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What Alternative to the Estate and Gift Taxes?

Harry J. Rudick*

FAULTS OF THE EXISTING SYSTEM

Implicit in the above title is a confession that the estate and gift taxes are not perfect instruments for the taxation of donative transfers. If they were merely imperfect, that would be no reason to condemn them: perfection in tax statutes is too much to expect in an imperfect society. However, the defects are too serious to overlook. Although they have been enumerated and subjected to critical examination in recent years a number of times, it is convenient, for purposes of appraising various alternatives to the present system, to list once more the major shortcomings of the present method of taxing inter vivos gifts and transfers from the dead to the quick.

1. Non-integration of the estate tax and gift tax

Apart from the question of whether the existing tax structure attains, to the fullest possible extent, the social purpose (hereinafter discussed) of death duties, the most serious objection to the present gift and estate taxes is that the two taxes are, in general, unrelated to each other, i.e., there are two sets of graduated rates and two sets of exemptions, neither related to the other. As a result of this dual

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1 E.g., Federal Estate and Gift Taxes, A Proposal for Integration and for Correlation with the Income Tax, A joint study prepared by an Advisory Committee to the Treasury Department and by the Office of the Tax Legislative Counsel, with the cooperation of the Division of Tax Research and the Bureau of Internal Revenue (U.S. Government Printing Office, 1947); Platt, Integration and Correlation—The Treasury Proposal, 3 Tax L. Rev. 59 (1947); Wales, Consistency in Taxes—The Rationale of Integration and Correlation, 3 Tax L. Rev. 173 (1948); Rudick, A Proposal for an Accessions Tax, 1 Tax L. Rev. 25 (1945). For a much earlier discussion, see Federal and State Death Taxes, A Report to the Joint Committee on Internal Revenue Taxation (U.S. Government Printing Office, 1933). The present article is based in part on the writer's A Proposal for an Accessions Tax, supra. However, the proposal contained herein for the taxation of property settled in trust is quite different from that suggested in the earlier paper; and a number of problems not considered in the previous article are discussed herein.

2 Except that the rate of gift tax in each bracket is exactly three-quarters of the estate tax rate for that bracket.
WHAT ALTERNATIVE

system an individual who gives away property to his heirs during his lifetime effects an ultimate saving for these heirs of the difference between the highest brackets of estate tax that would be payable with respect to such property and the much lower brackets of gift tax. Thus the earliest gifts ordinarily produce the greatest savings and though, as a result of the cumulative feature of the gift tax, the gap narrows as gifts beyond the annual exclusion and lifetime exemption are piled on top of previous taxable gifts, there is always a substantial gap. As a consequence those beneficiaries whose donors are able to and choose to make gifts of part of their property during life are much more fortunate, at least so far as tax costs are concerned, than those whose benefactors, either perforce or from choice, postpone their bounty until death. Thus, if a donor possessing $5,000,000 gave away none of it during life, the tax on his estate would be approximately $2,468,000, leaving his heirs $2,532,000. But if he gave away $2,500,000 during life, he would have effected a saving for his heirs of $1,074,000, computed as follows:

Gift tax on $2,500,000—assuming no other taxable gifts.$ 737,000
This gift tax would be paid out of the remaining
$2,500,000, reducing that figure to $1,763,000,
upon which there would be an estate tax of................. 646,000
The amount received by the heirs would thus be............. 3,617,000
($2,500,000 gift plus balance of estate after payment of estate tax.)

It will be noted from the foregoing example that the saving results not merely from the two sets of rates and exemptions. A substantial

3 There is a complete escape from tax (as there would also be under alternative methods) to the extent that the gift is within the allowable annual exclusions and the lifetime exemption. Under present law, Int. Rev. Code § 1003(b), the first $3,000 of gifts (other than gifts of future interests in property) made to any person by the donor during the calendar year are not included in the total amount of gifts made during such year. The lifetime exemption for a citizen or resident is $30,000 (Int. Rev. Code § 1004(a)(1)). There is no exemption for non-resident aliens. The 1948 amendment to the gift tax law whereby only half of a gift to a spouse is counted as a gift (Int. Rev. Code § 1004(a)(3)) and whereby gifts by one spouse to third parties may be attributed half to the other spouse (Int. Rev. Code § 1000(f)) permits a substantial portion of an individual's estate to be transferred to his heirs without any tax whatsoever. For example, an individual with a wife and three children could give away $24,000 a year for each year of his life without even eating into his specific lifetime exemption of $30,000.

4 The tax for any year is computed by figuring the tax at current rates on all taxable gifts made during the taxable year and prior years and deducting from that tax, the tax computed at current rates on gifts made in prior years.

