gains, of the appreciation in the values of assets transferred at death or by gifts The adoption of this recommendation . . . is essential to permit the reduction in estate tax rates and the removal of the limit on tax-free transfers between husband and wife which the Treasury is also recommending.

¹¹⁴H.R. REP. NO. 1380, *supra* note 105, at 36-37; reprinted in 1976 U.S. CODE CONG. & AD. NEWS at 3390-91.

¹¹⁵Tax Reform Act of 1976, § 2005(a)(1).

¹¹⁶*Id.*, § 2005(a)(2); adding I.R.C. § 1023(h) (since repealed by Crude Oil Windfall Profit Tax Act of 1980, § 401(a)).

¹¹⁷*Id.*

C. The Generation-Skipping Tax

A third revision enacted in the 1967 tax reform package was the addition of a new tax, a completely separate taxing structure for generation-skipping transfers.¹¹⁸ Once again, this was an area of reform recommended by the 1969 Treasury.¹¹⁹

The purpose of the Federal estate and gift taxes is not only to raise revenue, but also to do so in a manner which has as nearly as possible a uniform effect, generation by generation. These policies of revenue raising and equal treatment are best served where the transfer taxes are imposed, on the average, at reasonably uniform intervals

. . . While the tax advantages of generation-skipping are theoretically available to all, in actual practice these devices are more valuable (in terms of tax savings) to wealthier families

Generation-skipping also reduces the progressive effect of the transfer taxes, since families with moderate levels of accumulated wealth may pay as much or more in cumulative transfer taxes as wealthier families who utilize generation-skipping devices.

. . . Consequently, the committee bill provides generally that property passing from one generation to successive generations in trust form is to be treated . . . substantially the same as property which is transferred outright Your committee's bill does provide one limited exception to this general rule, however, to cover the case where a trust is established for the benefit of the grantor's grandchildren.¹²⁰

Essentially, the new tax was aimed at the relatively common estate planning practice¹²¹ of placing the estate — or one-half of it if the decedent was married — in a trust for a child's lifetime benefit¹²² without triggering a major estate tax at the child's death. This was the result even though the child had or could have had a lifetime income interest, access to principal if necessary for the child's health, support or education, the noncumulative right to withdraw the greater of 5% of corpus or \$5,000 a year, and a power to appoint the property at death or inter vivos among anyone other than himself, his estate, his creditors or creditors of his estate. Under the estate tax, this trust interest (except for the year of death "5/5" power)¹²³ would not be included in the child's gross

¹¹⁸Tax Reform Act of 1976, § 2006, adding Chapter 13 to I.R.C. §§ 2601-2622 (1982).

¹¹⁹1969 TREASURY STUDY, *supra* note 103 at 31. "Treasury recommends the imposition of a substitute tax upon arrangements accomplishing the avoidance of transfer taxation for one generation or more."

¹²⁰H.R. REP. NO. 1380, *supra* note 105, at 46-47, *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS at 3400-01.

¹²¹*See, e.g.*, THE PLANNING AND ADMINISTRATION OF ESTATES 152-155 (P.L.I., R. A. Wormser, 2d ed. 1966); *See also* Cooper, *A Voluntary Tax? New Perspectives on Sophisticated Estate Tax Avoidance*, 77 COLUM. L. REV. 161, 205-207 (1977).

¹²²Often the child's lifetime interest was preceded by a lifetime interest in the decedent's surviving spouse, which itself did not trigger any estate tax on the cessation of the spouse's interest.

¹²³I.R.C. § 2041(b)(2) (1982).

estate since the child was not the grantor of the trust and did not have a general power of appointment.¹²⁴

Although this is the paradigm for the tax, the generation-skipping tax as written is not limited to this model, nor is it operational primarily with the traditional confines of an individual decedent/donor. The tax is applicable to any generation-skipping trust,¹²⁵ i.e., any trust where the benefits are spread or could be spread across two sets of younger generation beneficiaries.¹²⁶ One is assigned to a generation either on the basis of spousal or family relationship to the grantor (any descendant of a grandparent of the grantor)¹²⁷ or if not so related, by the comparison of ages between the grantor and the beneficiary.¹²⁸ To decide whether a trust is in fact a generation-skipping trust, the focus is panoramic rather than discrete: one looks neither to the terms of the trust nor to an individual; rather one looks to the operation of the trust within the context of a family chain.¹²⁹ Similarly, the tax is imposed not merely because a trust is a generation-skipping trust, but because there is a transaction — a taxable termination or a taxable distribution — that triggers the tax.¹³⁰ Whether there is such a transaction again depends not on any one discrete fact (such as death, in the estate tax) but rather on the family chain: was there, at the critical time, more than one generation of present beneficiaries?¹³¹ Is there another beneficiary of the same generation?¹³² The tax trigger is neither static nor discrete, it is diffused.

The amount of the tax, however, is dependent upon one individual, the deemed transferor.¹³³ Determination of who that person is is again dependent on a family chain. Generally, the deemed transferor is the transferee's parent who is more closely related to the grantor than the transferee's other parent.¹³⁴

Like most taxes, the generation-skipping tax also as a "limited exception."¹³⁵

¹²⁴I.R.C. §§ 2033-2041 (1976); *See also* S. REP. NO. 938 (Part 2), 94th Cong., 2d Sess. 19 (1976), *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS at 405.

¹²⁵For purposes of this discussion as in the tax itself, the term "generation-skipping trust" also encompasses a generation-skipping trust equivalent. I.R.C. § 2611(d)(3) (1982).

¹²⁶I.R.C. § 2601, § 2611 (1982).

¹²⁷I.R.C. § 2611(c)(1) (1982).

¹²⁸I.R.C. § 2611(c)(5) (1982).

¹²⁹I.R.C. § 2611(b) (1982).

¹³⁰I.R.C. § 2601 (1982).

¹³¹*E.g.*, I.R.C. § 2613(a)(1) provides that in determining whether there is a taxable distribution, "an individual who at no time has had anything other than a future interest or future power (or both) in the trust shall not be considered as a younger generation beneficiary." Similarly for a taxable termination. I.R.C. § 2613(b)(1) (1982).

¹³²A taxable termination of a beneficiary's interest or power will be delayed until the time that the interest or power of the last beneficiary in that generation ceases. I.R.C. § 2613(b)(2)(A) (1982).

¹³³I.R.C. § 2602(a) (1982).

¹³⁴I.R.C. § 2612 (1982).

¹³⁵*See supra* note 120 and accompanying text. Originally, the "limited exception" was set at \$1 million. H.R. REP. NO. 1380, *supra* note 105, at 52-53, 1976 U.S. CODE CONG. & AD. NEWS at 3406-07. Published by IdeaExchange@Uakron, 1984

This exception allows an aggregate \$250,000 exclusion from taxable transfers for each deemed transferor, but only if the transferred property goes to a grandchild of the original grantor.¹³⁶ There must be this required family connection to receive the benefit.¹³⁷

The generation-skipping tax as thus viewed represents a significant break from the traditional focus of estate and gift taxes on definitional, transactional, computational and safeharbor bases. This transfer tax is not based on a discrete event or individual but rather primarily on a "family," dynastic perspective. This is consistent with the Congressional emphasis on "wealthier families."¹³⁸ Unfortunately, there is no detailed analysis from Congress that shows the reason for the shift of emphasis from an individual to a dynasty for this new tax.¹³⁹ This new focus was not confined to this new transfer tax. Evidence of a broader perspective is also apparent in the two remaining 1976 changes.

