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THE WHITE HOUSE

WASHINGTON

March 20, 1976

ADMINISTRATIVELY CONFIDENTIAL

MEMORANDUM FOR: L. WILLIAM SEIDMAN

FROM: JAMES E. CONNOR JEC

SUBJECT: Further Options for Estate and Gift Tax Revisions

Confirming phone call to Roger Porter last evening, the President reviewed your memorandum of March 19 on the above subject and approved the following:

Issue 1: Should the Administration propose a free inter-spousal transfer rule, or unlimited martial deduction, under which all transfers between spouses would be completely excluded from the estate and gift taxes?

Option 1: Propose exempting interspousal transfers from estate and gift taxes.

Issue 2: Should the Administration propose increasing the gift exemption from $30,000 to $75,000 (the same proportionate increase as the proposed estate tax exemption)?

Option 2: Propose no change in the present gift tax structure.

Issue 3: Tax Treatment of Unrealized Appreciation in Property Transferred at Death

Approved EPB Executive Committee recomendation that the Administration oppose any change in the present tax treatment of unrealized appreciation in property transferred at death.

Please follow-up with appropriate act i on.

cc: Dick Cheney

THE WHITE HOUSE
WASHINGTON

March 19, 1976

MR PRESIDENT -

Regarding Estate and Gift Tax Revisions, Jack Marsh supports Bill Seidman's recommendation.

Jim Connor

THE WHITE HOUSE

WASHINGTON

March 19, 1976

MR PRESIDENT:

Further Options for Estate and Gift Tax Revisions

Recommendations of senior staff members are included in Bill Seidman's memorandum on the above subject.

Comments have not been received from Jack Marsh at this writing.

Treasury has asked that this be sent forward to you now as they will be testifying on this subject on Monday and would like the guidance of your decisions.

Jim Connor

THE PRESIDENT HAS SEEN....

THE WHITE HOUSE

WASHINGTON

March 19, 1976

MEMORANDUM FOR THE PRESIDENT

FROM: L. WILLIAM SEIDMAN [signature]

SUBJECT: Further Options for Estate and Gift Tax Revisions

Background

You have previously approved proposing an increase in the estate tax exemption to $150,000 with a revised rate schedule eliminating the lower rate brackets (three percent to 28 percent) on the first $90,000 of taxable estate and starting the new rate schedule with a 30 percent rate. You also approved proposing that these changes be phased in over a five year period.

The proposed $150,000 estate tax exemption together with your previously proposed 25 year payment period for the estate tax on family-owned farms and family-owned small businesses, provide significant benefits to farmers and small businessmen many of whom are presently faced with a very substantial tax on their estates due to the effect of inflation on farm and business values.

The House Ways and Means Committee is now holding hearings on the broad issues of estate and gift tax reform. Secretary Simon or Assistant Secretary Walker will be presenting the Administration's proposals on Monday, March 22.

Two issues remain for your consideration.

Issue 1: Should the Administration propose a free interspousal transfer rule, or unlimited martial deduction, under which all transfers between spouses would be completely excluded from the estate and gift taxes?

The estate and gift tax marital deduction was introduced in 1948 to equalize the treatment of couples in community property states and common law property states. The property of couples in community property states is automatically split

50-50 between spouses without imposition of estate or gift taxes. The objective of the 1948 legislation was to provide equivalent tax treatment for couples in common law property states.

Under present law, a gift tax marital deduction may be claimed for one half the amount transferred to a spouse and an estate tax marital deduction may be claimed for up to one half of the adjusted gross estate.

These deduction provisions have been criticized on several grounds:

- o Community property laws operate automatically to split the spouse's property between two estates, while the estate tax marital deduction may be utilized only if the wealthier spouse dies first. A tax-free division of property may not be accomplished during life, because the gift tax marital deduction equals only one-half of the property transferred.

- o Many families regard their property as generated by their combined efforts and transfer property from separate ownership to joint ownership, without paying much attention to the legal change in ownership. Taxing such transfers that are basically merely incidents in the common management of a family's pooled resources is considered inappropriate by many.

- o The present 50 percent deduction has created difficult administrative problems for many estates because of attempts to maximize tax benefits by very exact utilization of the maximum deduction through complicated formula provisions.

In response to a question during his Senate Finance Committee tax reform testimony on Wednesday, March 17, Secretary Simon indicated our estate and gift tax recommendations would include a proposal exempting interspousal transfers.

<u>Option 1</u>: <u>Propose exempting interspousal transfers from estate and gift taxes.</u>

<u>Advantages</u>:

- o Responds fully to the above criticisms of the present marital deduction.

- o Maximizes flexibility in family estate planning.

Disadvantages:

- o May be attacked as unduly favorable to very large estates and as unnecessary to permit adequate provision for a surviving spouse.

- o Will cost approximately $500 million annually when fully effective, over and above the revenue loss from the $150,000 estate tax exemption of about 1.2 billion when fully effective.

  The cost is very difficult to phase in, though it could be postponed beyond fiscal year 1977.

Option 2: Propose liberalized marital deduction provisions without completely exempting interspousal transfers from tax.

For example, the maximum estate tax marital deduction could be $150,000 plus one-half of the portion of the adjusted gross estate in excess of $150,000.

Advantages:

- o This would be equivalent to complete exemption of marital transfers for most estates. Together with the proposed $150,000 estate tax exemption, it would permit an estate of up to $450,000 to be given tax free to a surviving spouse.