5 It is assumed that none of the heirs is a spouse, so that the marital deduction is ignored.
part of the saving results from the fact that the payment of the gift tax depletes the estate subject to tax whereas the payment of the estate tax does not deplete the estate for the purposes of that tax. This saving results even where the gift was made in contemplation of death (and hence was includible in the gross estate for death duty purposes) for the reason that in such a case the gift tax paid is allowed as a credit against the estate tax. In the case of a $5,000,000 estate one-half of which was transferred in contemplation of death, the saving at present rates would be in the neighborhood of $500,000. This makes one wonder why more tax-conscious decedents do not on their death beds give away a large part of their property before expiring.6

The asserted purposes of the gift tax were (1) to protect the estate tax, and (2) to recoup some of the income tax revenue lost by reason of transfers of income-producing property by donors in high income tax brackets to donees in lower brackets. The gift tax has utterly failed to accomplish these purposes. As to the first of them, Platt has aptly remarked that Congress “was sending a small boy to do a man’s job.”7 As to the second purpose, it is obvious that the earliest gifts purchase the highest income tax savings at the lowest gift tax cost; and as a consequence the gift tax cost is soon made up by annual reductions of the family income tax budget.

2. The overlapping of the two taxes

The two levies are not mutually exclusive. There are, and must be under the present scheme of taxing donative transfers, many situations besides contemplation of death where a gift which has been subject to gift tax nevertheless becomes subject to estate tax. For example, A, a widower, buys some real estate which he places in the joint names of himself and his daughter. By reason of the fact that A supplied the entire purchase price, he is deemed to have made a gift of one-half of the value of the property to his daughter; but when A dies the entire value of the property will be includible in his gross estate.8 Because of

6 Cf. Estate of Harold W. Grant, 1 T. C. 731 (1943) and Estate of Frank K. Sullivan, 10 T.C. 961, reversed 175 F.2d 657 (9th Cir. 1949).

7 Platt, Integration and Correlation—The Treasury Proposal, 3 TAX L. REV. 59, 60 (1948). The 1933 Report to the Joint Committee (Federal and State Death Duties), supra note 1, contains the surprisingly naive statement (pp. 9, 75) that the gift tax “measurably approaches the estate tax which would have been payable at the donor’s death if the gifts had not been made in his lifetime and the property instead had constituted a part of his estate.”

8 Other examples of the inclusion in the gross estate of property which has already been subjected to gift tax would be tenancies by the entirety (where one tenant has
these cases the estate tax law must contain necessarily intricate credit provisions\(^9\) whereby the gift tax paid with respect to the transfer is allowed as a credit against the estate tax. These provisions sometimes operate unfairly against the estate because of the complex limitations on the amount of the credit.

3. **Difficulties in taxing transfers which may have been made in contemplation of death**

Inherent in the present scheme of taxing gifts and estates is the vexatious problem of transfers alleged to have been made in contemplation of death. In an endeavor to minimize avoidance of death duty through *inter vivos* gifts, Congress has provided that gifts in contemplation of death are subject to estate tax and has further aided the Commissioner by providing that transfers without an adequate consideration in money or money's worth made within two years of the decedent's death are presumed to have been made in contemplation of death unless shown to the contrary. These provisions, which depend for their application upon a subjective test despite the fact that the subject no longer exists, have proven troublesome to the Treasury and taxpayer alike. The meaning of the term "contemplation of death," even after more than thirty years of estate tax experience, is still not clear and is a source of controversy rather than revenue. Most of the controversies, and there are indeed many, are settled without resort to litigation. Where they have been litigated the Government has not been very successful.\(^10\)

The British have attempted to dispose of the problem by arbitrarily including in the gross estate all transfers made within five (formerly three) years of death and by ignoring transfers completed beyond that period.\(^11\) A similar proposal was contained in the Revenue

\(^9\) Int. Rev. Code §§ 813(a), 936(b).


\(^11\) Barna, *Death Duties in Britain*, 26 Taxes 1062 (1948). The British do not impose any gift tax. Hence a transfer before the five-year period generally escapes tax completely. However, certain transfers are included in the taxable estate even if made more than five years prior to death, e.g., a transfer in which the decedent retained an income interest or a reverter. *Green, The Death Duties* (1936). Moreover, under British income tax law certain transfers where the income remains within the immediate family of the donor do not relieve the latter of income tax liability. KONSTAM, *The Law of Income Tax* 308 et seq. (1946).
Revision Act of 1948 (which failed of enactment) except that the dividing line was three years and except that there was only a rebuttable presumption as to transfers within the three-year period. A Congressional endeavor to tax arbitrarily all gratuitous transfers effected within two years of death as transfers in contemplation of death met with defeat at the hands of a Supreme Court with more conservative views than the present Court; and there is some reason to believe that if the attempt were revived it would succeed. However, such a solution merely reduces the magnitude of the problem; it does not eliminate it.

4. Lack of correlation between the income, gift and estate tax levies

This lack of correlation produces a number of anomalous results. A donor who has paid gift tax finds himself still subject to income tax on the income from property transferred, e.g., a transfer in trust the income to be used to pay premiums on policies insuring the life of the donor or transfers in trust such as that involved in the *Clifford* case where the grantor was held to have retained so many of the attributes of ownership of the property that he could justifiably be taxed on the income even though such income was paid to another. Then there are transfers which are complete for income tax purposes but not complete for estate tax purposes; for example, a trust for the benefit of another where the grantor and the beneficiary have power to revoke or amend. The last mentioned example is another illustration of the overlapping of the gift and death levies mentioned above whereby a transfer may be subject to both levies. In all of these cases the inconsistent treatment produces confusion, inequity and maladministration. The situation is obviously one which calls for correction whether the present scheme of taxation of gifts and trans-

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12 Revenue Revision Act of 1948, § 204(a). The bill died aborning—it was passed by the House but was not acted upon by the Senate. See also Report on the bill, H. R. Rep. No. 2087, 80th Cong., 2d Sess. 6.