D. Section 2032A Valuation

One of the tinkering changes in the 1976 legislation involved the introduction of a new valuation method¹⁴⁰ for qualified real property used in farming and other small businesses. This new section was added because it is "inappropriate" to value such property at its highest and best use "since it is desirable to encourage the continued use of property for farming."¹⁴¹ Essentially, an election is available to value family farms based on their actual use as farms instead of valuing the property at its highest and best use,¹⁴² subject to a maximum reduction in value originally set at \$500,000.¹⁴³ Because section 2032A addresses the secondary question of valuation and not the primary one of

¹³⁶I.R.C. § 2613(b)(6) (1982).

¹³⁷R. COVEY, GENERATION-SKIPPING TRANSFERS IN TRUST 57-66 (3d ed. 1978). See also, Letter from John E. Chapoton (Assistant Treasury Secretary for Tax Policy) to Sen. Steven D. Symms (Chairman, Senate Finance Subcommittee on Estate and Gift Taxation) (April 29, 1983), reprinted in 84 DAILY TAX REPORT (BNA), at J-5 (April 29, 1983): "It is unclear why transfers to grandchildren should receive more favorable treatment than transfers to other members of that generation. (for example, grandnieces and grandnephews.)"

¹³⁸See *supra* note 120.

¹³⁹"There has never been an attempt accurately to assess the 'evil' at which this tax is aimed" W. Timothy Baetz. (Quoted in BARNHART, *A Generation Gap That Is Taxing*, CHICAGO TRIBUNE, Aug. 23, 1983 at 9.)

¹⁴⁰Tax Reform Act of 1976, § 2003, enacting I.R.C. § 2032A. If length and complexity were the criteria for labeling a change structural or tinkering, section 2032A would easily be structural. The addition of § 2032A to the estate tax provisions of the Code virtually doubled the number of pages in Chapter 11.

¹⁴¹H.R. REP. NO. 1380, *supra* note 105, at 22, reprinted in 1976 U.S. CODE CONG. & AD. NEWS at 3376; See also ESTATE OF COON v. COMMISSIONER, 81 T.C. 602 (1983).

¹⁴²I.R.C. § 2032A(e)(7), (8) (1982).

¹⁴³I.R.C. § 2032A(a)(2) (1982). Currently the maximum reduction in value is \$750,000. Originally the Senate had proposed a \$1 million limit. With the Economic Recovery Tax Act of 1981, the positions of the two houses were reversed. The House version of the 1981 bill provided a phased-in increase from the \$500,000 level to \$750,000 in 1981, \$875,000 in 1982, and \$1,000,000 for 1983 and thereafter. H.R. REP. NO. 201, 97th Cong., 1st Sess. 171 (1981). The Senate Committee on Finance did not initially consider an increase in the limit (S. REP. NO. 144, 97th Cong., 1st Sess. 131-137, reprinted in 1981 U.S. CODE CONG. & AD. NEWS at 231-38; but later amended the House proposal to raise the limit to \$600,000 in 1982. The conference committee reached a compromise for a phased-in increase to \$600,000 in 1981, \$700,000 in 1982 and \$750,000 thereafter. H.R. REP. NO. 215, 97th Cong., 1st Sess. 248 (1981).

includibility, it does not fundamentally shift the focus of the estate tax structure. Within its own confines it has, like the generation-skipping tax, a decidedly dynastic glint.

Whether the benefits of section 2032A are available to a decedent's estate is dependent upon a family's operation of a farm: Was there material participation in the farm's operation by the decedent or a member of his family for a certain period of time?¹⁴⁴ Does the farm pass to a family member?¹⁴⁵ Does that person or a member of his family continue to operate the farm as such?¹⁴⁶ Consequently, it is not merely the decedent's actions that determine the availability of this election, but the actions of his family members as well.

The legislative action¹⁴⁷ relating to section 2032A since its introduction has been generally to expand its coverage by broadening its focus. First, the definition of a family member for section 2032A purposes has been modified, so that a section 2032A family now includes the decedent's spouse, parents, brothers and sisters, children, stepchildren, and spouses and lineal descendants of those individuals.¹⁴⁸ Second, it is possible to satisfy certain of section 2032A's requirements through attribution, i.e., one family member's qualified use of the property may be attributed to another.¹⁴⁹

In enacting section 2032A and its numerous amendments, Congress has consistently emphasized the status of the American family farm as a special case that deserves special consideration.¹⁵⁰ This Congressional history,¹⁵¹ in conjunction with the secondary nature of the valuation function, may rebut an assertion that this valuation provision is another attempt to shift the focus of the estate tax. There can be no denial, however, that section 2032A has a markedly different valuation perspective from the other two valuation

¹⁴⁴I.R.C. § 2032A(b)(1)(C) (1982).

¹⁴⁵I.R.C. § 2032A(b)(1)(A)(ii) (1982).

¹⁴⁶I.R.C. § 2032A(c)(1)(B); § 2032(A)(c)(6)(B)(ii) (1982).

¹⁴⁷Virtually every legislative session since the introduction of special use valuation by the 1976 legislation has seen proposals, if not enactments, on § 2032A. See, e.g., Revenue Act of 1978, § 702(d); Economic Recovery Tax Act of 1981, § 421(c) (1982).

¹⁴⁸I.R.C. § 2032(A)(e)(2), amended by the Economic Recovery Tax Act of 1981, § 421(i) (1982). Curiously the amendment may have narrowed, for years after 1981, the composition of the family by eliminating from the definition the lineal descendants of an individual's grandparents, i.e., aunts, uncles, and cousins. It added, however, the lineal descendants of the decedent's spouse, e.g., nonadopted children.

¹⁴⁹I.R.C. § 2032A(b)(1)(A)(i) (1982).

¹⁵⁰FEDERAL ESTATE AND GIFT TAXES: HEARINGS ON THE GENERAL SUBJECT OF FEDERAL ESTATE AND GIFT TAXES BEFORE THE HOUSE COMM. ON WAYS AND MEANS, 94th Cong., 2d Sess. 1178-79 (1976) (statement of Charles M. Walker, Assistant Secretary for Tax Policy, U.S. Department of Treasury). "Inflation has had a particularly serious impact upon the family farm. Property values have risen dramatically with the result that owners have been faced with higher estate taxes. This has created a greater need for liquidity than is faced by any other taxpayers because family farms . . . tend to represent a significant portion of the owner's estates"

¹⁵¹This concern is not new; special consideration has been given the United States farming community for years. For example, Mr. Lankford in a speech before the House of Representatives stated:

Let us legislate for all the Nation, but let us remember that when we legislate for the farmer we legislate for all We cannot benefit the farmer without benefiting all for all are dependent on him. He is the support of the Nation, and we cannot afford to do less than support every move in his behalf.