  Of 174,899 estates filing returns in 1973, only 11,314 (or 6.5 percent) had a gross estate value in excess of $500,000.

- o Avoids criticism of providing excessive benefits for large estates.

Disadvantages:

- o Revenue loss remains large, about $300-$350 million annually when fully effective. It would be difficult to phase in the loss though it could be postponed beyond fiscal year 1977.

- o Would retain the complexity of the present estate tax law.

Option 3: Propose no change in the present law.

With the proposed $150,000 estate tax exemption, the present law would permit an estate of up to $300,000 to be given tax free to a surviving spouse.

Advantages:

- o This would still provide complete exemption of marital transfers for most estates. In 1973, only 23,577 estates (13.5 percent) had a gross estate value in excess of $300,000.
- o Many consider $300,000 adequate provision for a surviving wife, and insurance and other devices may be used to transfer additional amounts to a spouse outside the estate.
- o Avoids a substantial revenue loss.

Disadvantages:

- o May be criticized as evidencing lack of concern for women's rights and as unresponsive to criticisms of the present interspousal transfer provisions.

If either Option 1 or 2 is selected, the Treasury Department would recommend the adoption of a postponed effective date designed to avoid any fiscal year 1977 impact, rather than an attempt to phase in the change. Any phase-in rule would seriously disrupt will drafting and estate planning during the phase-in period.

Decision

Option 1 ___RCF___ Propose exempting interspousal transfers from estate and gift taxes.

Supported by: Treasury, OMB, CEA, Cannon, Seidman, Morton

Option 2 ________ Propose liberalized marital deduction provisions without completely exempting interspousal transfers from tax.

Option 3 ________ Propose no change in the present law.

Supported by: Labor, Buchen

No comment: Commerce, State

Issue 2: Should the Administration propose increasing the gift exemption from $30,000 to $75,000 (the same proportionate increase as the proposed estate tax exemption)?

The present gift tax exemption is $30,000 and gift tax rates are set at three-fourths of the estate tax rates. Retaining the present relationship between gift and estate taxes would require, if the proposed $150,000 estate tax exemption and beginning estate tax rate of 30 percent are adopted, a gift tax exemption of $75,000 and a beginning gift tax rate of 22 1/2 percent.

However, there has been no particular political pressure for an increased gift tax exemption. The numerous bills to increase the estate tax exemption do not provide for any increase in the gift tax exemption. Taxable gifts are generally made by the very wealthy, rather than individuals who have an estate of $150,000 to $500,000.

Option 1: Propose increasing the lifetime gift tax exemption to $75,000, increasing the annual gift tax exclusion to $7,500, and increasing the beginning rate to 22 1/2 percent.

These changes would cost an estimated $200 million in FY 1977 assuming they would be immediately effective, for gifts after July 1, 1976. It is doubtful whether phasing in the changes would substantially reduce the first year revenue loss.

Advantage:

- Provides the same adjustment for inflation as the proposed increase in the estate tax exemption from $60,000 to $150,000.

Disadvantage:

- Increasing the lifetime gift tax exemption to $75,000 may be criticized as primarily a benefit to the wealthy.

Option 2: Propose no change in the present gift tax structure.

Advantages:

- Would have a neutral effect on existing estate plans and lifetime gift programs.

- Avoids the revenue loss of an increased gift tax exemption.

Disadvantage:

- o Would destroy the present symmetry between estate and gift tax structures.

Option 3: Propose an increase in the annual gift exclusion from $3,000 to $7,500 per donee. Propose no change in the $30,000 gift tax exemption or in the gift tax rates.

Raising the annual gift exclusion would cost an estimated $125 million annually.

Advantages:

- o Would provide the same proportionate increase in the annual gift tax exclusion that the Administration has proposed for the estate tax exemption.
- o Would preserve the function of the exclusion as an exemption for substantial gifts that are commonly made, such as a gift of a car to a child.
- o An increase in the annual gift exclusion would benefit a broader range of taxpayers than would an increase in the lifetime gift tax exemption.

Disadvantages:

- o Subject to criticism that we are being inconsistent by increasing the annual exclusion without making any change in the lifetime gift tax exemption.

Decision

Option 1 ________ Propose increasing the lifetime gift tax exemption to $75,000, increasing the annual gift tax exclusion to $7,500, and increasing the beginning rate to 22 1/2 percent.

Option 2 NRG Propose no change in the present gift tax structure.

Supported by: Labor, Buchen

Option 3 ________ Propose an increase in the annual gift exclusion from $3,000 to $7,500 per donee. Propose no change in the $30,000 gift tax exemption or in the gift tax rates.

Supported by: Treasury, OMB, CEA, Cannon, Seidman, Morton

No comment: Commerce, State

Tax Treatment of Unrealized Appreciation in Property Transferred at Death

Under present law, unrealized appreciation in property transferred at death entirely escapes income tax. Neither the deceased prior owner of the property or his heirs are taxed. Most tax reformers consider this one of the major tax loopholes. Any attempt to change the law would, however, either impose substantial tax burdens that would fall particularly heavily on the family-owned farms and small businesses we are seeking to aid by our other proposals, or would be exceedingly complicated. Moreover, it is likely that legislation in this area will be extremely controversial and that any provision that is enacted will contain so many exceptions and exclusions that its overall contribution to tax equity would be marginal at best.

Recommendation: The EPB Executive Committee recommends that the Administration oppose any change in the present tax treatment of unrealized appreciation in property transferred at death.

Approve MRF

Disapprove ____________