16 As stated above, this overlapping requires a credit provision.

fers at death is retained or one of the alternative methods discussed below is adopted.\textsuperscript{18}

5. \textit{Property settled in trust}

Under existing law, if a decedent leaves his property outright to his wife and the latter leaves the same property to their son, there are two death duties, one on the death of the husband, the other on the death of the wife;\textsuperscript{19} but if the decedent leaves his property to his wife for life with remainder to the son, only one death duty is imposed. The death of the wife and the termination of the trust do not give rise to a second tax. As a consequence, there is a discrimination in favor of those heirs whose decedents decided to establish trusts. For example, if husband leaves an estate of $1,000,000 to widow for life, then to son for life, and then to grandson, the latter will ultimately receive $675,000\textsuperscript{20} (assuming no change in market values between the deaths of husband and son). In the meantime, widow and later son would have received the income from $675,000 which income would ordinarily have been subject to income tax. But if husband were to leave his property (after deducting death duty) outright to widow, who in turn left it (after again deducting death duty) to son, who in turn left to (after deducting a third death duty) to grandson, the latter would ultimately receive $409,000, and in the meantime son would have received the income from only $583,000.\textsuperscript{21} The advantages, taxwise, of settling property in trust are apparent.

The British have attempted to solve the problem of settled property by treating each shifting of benefits as a separate succession.\textsuperscript{22}

\textsuperscript{18} However, under some of the alternatives the necessity for coordination is less than under others.

\textsuperscript{19} By virtue of the marital deduction (§ 812(e)) added to the estate tax law by the 1948 Revenue Act, the double tax would only extend to one-half the estate. Prior to the amendments effected by the 1948 Revenue Act, if the wife died within five years of the husband the double tax would, in effect, be eliminated. See \textit{Int. Rev. Code} § 812(c) which allows a deduction, subject to limitations, for previously taxed property. Under the 1948 amendments, this deduction is not allowable with respect to property received from a spouse.

\textsuperscript{20} $1,000,000 less the estate tax ($325,000) on that amount at current rates. (The specific exemption is ignored in this computation, and the amounts stated are approximations).

\textsuperscript{21} It is assumed in this example that husband's estate received a marital deduction of $500,000, and that the widow left an estate of $854,000 ($1,000,000 less a tax on the husband's estate of $146,000), and that son survived widow by at least five years, also that grandson outlived son by at least that period. The amounts stated are approximate and the specific exemptions have been ignored in the computation.

\textsuperscript{22} \textit{Green, The Death Duties} 5 \textit{et seq.} (1936) and Supplement 2-3 (1945).
When the beneficiary of a life estate or term for years dies, the trust principal is aggregated with the beneficiary's own property and the tax computed thereon. The tax is apportioned between the trust property and the beneficiary's own property. This procedure is, in part, inequitable, since it subjects the beneficiary's own property to higher rates by reason of including in his taxable estate property over the disposition of which he has no control.

In an ideal system the decision to settle property in trust or to dispose of it outright would not turn upon tax considerations. Under the present system the decision is often made solely on the basis of tax saving and under perhaps any system of gift and death taxation the decision would be affected by tax consequences; but under some of the alternatives discussed below the tax factor would be less significant than under others.

CONSIDERATION OF ALTERNATIVES

Having listed the foregoing weaknesses of the present method of taxing gifts and estates, we proceed to a consideration of alternative methods of taxing donative transfers to see whether the alternatives are free from these defects, and if so, what shortcomings beset the alternatives. Among the alternative methods which have been tried or suggested are the following:

(1) The British estate duty method: Elimination of the gift tax and the retention of the present estate tax plus the adoption of provisions which would require donative transfers made within a specified period prior to death to be included in the measure of the estate tax.\(^2\)

(2) Inheritance tax as a substitute for estate tax: Elimination of the present estate tax and the substitution of an inheritance tax, whether limited to actual inheritances or broadened to include certain \textit{inter vivos} gifts. If this method were adopted, it would presumably be necessary to either retain the present gift tax or supplant it with a gift tax on donees of \textit{inter vivos} gifts.

(3) A supplementary inheritance tax and a supplementary tax on donees of \textit{inter vivos} gifts: Retention of the present estate and gift levies but supplementing the former by an inheritance tax, \textit{i.e.}, a tax on those inheriting from the decedent (whether by will or intestacy) rather than a tax upon the estate of the decedent, and supplementing the latter by a gift tax on donees.