58 CONG. REG. H4989 (daily ed. Sept. 6, 1919).

provisions.¹⁵²

The last major 1976 changes incorporate into the estate tax structure a focus looking beyond the decedent.

E. Marital and Orphan's Deductions and Spousal Joint Tenancies

The final reforms in 1976 involved tinkering with the twenty-eight year old marital deduction, the introduction of a new deduction for orphan children,¹⁵³ and the liberalization of the joint interest provision. Quite simply, the original 50% limit on the estate tax marital deduction was replaced by the greater of \$250,000 or one-half of the decedent's gross estate¹⁵⁴ because "a decedent with a small — or medium — sized estate should be able to leave sufficient property directly to the surviving spouse for support during the lifetime of the spouse without the imposition of an estate tax."¹⁵⁵ The gift tax marital deduction was also revised so that the first \$100,000 (beyond annual exclusions) of aggregate post-1976 interspousal transfers was tax-free, the next \$100,000 was completely taxable, and any amount over \$200,000 was one-half taxable.¹⁵⁶ There was a potential "cut-down" of the estate tax marital deduction provided if gift transfers to the surviving spouse were made and they totalled less than \$200,000, in order to insure that overall transfers were basically taxed on a one-half basis.¹⁵⁷

In these two marital deduction changes — the first major quantitative changes since the introduction of the marital deduction in 1948 — the focus is neither the original focus on the decedent nor the amended focus on geographic equalization.¹⁵⁸ Instead, the underlying theme is the surviving spouse's need, Congressionally-judged to be at least \$250,000. With the standard of need as the basis for reform, Congress addressed an orphan's needs

¹⁵²Neither § 2031 nor § 2032 provides a method of valuation, rather each provides a timing perspective. Section 2031 provides the general time of valuation, property included in a decedent's gross estate shall be "valued at the time of his death." Treasury regulations supply the valuation standard: fair market value, or "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell, and both having reasonable knowledge of relevant facts." Treas. Reg. § 20.2031-1(b) (1965).

Section 2032 provides an alternate time frame. In general, instead of valuing the estate at the date of death, an estate may elect to value the assets as of six months after the date of death. Treas. Reg. § 20.2032-1(a) (1972).

¹⁵³Tax Reform Act of 1976, § 2007, adding I.R.C. § 2057, since repealed by Economic Recovery Tax Act of 1981, § 403(a)(1)(A).

¹⁵⁴Tax Reform Act of 1976, § 2002(a), amending I.R.C. § 2056(c)(1), since repealed by Economic Recovery Tax Act of 1981, § 403(a)(1)(A).

¹⁵⁵S. REP. NO. 938 (Part 2), 94th Cong., 2d Sess. 14 (1976), reprinted in 1976 U.S. CODE CONG. & AD. NEWS at 4040.

¹⁵⁶Tax Reform Act of 1976, § 2002, amending I.R.C. § 2523; since repealed by Economic Recovery Tax Act of 1981, § 403(b)(1).

¹⁵⁷Tax Reform Act of 1976 § 2002(a), amending I.R.C. § 2056(c)(1)(B), since repealed by Economic Recovery Tax Act of 1981, § 403(a)(1). See also J. MCCORD, 1976 ESTATE AND GIFT TAX REFORM: ANALYSIS, EXPLORATION AND COMMENTARY 280-286 (1977).

¹⁵⁸See the discussion on the introduction of the marital deduction in 1948, *supra* notes 86-102 and accompanying text.

as well: "Where an interest in property passes or has passed to a minor orphan, a limited deduction . . . should be allowed. This is based on the view that during the child's minority there is a generally accepted responsibility on the part of the decedent to support the child."¹⁵⁹ The Congressional standard of an orphan's need was \$5,000 for each year the orphaned child is under twenty-one years at the time of the decedent's death.¹⁶⁰

There is little in the way of compelling legislative reasoning for either the increased marital deduction or the new orphan's deduction. The marital deduction was increased because a decedent "should be able" to provide support for the surviving spouse. Similarly, an orphan's deduction "should be allowed" because of the "generally accepted responsibility on . . . the decedent to support" a child.¹⁶¹ The significance of these 1976 changes is not in terms of overall estate planning or in terms of dollars, although each would obviously result in reduced estate tax revenue.¹⁶² Rather, they signal the beginning of a shift, knowing or not, in the focus of the estate tax. It is the status of the recipient, not the estate's ability to pay, that determines the estate tax. The focus is no longer merely on the decedent,¹⁶³ it also encompasses the recipient. Why? Because one "should be allowed" to support a surviving spouse and orphans without an estate tax.

In addition, Congress amended section 2040 to provide that for certain qualified joint interests¹⁶⁴ of husband and wife, the general consideration-paid

¹⁵⁹H.R. REP. NO. 1380, *supra* note 105, at 59, *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS at 3413.

¹⁶⁰Tax Reform Act of 1976, § 2007, adding I.R.C. § 2057(b), since repealed by Economic Recovery Tax Act of 1981, § 427.

¹⁶¹There is, of course, a general legal obligation on a parent to support a minor child; it is unclear whether there is in fact a similar obligation on a deceased parent's estate. While most jurisdictions give a surviving spouse some superior right in the decedent spouse's estate (*see, e.g.,* ILL. REV. STAT. ch. 110-1/2, § 2-8 (1976)), there is, in general, no analogous provision for a child, and therefore a child can be "disinherited." T. ATKINSON, *LAW OF WILLS* 138-146 (2d ed. 1953). There may be some protection afforded a minor child (or even an adult dependent child) via a child's award — a sum of money for the child's "proper support . . . for the period of nine months after the death of the decedent." ILL. REV. STAT. ch. 110-1/2, § 15-2 (1976). Therefore, this "generally accepted responsibility" is probably not a legally enforceable duty.

¹⁶²According to House estimates, the increased marital deduction would reduce estate and gift tax revenues by \$153 million in fiscal 1978, by \$162 million in fiscal 1979, by \$171 million in fiscal 1980 and \$181 million in fiscal 1981. Similarly, the orphan's deduction would decrease revenues by less than an estimated \$5 million for each fiscal year 1978 through 1981. H.R. REP. NO. 94-1380, *supra* note 105, at 9, *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS at 3362.

¹⁶³This of course is not exactly correct because of the charitable deduction. I.R.C. § 2055 (1982).

¹⁶⁴Tax Reform Act of 1976, § 2002(c), adding I.R.C. § 2040(b)(2), since amended by Economic Recovery Tax Act of 1981, § 403(c)(1), which provides that a "qualified joint interest" means an interest held by a husband and wife as joint tenants or tenants by the entirety, but only if:

(A) such joint interest was created by the decedent, the decedent's spouse, or both,

(B)(i) in the case of personal property, the creation of such joint interest constituted in whole or in part a gift for purposes of chapter 12, or

(ii) in the case of real property, an election under section 2515 applied with respect to the creation of such joint interest, and

(C) in the case of a joint tenancy, only the decedent and the decedent's spouse are joint tenants.