\(^2\) Presumably no one would advocate elimination of the gift tax without the adoption of some provision sweeping into the measure of tax certain transfers during life, for without such a provision the estate tax would be pretty well emasculated.
(4) Integration of the gift and estate taxes, i.e., cumulation for purposes of a single progressive tax of all donative transfers, whether in life or death, so that in general the tax would be the same regardless of whether the donor gave away part or all of his property while living or retained it until he died.

(5) An accessions tax, i.e., a progressive and cumulative tax on each recipient of money or other property by way of inheritance or inter vives gifts.

Before weighing the pros and cons of each of these alternatives, we should first orient the discussion by a brief consideration of the function of gift and estate taxes in a society and economy such as our own. It is obvious that the gift and estate taxes are no longer imposed with a primary view to the revenue which they yield. Even before the enactment of the 1948 Revenue Act, the provisions of which materially reduced the current yield of the taxes, they produced only between 1½% to 2% of the total internal revenue collections. Under the 1948 amendments which allow the so-called "marital deduction" for both gift and estate tax purposes and provide for splitting of gifts to third parties by spouses the yield will be even lower. This

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24 So-called for want of a better name. See Rudick, A Proposal For An Accessions Tax, 1 Tax L. Rev. 25 (1945).
25 There are, of course, other methods of taxing inheritances, e.g. (1) treating inheritances as income subject to income tax, and (2) making the progression depend upon the wealth of the recipient. The first of these was incorporated in the 1894 Income Tax Law which was declared unconstitutional in Pollock v. Farmers' Loan and Trust Company, 157 U.S. 429, rehearing, 158 U.S. 601 (1895), but not because of the taxation of inheritances as income. The latter method has been tried in several European countries and abandoned. See Schultz, Taxation of Inheritances 310 (1926). Both of these methods discriminate against those who have earned their wealth. Moreover, the second would be utterly impracticable. For still other methods, see Schultz, ibid., at 283 et seq. See also 1933 Report to the Joint Committee, supra note 1, at 61-69.
26 For a fuller discussion of this point, see 1933 Report to the Joint Committee, supra note 1 at 142 et seq., also Rudick, supra note 24 at 28 et seq.
27 Following are the figures for the fiscal years 1945 to 1949, inclusive:

<table>
<thead>
<tr>
<th>Fiscal Year Ended</th>
<th>Total—All Revenue Collections</th>
<th>Gift and Estate Taxes</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1945</td>
<td>43,902</td>
<td>643</td>
<td>1.46</td>
</tr>
<tr>
<td>1946</td>
<td>40,310</td>
<td>677</td>
<td>1.68</td>
</tr>
<tr>
<td>1947</td>
<td>39,379</td>
<td>779</td>
<td>1.98</td>
</tr>
<tr>
<td>1948</td>
<td>41,853</td>
<td>899</td>
<td>2.15</td>
</tr>
<tr>
<td>1949</td>
<td>40,307</td>
<td>796</td>
<td>1.97</td>
</tr>
</tbody>
</table>

29 Int. Rev. Code § 812(e).
30 Int. Rev. Code § 1000(f).
is not to say that the yield cannot or should not be increased, but the fact remains that the true basis for the taxes is no longer a dire need for the revenue that they produce but rather a realization that in the current climate of public opinion it is necessary to have some device to counteract, at least to some degree, the tendency towards concentration of wealth. In other words, death and gift duties in this generation serve as an implement of social, not fiscal, legislation.

This point of view naturally colors any consideration of the advantages and disadvantages of the different methods listed above since, if we conceive of the gift and death duties as an instrument for the moderate dispersion of wealth, a system which tends to promote dispersion is, other things being equal, to be preferred to one which encourages, or at least does not discourage, concentration. In this respect the present system fails miserably since the tax is identical, regardless of whether the property given away (in life or at death) is distributed to one person or to a hundred persons.

Another question which should be considered in orienting the discussion is whether the imposition of gift and death duties designed to aid in preventing immoderate concentration of wealth produces any beneficial or adverse effects on the national economy. Professors Groves and Harris cover this point, but the writer wishes to make his own view clear that the imposition of gift and death duties in amounts which will always leave a man's surviving family with enough to live on in moderate relative comfort does not adversely affect the economy but rather produces beneficial effects. In the absence of progressive death duties there is little question but that concentration of wealth and the resulting economic power would be substantially greater than they are and that equality of opportunity—one of the

31 If it were merely decided to increase the yield of the tax, it could be enlarged very considerably by broadening the base, i.e., by reducing the exemption and increasing the rates in the lower brackets. Even in 1932 it was estimated that property passing by inheritance in this country amounted to $10 billion annually. 1933 Report to the Joint Committee, supra note 1, 156.

32 As early as 1924, Congress—and a Republican Congress at that—recognized this when it increased the death duties at the same time that it was materially lowering other taxes because of a Treasury surplus. 1933 Report to the Joint Committee, supra note 1, 20, 143-44. President Coolidge and Secretary of the Treasury Mellon were very much opposed to the bill as Congress passed it, but the President eventually signed it. Ratner, American Taxation 416 (1942).