Moreover, this new provision of one half inclusions only applied to joint interests created after December 31, 1976. Tax Reform Act of 1976, § 2002(d)(3). Taxpayers who wished to take advantage of the new section were often advised to sever their pre-1977 joint interests, and then recreate them. *Cf. McCORD,*

test was irrelevant and instead an automatic one-half would be included into the estate of the first decedent spouse.¹⁶⁵ Congress took this action because the joint tenancy rules were “unnecessarily complex,” and as a practical matter “it is often difficult, as between spouses, to determine the degree to which each spouse” contributed consideration.¹⁶⁶ Consequently, for administrative ease husbands and wives were accorded special treatment for certain joint interests.

F. Summary of the 1976 Act

In attempting an overview of the estate and gift tax provisions of the Tax Reform Act of 1976, it is extremely difficult to discern any consistent guiding principle on the appropriate taxpayer. If there is such a guiding principle, it is only on a section-by-section basis. Ignoring carryover basis and the unified structure, which seem to be neutral¹⁶⁷ from the perspective of the appropriate unit of transfer taxation, each of the three other reforms (generation-skipping, section 2032A valuation and the spousal joint tenancies and marital and orphan's deductions) points to a separate unit of taxation. Each differs from the other two, yet all three are far removed from the individual of 1916.

Each level of the generation-skipping tax structure, from definitional through computational, deals with a dynastic model. In order for a tax to be imposed, three generations must be represented. Section 2032A, although it addresses a secondary issue within the estate tax structure, has the aura of an extended family about it. An estate can only qualify for this beneficial election if the property was, is, and will be a “family” farm operated by family members for family members' benefit. The increased marital deduction and the new spousal joint tenancy inclusion point to a marital unit, while the new orphan's deduction has a steady eye on benefitting a nuclear family unit.

While there may not be a common focus for each of these reforms, they do share at least one common trait: The relationship of the recipient of the property to the decedent/grantor is critical. If the appropriate relationship is present — i.e., grandparent-grandchild, “extended” family, husband-wife, parent-child — the tax burden will generally be reduced.¹⁶⁸ The uncertainty as to the focus of the appropriate taxpaying unit may in truth be due to the

¹⁶⁵Tax Reform Act of 1976, § 2002(c), adding I.R.C. § 2040(b)(1), since repealed by Economic Recovery Tax Act of 1981, § 403.

¹⁶⁶H.R. REP. NO. 1380, *supra* note 105, at 19-20 (*reprinted in* 1976-3 C.B. at 753-754).

¹⁶⁷Carryover basis also arguably suggests the deviation from the individual as the unit of transfer taxation because the recipient's income tax liability on sale or exchange is determined by the decedent's basis. From the perspective of transfer taxation, the provision appears structurally neutral.

¹⁶⁸It was possible under the 1976 reform of spousal joint interest for there to be more tax paid than under the prior system. This would be the case where the noncontributing spouse died first, thereby increasing the size of that spouse's gross estate, and where the maximum marital deduction was already obtained. For example, assume a spouse with her “own” gross estate of \$400,000, of which \$250,000 is insurance payable to the surviving spouse. Her taxable estate would be \$150,000 and her tax (after the unified credit) in 1977 would be \$8,800. If \$50,000 is added for the one-half interest in the \$100,000 spousal joint tenancy property (to which she did not contribute), her gross estate would be \$450,000, of which \$250,000 is still the maximum marital deduction, and her taxable estate would be \$200,000 which generated a tax (after the unified credit) in 1977 of \$24,800.

uncertainty as to why transfer taxes are imposed. As Representative Ullman stated in House Ways and Means Committee hearings, "there is mass confusion as to what it is all about."¹⁶⁹ Confusion, unfortunately, does not hinder reform.

IV. 1981: THE MARITAL UNIT ENSCONCED

The reforms enacted by the 1976 legislation have certain kinship with the 1942 reform amendments. The repeal of some, and surprising revision of other, of these "equitable" changes was imminent.

One of the first targets for repeal was the provision for carryover basis. After an impressive array of lobbying by the estate planning community,¹⁷⁰ the effective date for carryover basis was postponed until 1980,¹⁷¹ and ultimately repealed in 1980,¹⁷² only four years after its enactment. The reaction against carryover basis was so entrenched that Congress was persuaded to repeal it retroactively¹⁷³ — something they were not persuaded to do in 1948 to the 1942 amendments.¹⁷⁴

Currently the prime target for repeal is the generation-skipping tax.¹⁷⁵ Each session since its enactment has seen at least one bill calling for its repeal, generally on grounds of complexity.¹⁷⁶ The fact that the Treasury Department required six years to develop a form for the tax is compelling evidence.¹⁷⁷ Although Congress has twice extended the transitional rule, it has not been persuaded to repeal the tax.¹⁷⁸ The continued existence of the present tax is unlikely, given that the Treasury Department itself has recently proposed the retroactive repeal of the generation-skipping tax and the imposition of a new generation-skipping

¹⁶⁹FEDERAL ESTATE AND GIFT TAXES: PUBLIC HEARINGS AND PANEL DISCUSSIONS BEFORE THE HOUSE COMM. ON WAYS AND MEANS (Part 1), 94th Cong., 2d Sess. 762 (1976). See also, Part 2, at 1285-1289 (remarks by Rep. Conable). "I think this committee in dealing with the basic instrument of federal taxation has to first of all make a decision about what we really want to accomplish"

¹⁷⁰See, e.g., Conway, *Carryover Basis — An Impossible Dream*, 118 TR. & EST. 10 (March 1979).

¹⁷¹Revenue Act of 1978, § 515(3) and (4).

¹⁷²Crude Oil Windfall Profit Tax Act of 1980, § 401(a). "The committee believes that the carryover basis provisions are unduly complicated. The committee therefore believes that the carryover basis provisions should be repealed." S. REP. NO. 394, 96th Cong., 2d Sess. 122, reprinted in 1980 U.S. CODE CONG. & AD. NEWS at 531.

¹⁷³"The amendments are to take effect as if included in the Tax Reform Act of 1976." S. REP. RO. 394, 96th Cong., 2d Sess. 123, reprinted in 1980 U.S. CODE CONG. & AD. NEWS at 531.

¹⁷⁴See *supra* note 98. One difference, of course, is that carryover basis never really came in full force because of the delay in its effective date. Consequently there was not a question of refunding taxes already paid, as there was with respect to the 1942 amendments.

¹⁷⁵See, e.g., Baetz, *Is Repeal the Answer to this Dilemma?*, 121 TR. & EST. 16 (March 1982).

¹⁷⁶See, e.g., S. 1695, 97th Cong., 1st Sess. (1981); S. 1252, 98th Cong., 1st Sess. (1983).

¹⁷⁷The Treasury first issued Form 706-B Generation-Skipping Transfer Tax Return in the fall of 1982, with the first returns due by December 31, 1982.

¹⁷⁸Originally wills (or revocable trusts) creating generation-skipping trusts were exempt if the grantor-decedent died prior to January 1, 1982. Tax Reform Act of 1976 § 2006(c)(2). This grandfather provision came to protect pre-June 11, 1976 documents (Revenue Act of 1978, § 702(n)) and was then extended to exempt generation-skipping trusts if the decedent grantor died prior to January 1, 1983 (Economic Recovery Tax Act of 1981 § 428).

tax in its place.¹⁷⁹

Whether prompted by the complexity and artificiality of the 1976 reforms or the organized resistance those changes engendered, new hearings began on estate and gift tax reform in 1980. The Treasury Department welcomed the Congressional initiative: "We do need an identification of the normative structure of the estate and gift tax, and an analysis of the cost of special provisions We do believe that we need an overall review of the policy and structure of the transfer tax before any change is made."¹⁸⁰ With the estate and gift tax reforms of the Economic Recovery Tax Act of 1981 ("ERTA"), one wonders if Congress heeded the Treasury Department's advice.