33 Except for the effect of the annual exclusions allowed for gift tax purposes and except for the exemption of transfers to educational and charitable institutions.

34 The writer favors the complete exemption of interspouse transfers so that tax would only be imposed on the death of the surviving spouse. See infra, p. 178; DeWind, supra p. 109.
cornerstones of democracy—would be lessened. It is sometimes said that high death duties constitute a brake on incentive. But there does not appear to be any evidence to support this theory. Assuming that it has some validity, is it not balanced by the argument that the inability of an ancestor to transmit his entire riches to his descendents tends to stimulate the enterprise of the latter?

We now pass to a consideration of the different alternatives enumerated above:

1. The British estate duty method: Great Britain’s estate duty is not fortified by a gift tax, and although gifts within five years of death are included in the taxable estate, gifts prior to that time escape completely. This method offers a strong inducement to the making of substantial gifts to intended beneficiaries during life and it has apparently become customary in Britain for the wealthy, when they are approaching old age, to give at least part of their property to their children. Besides the gaping loop-hole—much wider than our own—whereby lifetime gifts minimize death duties, the British system, like our own, is weak in that it does not encourage a wider distribution of the decedent’s wealth since the estate duty is the same re-

35 The argument that high income taxes tend to discourage incentive is much more persuasive. See Nathanson, The Ethics of Inheritance, in 1 Social Meaning of Legal Concepts (Inheritance of Property and the Power of Testamentary Disposition) 74, at 87-88 (N.Y.U. School of Law, 1948). Admittedly, death duties, if they go far enough in confiscating a decedent’s property, would have an important bearing on personal initiative. Even the Communists, who had originally abolished all inheritance, had to restore it. Cahn, An Outline of the Three Great Systems, 1 Social Meaning of Legal Concepts, supra, 1 at 3. This publication, in addition to the two papers cited, contains three other interesting articles: Hoebel, Anthropology of Inheritance; Friedrich, Economics of Inheritance; Tappen, Sociology of Inheritance. For a brief statement of historical facts relating to descent and distribution and death taxes, see 1933 Report to the Joint Committee, supra note 1, at 27 et seq.; and for a concise statement of legal and economic concepts underlying death taxation, see ibid., 97 et seq.

37 In addition to the estate duty, the British impose legacy and successions duties on individual inheritances, i.e., after reduction of the estate duty. The rate on a spouse, ancestor or descendant is 2%; on a brother, sister or their descendants, 10%; charities, 10%; other beneficiaries, 20%. Barna, Death Duties in Britain, supra note 12, at 1062. However, the legacy and successions duties are apparently to be repealed in favor of increased death duty rates. See 207 The Law Times 308, May 27, 1949.

38 Id. at 1063. Dr. Barna comments: “This deprives the state of revenue and defeats some of the social aims of the tax.”

39 “According to an estimate of the distribution of capital in Great Britain, in 1937 less than one per cent of the population possessed about forty per cent of all capital in personal ownership . . . . These persons paid eighty-five per cent of all estate duties.” Barna, supra note 11, at 1063.
Regardless of the number of distributees. On the other hand, the vexing problem of contemplation of death is solved. There is, of course, no overlapping of gift and death duties since there is no gift tax. The lack of correlation between the income tax and death duties either disappears or becomes less serious under the British system although there is necessarily some lack of correlation.  

As to property settled in trust, the British method, by aggregating the trust corpus with the income beneficiary's own property for purposes of computing estate duty, does, as previously pointed out, eliminate to a very large degree the avoidance of tax on the passing of property from one generation to another, and it tends to equalize the tax as between property given outright and property given in trust. Thus the settling of property in trust is not likely to be influenced as much as it is here by tax consequences. However, as also pointed out above, this method is not completely equitable: the income beneficiary's own property is pushed up into higher brackets by reason of aggregation with property the disposition of which is not within his control.

2. An inheritance tax as a substitute for the estate tax: An inheritance tax rather than an estate levy has been adopted by many jurisdictions including a large number of our states; and in fact if the states had not entered the inheritance tax field before the Federal government did, it is not unlikely that we would today have a Federal inheritance tax rather than a Federal estate tax. Under an inheritance tax the size of the decedent's estate is ignored and the rates are graduated according to the amount received by a particular legatee.

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40 E.g., certain gifts of income-producing property made more than five years prior to death. The donor may apparently be subject to income tax even though his estate will escape death duty.