The Reagan Administration proposed several changes which could be called tinkering, except that their cumulative effect is basically to emasculate the system. The changes are (1) a phased-in increase in the tax-free transfer amount to \$600,000¹⁸¹; (2) an unlimited marital deduction for both estate and gift tax purposes¹⁸²; (3) an increased gift tax annual exclusion of \$10,000¹⁸³; and (4) paradoxically, a restriction in step-up basis for property transferred to a decedent.¹⁸⁴ The administration forces passed all this and more.

As finally enacted at the eleventh hour and after much legislative debate and compromise,¹⁸⁵ ERTA represents a conscious step away from the individual as the appropriate focus for transfer taxation purposes towards a more dynastic model. It is a rather surprising step in light of current social norms and the avowed purpose of the system to control the undue accumulation of wealth.

A. *The Unlimited Marital Deduction*

1. The Reasons

In enacting the unlimited marital deduction, the House Committee reports and hearings are replete with references to "the marital unit":

¹⁷⁹Letter from Chapoton to Senator Steven Symms, *supra* note 137:

Treasury still believes that a tax on generation-skipping transfers is an essential part of the Federal transfer tax system. After further study of this area, however, we have concluded that a new and fundamentally different approach to the problem of generation-skipping is preferable to attempting to make more limited changes in the existing statute. Accordingly, we are enclosing "a proposal for a new generation-skipping transfer tax. This new tax would be simpler When the new generation-skipping tax is enacted, the existing statute would be repealed retroactively.

(See also, Wentworth and McKenzie, *The Treasury's New Proposal on Generation Skipping*, 122 Tr. & Est. 35 (June 1983)).

¹⁸⁰FAMILY ENTERPRISE ESTATE AND GIFT TAX EQUITY ACT AND MISCELLANEOUS TAX BILLS: HEARING BEFORE THE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT GENERALLY OF THE SENATE COMMITTEE ON FINANCE, 96th Cong., 2d Sess. 104 (1980) (statement of Daniel Halperin, Deputy Assistant Secretary for Tax Legislation).

¹⁸¹STAFF OF JOINT COMM. ON TAXATION, 97th Cong., 1st Sess., BACKGROUND AND DESCRIPTION OF ADMINISTRATION PROPOSAL RELATING TO ESTATE AND GIFT TAXES 32 (Jt. Comm. Print. 1981).

¹⁸²*Id.* at 33.

¹⁸³*Id.*

¹⁸⁴*Id.* at 34.

¹⁸⁵See, e.g., "Yesterday's event (Presidential signing) was pure public relations. The real climax was in securing approval of the measures from Congress over the past two months, especially in the Democratic controlled House, where rancorous battles were waged." A. Hunt, *Reagan Signs Tax Spending Cuts, Taking Responsibility For Economy*, Wall Street Journal, August 14, 1971, at 2.

[U]nder present law . . . , the estate of a decedent who bequeathes his entire estate to his surviving spouse may be subject to estate taxes even though the property remains within the marital unit.

. . . [T]he committee . . . believes that an individual should be free to pass his entire estate to a surviving spouse without the imposition of any additional tax.¹⁸⁶

Similarly, the Senate Report succinctly states that “a husband and wife should be treated as one economic unit for purposes of estate and gift taxes, as they generally are for income tax purposes. Accordingly, no tax should be imposed on transfers between a husband and wife.”¹⁸⁷

There are only two articulated reasons for the adoption of the marital unit concept. The first is a committee’s belief that “an individual should be free . . . without the imposition of any additional tax” to pass his entire estate to his spouse. Whether it is desirable from a policy perspective to pass an entire estate to one person, a surviving spouse, is not specifically addressed. In fact this seems contrary to the anticoncentration motive underlying the tax. The argument against the imposition of an “additional” tax on spousal transfers is puzzling. A transfer to a spouse is not subject to any additional estate tax; actually, even before ERTA it was — and still is — quite the contrary.¹⁸⁸

The second articulated reason is that a husband and a wife “should be treated as one economic unit for purposes of estate and gift taxes, as they generally are for income tax purposes.” The income tax analogy seems inapposite given the different rationales and timing¹⁸⁹ for the two taxes and curious given the ERTA “marriage penalty” tax deduction.¹⁹⁰ Nor is it clear that the income tax analogy is conclusive. The question of the appropriate tax-paying unit for income tax purposes is being asked again,¹⁹¹ spurred in large measure by the increasing incidence of two-earner couples and the consequently higher income tax burden often associated with that married status.

Additionally, the analogy to the income tax is, of course, incomplete. For

¹⁸⁶H.R. REP. NO. 201, 97th Cong., 1st Sess. 159 (1981).

¹⁸⁷S. REP. NO. 144, 97th Cong., 1st Sess. 127, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS at 228.

¹⁸⁸Given the existence of the marital deduction within the basic estate structure, property passing to the spouse qualifying for the deduction is exempt from the tax. There is no “additional” tax because property is going to a spouse, instead there is an exemption from the estate tax. The use of “additional” in the House report implies a basic (and quite telling) misunderstanding of the independent positioning and status of the transfer tax. “Additional” implies extra or added on, which raises the question added on to what? Perhaps the income tax is the basic tax and any other tax is additional?

¹⁸⁹It is generally assumed today that the income tax is imposed primarily to raise revenue for ongoing governmental needs. The estate tax is now imposed to avoid the undue concentrations of wealth. The income tax is on an annual basis while the estate tax is imposed but once.

¹⁹⁰Economic Recovery Tax Act of 1981 § 103, adding I.R.C. § 221 (1982).

¹⁹¹*See, e.g.,* TAX TREATMENT OF MARRIED, HEAD OF HOUSEHOLD, AND SINGLE TAXPAYERS: HEARINGS BEFORE THE HOUSE COMM. ON WAYS AND MEANS, 96th Cong., 2d Sess. (1980).

income tax purposes there is an aggregation of income as well as an aggregation of deductions and credits.¹⁹² In the estate and gift taxes, the marital unit is limited to the deduction side of the taxes.¹⁹³ If the income tax analogy is appropriate, should all the marital unit's property be included in the gross estate of the first to die? Similarly, should all the inter vivos transfers of both spouses be aggregated to calculate current gift taxes whether or not gift splitting is present? Should the first decedent spouse be able to use the surviving spouse's unified credit?

An incidental curiosity in the "one economic unit" concept would be its relationship to the relatively new generation skipping tax. For example, if husband and wife are one economic unit, should they then be "deemed co-transferors," so that their children can receive only \$250,000 (instead of \$500,000 if both sets of grandparents had established generation-skipping trusts) without triggering the tax? Or can their children receive \$500,000 from one set of grandparents, if the other set of grandparents has not yet used their own child as a deemed transferor? Would a marriage subsequent to a divorce result in a new \$250,000 or \$500,000 amount for this new marital unit?

In assessing these two articulated reasons for this shift from the individual to the married couple as the appropriate unit for estate and gift tax purposes, it is apparent that these reasons are makewright. One suspects that the real reason is much more mundane; it just does not seem quite right to tax a widow. This explanation for the shift, even if not consistent with the policies behind the tax — revenue raising and anticoncentration of wealth — is at least grounded in a very strong historical tradition. In ancient Rome, Pliny the Younger argued against a death tax, calling it "unnatural" and "augmenting the grief . . . of the bereaved."¹⁹⁴ The structural shift in focus must be recognized for what it is, a discrimination based on family relationship:

The fundamental basis of such discrimination is not found in the arguments of chamber economists, but in the popular prejudice approving such discrimination, in the "universal recognition of the great social fact of family relationship, with its implications of expectancy and dependency" This popular notion may have neither logic nor reason behind it; it is thereby the stronger. Legislators may appeal to economic theories as excuses or explanations of collateral discrimination in their inheritance taxes; their reason is the popular approval which they know such discrimination will elicit.¹⁹⁵

The 1981 unlimited marital deduction reform so shifts the focus of the

¹⁹²While this is generally true, there are some curious deviations. In the personal exemption, for example, a married couple receives twice the benefit of a single person (I.R.C. § 151) (1982), while with respect to the \$3,000 limitation on the deductibility of a capital loss against ordinary income, a married couple has the same limit as a single taxpayer. I.R.C. § 1211(b) (1982).

¹⁹³I.R.C. § 2056 (1982).

¹⁹⁴W. SCHULTZ, *supra* note 8, at 6.

¹⁹⁵*Id.* at 264-265.

federal estate tax structure that it may no longer properly be an estate tax (i.e., an excise tax on the transfer of property), but rather an inheritance tax (i.e., a tax on the receipt of property often based on the relationship of the recipient to the donor).¹⁹⁶ In doing so, however, Congress may have conclusively identified for the Treasury Department the "normative structure"¹⁹⁷ for the tax: "expectancy and dependency."

2. Individual Control of the Unit

Although the introduction of the marital unit concept may have been incomplete in its presentation and analysis, the concept does have a superficial gloss of equality vis-a-vis marriage as partnership. On examination, however, there is an undercurrent of individual ownership and control which is jarring and which surfaces dramatically in the ERTA revision to the terminable interest rule.¹⁹⁸

Prior to ERTA, in order for a decedent's estate to claim the marital deduction the property interest left to the surviving spouse had to include current economic benefit as well as control over the ultimate disposition of the property. At a minimum, an income interest for life and a general testamentary power of appointment in favor of the survivor's estate was required.¹⁹⁹ This general testamentary power of appointment was the trigger for the subsequent estate taxation at the surviving spouse's death.²⁰⁰ Although the decedent spouse may have reconciled himself to loss of control over half of his estate in exchange for the one-half marital deduction, Congress was not sure that loss of control over the entire estate was the same thing:

Because the surviving spouse must be given control over the property, the decedent cannot insure that the spouse will subsequently pass the property to his children. Because the maximum marital deduction is limited under present law to one-half of the decedent's adjusted gross estate, a decedent may at least control disposition of one-half of his estate and

¹⁹⁶The difference between these two focuses was stressed at the outset of the tax Article 1 of the Treasury Regulations stated:

The federal estate tax is imposed upon the transfer of the net estate . . . of every person dying after September 8, 1916. The tax is not laid upon the property, but upon its transfer from the decedent to others. The subject of the tax is the transfer of the entire net estate, not any particular legacy, devise, or distributive share. It is not an individual inheritance tax. The value of the separate interests and the relationship of the beneficiary to the decedent have no bearing upon the question of liability or the extent thereof.

T.D. 2910, Regulation 37, 21 Treas. Dec. 753 (1919).

The blurring of the two schemes is not limited to the statutory structure itself. Recently in *Estate of Bright v. U.S.*, 658 F.2d 999 (5th Cir. 1981), for example, the Service asked the court to consider the individual stock holdings of a recipient in determining the estate tax value of the stock transferred to him (as a trustee of a testamentary trust for the benefit of their children). The Fifth Circuit refused: "It would be strange indeed if the estate tax value of a block of stock would vary depending on the legatee to whom it was devised." *Id.* at 1006. The Service has announced it will not follow the *Bright* decision. Rev. Rul. 81-253, 1981-2 C.B. 187.

¹⁹⁷See *supra* note 180 and accompanying text.

¹⁹⁸Wall Street Journal, Sept. 2, 1981, at 6, col. 1.

¹⁹⁹I.R.C. § 2056(b)(5) (1982).

²⁰⁰I.R.C. § 2041 (1982).

still maximize current tax benefits. However, unless certain interests which do not grant the spouse total control are eligible for the unlimited marital deduction, a decedent would be forced to choose between surrendering control of the entire estate to avoid imposition of estate tax at death or reducing his tax benefits at his death to insure inheritance by the children. The committee believes that the tax laws should be neutral and that the tax consequences should not control an individual's disposition of property.²⁰¹

The neutrality of the tax laws has long been a goal of the system.²⁰² It is obviously impossible to reconcile this quest for neutrality with the ERTA provisions on the marital deduction, both quantitatively and qualitatively. By providing a tax deduction for dispositions to a spouse, the tax system is quantitatively skewed in favor of spousal transfers. By removing the 50% limitation, the system dramatically increases the quantitative incentive for spousal disposition,²⁰³ which in turn reduces current revenue from the estate tax²⁰⁴ and runs counter to the professed purpose of reducing the undue concentration of wealth. Qualitatively, ERTA can be seen as favoring spousal transfers in trust, given the relaxation of the terminable interest rule.²⁰⁵ Consequently, the decedent spouse can have the tax deduction and control the ultimate disposition of "his" marital unit property. This jarring practical reality is somewhat inconsistent with the theoretical underpinnings of the marital unit concept. Moreover, this preference for transfers in trust may be contrary to the spirit of the generation-skipping tax which strives for neutrality with respect to the type of disposition: "there should be no tax advantage available in setting up trusts."²⁰⁶

B. Spousal Joint Tenancies

In 1976, Congress amended section 2040 to provide that for certain qualified joint interests of spouses, one-half of the interest would automatically be included in the gross estate of the first spouse to die because the consideration-

²⁰¹H.R. REP. NO. 201, 97th Cong., 1st Sess. 160 (1981). It should be noted that the choice posed by the Report is inaccurate in at least one respect: a decedent would not be forced to surrender control over his *entire* estate in order to avoid imposition of the estate tax, but rather only with respect to the amount in excess of the tax free amount.

²⁰²Similarly situated taxpayers should be treated similarly. This is the notion of horizontal equity. See, e.g., Hudson, *Tax Policy and the Federal Taxation of the Transfer of Wealth*, 19 WILLAMETTE L. REV. 1, 3 (1983).