41 In 1898, the federal government imposed an inheritance tax which was upheld in Knowlton v. Moore, 178 U.S. 41 (1900); and in 1909 the House passed an inheritance tax bill, but the Senate substituted an excise tax on corporations measured by income. Flint v. Stone Tracy Co., 220 U.S. 107, 143 (1911). The Ways and Means Committee, in recommending the estate tax that was enacted in 1916, pointed out that 42 states (at that time) had inheritance taxes, twelve upon collateral heirs or strangers only, and the other thirty on direct as well as collateral heirs and strangers. Only one state had an estate tax. The Committee stated that the Federal estate tax recommended formed a well-balanced system of taxation as between the Federal Government and the various states, and was one which could be administered with less conflict than a tax based on the shares. H.R. REP. No. 922, 64th Cong., 1st Sess. (1916), 1939-1 (Part 2) CUM. BULL. 25. Two years later the Senate Finance Committee urged that an inheritance tax be substituted for the estate tax on grounds of fairness and equity, SEN. REP. No. 617, 65th Cong., 3d Sess. (1918), 1939-1 CUM. BULL. 127, but the Ways and Means Committee did not go along.
from the particular donor. Thus, if a decedent divided his wealth equally among a dozen persons (or the state, by its laws of descent and distribution, did it for him), the aggregate tax on these dozen people would be very much less than the tax on one legatee who received the entire estate. Although the tax is measured by the shares of the estate passing to the respective beneficiaries, it is generally payable by the executor and deducted from the amount otherwise distributable to the distributee.

Under this system no regard is given to any amounts the legatee may have inherited from other decedents. Thus, if a husband died leaving $1,000,000 to his son and later the widow died leaving another $1,000,000 to the son, the tax would be much less than if the son had inherited the entire $2,000,000 from one parent. This method does tend to impel an allotment of smaller shares to more people but, by failing to take into account other inheritances, it does not produce optimum distribution. Moreover, it departs, although less than the first method, from the doctrine of ability to pay: the son who inherits a million dollars from his father and a million dollars from his mother is ordinarily able to pay as much as a son who inherits two million dollars from one parent.

A minor argument in favor of the inheritance tax as against the estate tax is that it permits, more readily than the latter tax, "a logical differential in the tax according to the degree of consanguinity of the heirs." Thus a son might be subjected to a lower rate than a nephew. However, if we accept as a premise that the primary objective of death duties is diffusion of undesirable concentration of wealth and economic power, this argument loses its force.

Another minor argument in favor of the inheritance tax vis-a-vis the estate tax is that under an estate tax a failure to insert appropriate provisions in the decedent's will with respect to the payment of tax might result in inequities which could not occur under an inheritance tax.
tax. Thus, if a decedent made specific bequests to collateral relatives and directed that death duties should be paid out of his residuary estate, and the value of the estate declined seriously prior to distribution, the residuary legatees who would normally be those closest to the decedent, let us say his children, might be unfairly deprived of the share which they and the testator expected they would have. However, since the situation can be prevented by a properly drawn will as well as by the allowance to the executor of an option to value the estate for tax purposes at its value a year after death (value at date of disposition in the event of disposition within the year), the argument is not particularly cogent.

The principal argument against an inheritance tax as compared with an estate tax is that the latter levy is more easily administered. It is said that under an estate duty the revenue officials can determine the tax shortly after the decedent's death and need not wait until the shares of the beneficiaries are ascertained; further, the relationship of the beneficiaries or of the respective shares to which they are entitled need not be taken into account, nor is it necessary to determine the tax on life estates and remainders. "This eliminates the necessity for considering the many complicated problems which arise in connection with the construction of wills and trusts, the application of probate laws, and the determination of the rights of particular legatees. These problems would be especially difficult in the case of the Federal Government, as the regulatory control over the passing of property at death is reserved to the states and there is a great divergence in the various state laws." Upon analysis, this argument is not too persuasive. Where an optional valuation date is allowed, the tax cannot ordinarily be determined quickly under an estate tax. Nor, as experience has shown, is it possible completely to avoid problems of interpretation engendered by local law. Very few of the substantive provisions of the estate tax law are unaffected by the diversities of state law. It is even necessary under the estate tax sometimes to value life estates and remainders. While it must be admitted that an estate tax disposes of vexing problems in taxing life estates and remainders, it does so at the cost of favoring such interests over outright transfers.

Still another argument sometimes urged in favor of the estate tax over the inheritance tax is that the former produces more revenue

44 Id. at 103. The equivocal conclusion of the Report, p.104, is that "the estate tax is simpler and more easily administered than the inheritance tax, but that the latter tax is the more equitable."
than the latter at similar rates. Assuming the validity of this argument, is it germane if we assume that revenue considerations in death taxation are now subsidiary and that diffusion of immoderate wealth is paramount?

The most serious problem involved in an inheritance tax is the treatment of property settled in trust. The valuation and taxation of life estates, terms for years, vested and contingent future interests, interests subject to invasion or to termination upon the happening of some contingency or the fulfillment of some condition, present confusing and baffling difficulties; and no completely satisfactory solution has ever been worked out. Life estates are generally valued on the basis of mortality tables and interest rates prescribed by the law of the taxing jurisdiction, and the tax is usually payable immediately out of the corpus of the trust. These mortality tables, which are necessarily based on averages, ignore such variables as physical condition, medical history and occupation; and the averages on which they are based as well as the interest rate used are, as a rule, outmoded.