²⁰³Most of the estate planning literature proceeds on the assumption of full use of the marital deduction in order to defer the tax to the death of the survivor. While it may make mathematical sense to pay some tax at the death of the first spouse (See Zelinsky, *The Estate and Gift Tax Changes of 1981: A Brief Essay on Historical Perspective*, 60 N.C.L. REV. 820, 826 (1982)), there is a feeling that given the present state of uncertainty, deferral is preferable.

²⁰⁴The estimated revenue loss due to the unlimited marital deduction was \$259 million for fiscal year 1983 and \$242 million for 1986. S. REP. NO. 144, 97th Cong., 1st Sess. 128, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS at 229.

²⁰⁵I.R.C. § 2056(b)(7) (1982).

²⁰⁶S. REP. NO. 938 (Part 2), 94th Cong., 2d Sess. 20, *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS at 4046. It is true that here is no tax advantage since an outright gift will also qualify for the marital deduction, rather it is the element of retained control, sanctioned by the tax law, that will dictate the use of the trust.

paid test was “unnecessarily complex” and administratively “difficult” with respect to spouses.²⁰⁷ In 1978, a second amendment to section 2040 added a special election for including a percentage of jointly held property used in a farm or other trade or business where each of the spouses materially participated in the business operations.²⁰⁸ ERTA repealed both of these complex subsections²⁰⁹ and provided a very simple, “easily administered” rule of inclusion: with respect to all property jointly held by a husband and wife, no matter when acquired, one-half of the property is automatically included in the estate of the first to die.²¹⁰ Since there is an unlimited marital deduction, and since joint tenancy property passes by operation of law to the surviving spouse as the surviving joint tenant, there should be no direct federal estate tax cost.²¹¹

The simplicity and clarity of the ERTA amendment is gratifying; its rationale (“unnecessarily complex,” “burdensome” tracing requirements) could apply to many other joint tenants, married or not. In all likelihood, the reason for ERTA’s simplification of section 2040 was not tied solely to its complexity and burdensomeness.²¹² As a practical matter, given ERTA’s unlimited marital deduction there was no substantial reason to retain the complexity of sections 2040(b) and 2040(c) for spousal joint tenancies. Although the language of section 2040 now provides for a specific carve-out for spousal joint interests, and therefore suggests a marital unit focus for this section, as a practical matter this focus is primarily derived from the unlimited marital deduction.

C. Other ERTA Amendments

Three further changes enacted by ERTA deserve mention. First, Congress repealed the recently-enacted orphan’s deduction,²¹³ explaining that the provi-

²⁰⁷See *supra* notes 164-166 and accompanying text.

²⁰⁸Revenue Act of 1978, § 511(a), adding I.R.C. § 2040(c) (since repealed by Economic Recovery Tax Act 1981 § 403(c)(3)(A)).

²⁰⁹Economic Recovery Tax Act of 1981, § 403(c)(3)(A). The complexity of the repealed sections may be attested to by the variety of commentary dealing with their intricacies. See, e.g., Maxfield, *Some Reflections on the Gift and Estate Taxation of Jointly Held Property*, 34 TAX LAW. 47 (1980); See also Messinger, *Section 204(c): More Complexity and Limited Relief in Taxation of Jointly Held Interests of Spouses*, 34 TAX LAW. 89 (1980).

²¹⁰Economic Recovery Tax Act of 1981 § 403(c)(1).

²¹¹There may however be some indirect tax costs. For example, assume husband provides the consideration for joint tenancy property, at his death one-half of its value is included in his gross estate and therefore for income tax purposes only one-half of the property receives a step up in basis. Under prior law, with the entire value included in husband’s gross estate there was a step up in basis for the entire amount. Of course, if wife were the first to die one-half would be included in her estate with the concomitant “bonus” step up for income tax purposes.

Another direct tax cost may involve the availability of certain elective provisions such as § 303, § 2032A and § 6166, since those sections depend upon the business interest or farm property (as the case may be) constituting a certain percentage of the estate. Therefore, as the numerical size of the estate changes, the availability of these elective provisions may also change.

²¹²“Complexity” and “burdensomeness” at times seem to be code words for repeal. For example, the 1948 Act repealed the “burdensome” 1942 community property amendments; similarly carryover basis was repealed on these grounds. See *supra* note 172.

²¹³Economic Recovery Tax Act of 1981 § 427(a).
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sion "substantially complicates estate planning and the preparation of wills."²¹⁴ Furthermore, the committee: "believes it more appropriate to provide tax-free amounts for eligible minor children through an increased unified credit."²¹⁵ Curiously, "ineligible" minor children as well as adult children or even non-children would also benefit through the increased credit. In addition, the originally perceived need²¹⁶ of an orphan yields to the need for tax simplicity. From the perspective of the appropriate unit of taxation, the repeal of the orphan's deduction represents a moderate step back from the expanding notion of the appropriate taxpaying unit. This slight constriction is more than offset by the other ERTA changes.

If tax simplification was the true order of the day, then the ERTA amendments to special use valuation were misplaced. ERTA continued the tinkering changes within section 2032A, those of a technical nature as well as those of a substantive nature.²¹⁷ This was done to "expand [the] availability of current use valuation" to "assist further in the preservation of family owned and operated farms."²¹⁸ Significantly, the definition of family member was altered.²¹⁹

The third change affected only the gift tax, a relatively unusual event since gift tax changes are generally reflective of estate tax changes. This new provision completely excludes from the operation of the gift tax "any amount paid on behalf of an individual" either as tuition or as payment for medical care.²²⁰ This is so without regard to the relationship (or lack thereof) between the donor and the donee.²²¹ The focus of this new exclusion appears theoretically neutral or as the most expansive unit — the brotherhood of man. As a practical matter, such payments are most often made within family groups.²²² Family wealth may thus be shifted up, down, diagonally or across generational lines without gift tax consequences to the donor or donee.²²³

²¹⁴H.R. REP. NO. 201, 97th Cong., 1st Sess. 192 (1981).

²¹⁵*Id.*

²¹⁶See *supra* note 159-160 and accompanying text.

²¹⁷Economic Recovery Tax Act of 1981 § 421; See also H.R. REP. NO. 201, *supra* note 214, at 165-179, especially 168.

²¹⁸*Id.* at 169.

²¹⁹Economic Recovery Tax Act of 1981 § 421(i), amending I.R.C. § 2032A(e)(2); See also *supra* note 148.

²²⁰Economic Recovery Tax Act of 1981 § 441(b), adding I.R.C. § 2503(e).

²²¹H.R. REP. NO. 201, *supra* note 214, at 193. "This exclusion for medical expenses and tuition would be in addition to the \$10,000 annual gift tax exclusion and would be permitted without regard to the relationship between the donor and the donee." See also, Rev. Rul. 82-98, 1982-1 C.B. 141, 142: "The entire amount expended by the donor with respect to the donee's medical and hospital bills is not subject to the gift tax [T]he result would be the same regardless of the relationship of the donee to the donor."

²²²In giving its reasons for this change, the committee underscored the family nature of these payments: "In addition, the committee is concerned that certain payments of tuition made on behalf of *children* who have attained their majority and medical expenses on behalf of *elderly relatives* are technically considered gifts under present law." (emphasis added) H.R. REP. NO. 201, *supra* note 214. Indeed the Committee was correct, as shortly thereafter a private ruling appeared in which gift tax liability was asserted where a mother paid her handicapped adult daughter's medical expenses. Private Letter Rul. 8135032 (June 1, 1981).

²²³The income tax consequences of such payments, however, are specifically not changes. H.R. REP. NO. 201, *supra* note 214, at 194.

It is not difficult to guess the genesis of this exclusion. In the 1980 hearings on estate and gift tax reform, Mr. Halperin of the Treasury Department was speaking generally of the need to reevaluate the entire structure, and mentioned the then-current \$3,000 annual exclusion:

Mr. Halperin: If, in fact, things like paying college tuition are really considered gifts, then it is appropriate for the exemption level to be higher because we do not want people including those things —

Sen. Byrd: What is the Treasury ruling on that?

Mr. Halperin: I believe that it probably [is] considered a gift —

Sen. Byrd: Let me ask you, to see whether I understand what you are saying.

If a parent pays the college tuition for a son or a daughter, whatever it might be, \$8,000, that is subject to a gift tax under the present law?

Mr. Halperin: . . . it would be a gift.

Sen. Byrd: But under the law the Government could require that tax be paid; is that what you are saying?²²⁴

It is easy to imagine Senator Byrd shaking his head in disbelief at a structure that would tax parents for paying their children's college tuition, a disbelief obviously grounded in a normative approach ("expectancy and dependency") to the tax structure.

D. Summary of ERTA '81

In surveying these ERTA changes in the estate and gift taxes, once again there is evidence of a certain degree of confusion as to the focus for transfer taxation. There is, however, a clear statement via the unlimited marital deduction that, for the basic structure of the estate and gift taxes, the proper focus should be the marital unit. The articulated reasons for that statement, however, are less than persuasive. The simplification of spousal joint tenancies is consistent with this focus, although not itself determinative of it. Similarly, to the extent the orphan's deduction departed from a marital unit, its repeal maintains the marital unit character of the structure.

The gift tax exclusion for payments of tuition and for medical care does not itself literally violate the original principle of the individual as the focus in transfer taxation, nor does it continue the expansion of the marital unit. By placing these payments completely outside the framework of the tax, the structure has surrendered control. Similarly, the ERTA amendments to section 2032A, being a valuation mechanism, neither advance nor retard the notion

²²⁴FAMILY ENTERPRISE ESTATE AND GIFT TAX EQUITY ACT AND MISCELLANEOUS TAX BILLS: HEARING BEFORE SUBCOMM. TAXATION AND DEBT MANAGEMENT GENERALLY OF THE SENATE COMM. ON FINANCE, 96th CONG., 2d Sess., 105 (1980).
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of the marital unit as the basic structural unit for transfer tax purposes. Each of these two changes does, however, reinforce the shift from an individual to something greater. The gift tax exclusion does so as a practical matter, since most tuition or medical payments would be within the family setting. The special use valuation does so by its own terms since it is limited to farms and businesses owned and operated by family members.

V. THE OVERVIEW

The preceding selective history of the transfer tax system demonstrates several key points. First, the origins of the system are in raising revenue. A death tax system was a tried and true way to raise revenue, albeit in modest amounts. Given the constant presence of a relatively generous exemption, most estates have never borne the tax.²²⁵

Second, even as the primary articulated purpose moved from revenue-raising during the 1916-1926 period to the prevention of undue accumulation of wealth during the 1930's, there was still a structural commitment to the individual as the appropriate unit for transfer taxation purposes. The 1948 addition of the marital deduction was not consciously shifting this structural focus, but rather attempting to alleviate the very real difference in estate taxation due to the community property/common law property dichotomy. Therefore it was not an internally generated discrepancy due to the unit of taxation, but a response to an external discrepancy in the consequences of the ownership of property.

Third, in 1976, a move towards a more expansive notion of the appropriate unit began. It was not really the moderately increased marital deduction that marked the subtle shift. The shift may be better characterized by the qualified joint interests provision, the orphan's deduction or the relief provision of section 2032A, on the one hand, and by a tax tightening provision — the generation-skipping tax — on the other. In 1981, the unlimited marital deduction seemed to have anchored the marital unit as the basic format. At the same time other changes, such as the gift tax exclusion for tuition and medical care, signaled a certain restlessness even in that conception of the unit.

It is clear that these latest reforms in the transfer taxes are based not on the need for revenue nor the policy against concentrations of wealth, but rather on normative notions of "expectancy and dependency" in a traditional format. Unfortunately, the reforms inadequately address the question of whether those historical norms retain validity in a modern day taxing structure. It is naive to suggest that normative notions do not influence the tax system. As increasing numbers of taxpayers move outside the norm of one husband/one wife for life, the unquestioned "universal" acceptance of the norm of relationship discrimination in transfer taxation is less clear.

²²⁵In the history of the estate tax, 1977 marks the year with the greatest number of returns filed (200,747) and the greatest number of taxable returns (139,115); meaning that approximately 10.5% of all decedents filed returns and 7.3% of all decedents paid and estate tax. STAFF OF JOINT COMM. ON TAXATION, 97th Cong., 1st Sess., BACKGROUND AND DESCRIPTION OF ADMINISTRATION PROPOSAL RELATING TO ESTATE AND GIFT TAXES 32 (U.S. Comm. Print 1981).

The expectancy of the receipt of property at death may be just as great, and as legitimate, in a sibling relationship as in a spousal relationship. This may be especially true today given the growing number of never married individuals. Similarly, dependency may be more acute in the parent-child relationship than in the spousal relationship, given the increasing number of women in the work force and the increasing incidence of two "families" within one household. Neither of these examples suggests that reflecting the norms within the taxing structure is inappropriate; rather, the manifestation of the norms within that structure may be. Each of these norms may be more fairly addressed in the tax free amount which applies to all decedents/grantors regardless of marital or family status. The massive injection of these notions of relationship discrimination into the well established transfer tax structure in 1976 and again in 1981 has only made that structure and its operational system confused, unfocused and vulnerable to attack.

One may well reach the conclusion that, as there has been movement away from the individual as the focus of taxation towards a married couple or perhaps a family unit, be it nuclear or extended, the justification for the entire system is strained. The revenue raising motive is clearly minimized, and as for the undue concentration of wealth rationale, the opposite is actually better served.

It seems that the only rationale for the continuation of the system is that it exists, and has existed for a long time.²²⁶ It may serve a political purpose as skeletal evidence that wealthy persons, or more precisely "wealthier families," are not favored by the tax structure. It is time to rethink the current purpose of the transfer tax system and to test the articulated purpose against the current structure. In doing so, many of the provisions, and perhaps the entire system, may just fail.

²²⁶"I suspect that the real function of the estate and gift tax structure as (it) presently exists is to provide the illusion to the uninformed middle class that wealthy people pay excessive estate and gift taxes, and the corollary illusion to the wealthy people that they pay an excessive tax on their estates." FEDERAL ESTATE AND GIFT TAXES, HEARINGS AND DISCUSSIONS BEFORE THE HOUSE COMM. ON WAYS AND MEANS, 94th Cong., 2d Sess. 761 (1976) (statement of Prof. Gerald Moran).