Remainder interests are valued by deducting from the undiminished value of the corpus the value of intervening estates. The tax on vested remainders is usually payable immediately by the remaindermen, without waiting for the termination of prior estates, but some jurisdictions permit postponement of payment upon a deposit out of corpus or the filing of a bond. The tax on contingent remainders is also payable immediately in most jurisdictions. The methods of taxing such remainders vary: some jurisdictions impose tax at the highest rate that could be payable on any contingency and allow a refund if it develops in the light of subsequent events that there has been an overpayment; others tax at the lowest possible rate and impose an additional tax later if one proves to be due; still others impose no tax until the remainder vests in possession and enjoyment; and still others permit their taxing officers to compound the tax on some basis

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45 Id. at 103.
40 Since most estates are likely to have more than one beneficiary, it would probably be necessary to raise the rates, at least in the lower brackets. The extent of the increase would depend to a considerable extent upon whether a preferential rate was allowed for direct heirs over collateral heirs and strangers, and upon the provisions adopted with respect to testamentary trusts.
47 Id. at 122-124.
48 When the tax on the remainder is payable immediately out of the trust corpus, the income beneficiary loses the income on the amount paid out as tax on the remainderman. On the other hand, where the tax on the income beneficiary is payable out of corpus, the remainder is cut down by the tax on the income interest.
considered equitable by the interested parties. None of these methods, as previously stated, is completely satisfactory.

Presumably the gift tax would have to be retained if an inheritance tax were substituted for the estate tax (or else a gift tax would have to be imposed on donees of *inter vivos* gifts), since otherwise there would be, as in the case of the first (British) method, an easy means of avoidance. Assuming the coexistence of the gift tax, there would still be opportunities for avoidance although perhaps not as many. Also there would still be the problem of gifts in contemplation of death, overlapping of gift and inheritance taxes and lack of correlation. Whether there would be a tax differential in favor of property settled in trust would depend on the provisions adopted with respect to such property.

On the whole, an inheritance tax seems a more equitable exaction than the estate tax and more in consonance with the assumed current function of death taxes. Jurisdictions which have adopted it usually continue it. Except for the taxation of contingent future interests and defeasible income interests, the asserted administrative difficulties of an inheritance tax seem exaggerated. The inheritance tax on all legatees is payable by the personal representative of the decedent so that the revenue officials deal only with that person and not with multiple beneficiaries. However, the difficulties involved in taxing limited estates and future interests—at least under the procedures that have thus far been employed—are quite real and constitute a formidable objection to the inheritance tax. However, as previously indicated, the two major defects of the inheritance tax are (1) it does not equalize dispositions during life with dispositions at death, and

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49 Under the inheritance tax sponsored by the Senate in 1918, *supra* note 41, vested interests, present and future, were valued in the ordinary way, and all contingent interests were lumped together and taxed as if they belonged to one person. See §§ 403 and 404 of the 1918 Bill as introduced by the Senate Finance Committee. Under the inheritance tax proposed by the House in 1935, *infra*, p. 20, provision was made for filing a bond based on the highest rate or for compromising the tax. H. R. Rep. No. 1681, 74th Cong., 1st Sess., 1939-1 Cum. Bull. 649.

50 Some of the states, for example New York, which used to have in inheritance tax dropped it in favor of the estate tax for reasons of administrative convenience. *Report of the Commission to Investigate Defects in the Laws of Estates* 195 (1930). However, if there were no federal estate tax, it is doubtful whether New York would have discontinued the inheritance tax. Nearly all the states which still have an inheritance tax also impose an estate tax to pick up the full amount of the credit allowed (subject to certain limitations) against the Federal estate tax for death taxes paid to the states under Int. Rev. Code § 813(b).

51 *Id.* at 195, 196-7, 224.
(2) it does not tend to promote optimum dispersion of a decedent’s wealth. The advantages of an inheritance tax are not sufficient to justify a shift to that tax after all the years we have lived with the estate tax.

There is a form of inheritance tax under which the tax depends, in part, on the size of the estate. It is now in use in the Dominion of Canada and some of the Canadian provinces. The rates are fixed by a combination of two or more factors, i.e., the size of the estate, the amount received by the individual legatee and the relationship of the legatee to the decedent. Under the Dominion law the tax consists of an initial duty and an additional duty. The former is a flat rate tax which varies upward with the size of the estate. Thus, a $100,000 net estate pays 4.9%, a $200,000 net estate pays 7.9%, and so on. The additional duty is at a flat rate which varies upward with the amount received by an individual legatee, and is also affected, although to a lesser degree, by the relationship of the legatee to the decedent. For example, an inheritance of $50,000 received by a spouse would bear additional duty at 6.9% and an inheritance of $100,000 received by a spouse would bear additional duty at 9.8%, while inheritances of the same amounts received by a nephew would bear additional duty at the respective rates of 9.8% and 13.8%. As under the previously described inheritance tax, no consideration is given to the factor of whether the legatee has inherited from another decedent. Thus this variation of the inheritance tax, which is in essence a compromise between the estate tax and the inheritance tax, suffers in part from the defects of both of these. Besides, its attempt to reach greater equity as between the distributees is purchased at the cost of considerable complexity.

3. A supplementary inheritance tax and a supplementary gift tax on donees: This alternative contemplates an inheritance tax in addition to the existing estate tax and a gift tax on donees in addition to the existing gift tax on donors. It was proposed by Franklin D. Roose-

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62 The Dominion Succession Duty Act, 1947-8, 11-12 George VI, c. 47. Canada also imposes a progressive but non-cumulative gift tax on donors (Part XII of the Income War Tax Act, c. 97, R. S. Canada) similar to the ineffective gift tax imposed by the U.S. Act of 1924 and repealed shortly thereafter. Under the Canadian law gifts made within three years of death are subject to death duty but only to the extent that gift tax has not been paid. §§ 3(c) and 7(h).

63 This variation of the inheritance tax is not, in principle, different from the British law which imposes legacy (as to personal property) and succession (as to real estate) duties in addition to an estate duty; nor is it in principle different (except as to taxes on inter vivos gifts) from the third method next described.
velt in his message to Congress on June 17, 1935 and passed by the House in that year, but was rejected by the Senate and never became law. The primary reason assigned for it, i.e., further to counteract the tendency of wealth to concentrate, is a much stronger argument for the complete abolition of the existing gift and estate taxes and the substitution of a single tax measured by what is received by each individual donee rather than by the total amount given away by any particular donor.

President Roosevelt's 1935 proposal, which was ultimately rejected by the Congress in favor of higher estate tax and gift tax rates, is in some respects similar to the British and Canadian systems discussed above and suffers from the same defects. It would not decrease the present gap between the tax on gifts and the tax on property left at death. It would not eliminate contemplation of death problems, overlapping and lack of correlation. The differential in favor of property settled in trust would be reduced but not eradicated. (Under the bill as passed by the House, vested interests would be taxed immediately and the tax on contingent interests would be suspended on filing a bond or would be compromised.)

4. Integration of the gift and estate levies into a single cumulative transfer tax: This is the alternative proposed in "A Joint Study Prepared by an Advisory Committee to the Treasury Department and by the Office of the Tax Legislative Counsel, with the cooperation of the Division of Tax Research and the Bureau of Internal Revenue." Strictly speaking, it is not an "alternative" but rather a phase of a

54 H. R. REP. No. 1681, 74th Cong., 1st Sess., 1939-1 CUM. BULL. 643. It was further proposed that the proceeds of the supplemental taxes should be segregated and applied to the reduction of the national debt. Ibid.

55 The Senate Finance Committee, in shelving the proposal, said (1939-1 CUM. BULL. 655):

While it is recognized that the inheritance tax, in a number of respects, is more equitable than the 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.

56 U.S. Government Printing Office (1947). The Advisory Committee consisted of Mr. George K. Bowden of Chicago, Mr. Jesse R. Fillman of New York City, Mr. Lawrence E. Green of Boston, Dean Erwin N. Griswold of the Harvard Law School, and the writer. The proposal has been the subject of considerable discussion, e.g., Platt, Integration and Correlation—The Treasury Proposal, 3 TAX L. REV. 59 (1947); Wales, Consistency in Taxes—The Rationale of Integration and Correlation, 3 TAX L. REV. 173 (1948); Alexandre, A Summary of the Treasury's Study on Integration and Correlation, 25 TAXES 955 (1947); Note, 60 HARV. L. REV. 1120 (1947).
comprehensive revision of the estate and gift taxes.\textsuperscript{57} This proposal has been discussed at length in a preceding article of this issue by Mr. DeWind and hence is only described briefly in this paper. Under this method there would be a single progressive, cumulative, integrated transfer tax on all donative and testamentary transfers, whether in life or at death. There would be one exemption\textsuperscript{58} and one cumulative set of rates. The tax on lifetime transfers would amount to an advance payment of death duty. Of the methods thus far discussed this one, in the writer's opinion, is superior to the other three. It eliminates avoidance through \textit{inter vivos} gifts almost\textsuperscript{59} entirely. Moreover, contemplation of death problems disappear, as do overlapping taxes, and correlation is made much easier.\textsuperscript{60} Nevertheless, this method does not attain as perfectly as the fifth method, next to be discussed, the social and economic purposes of death taxation since the tax is the same regardless of the number of distributees. Further, integration does not to any degree solve the problem of avoidance through the device of settling property in trust.\textsuperscript{61}

5. \textit{An accessions tax, as a substitute for the gift and estate taxes:} This alternative would call for repeal of the present Federal estate and gift taxes and the substitution therefor of a progressive cumulative tax on each recipient of money or other property by way of inheritance,\textsuperscript{62} or \textit{inter vivos} gifts. The brackets of tax would progress, not according to the size of the donor's\textsuperscript{63} taxable dispositions,\textsuperscript{64} but according to the aggregate taxable acquisitions of the donee,\textsuperscript{65} no


\textsuperscript{58} Part of the exemption would be allowed during life and the remainder at death.

\textsuperscript{59} A small element of avoidance is left: the tax on \textit{inter vivos} transfers (except transfers made within one year of death) is eliminated from the base subject to tax at death.

\textsuperscript{60} The study proceeds on the assumption that correlation should in general start with the estate tax rules as a basis. Some authorities have questioned this and suggest that correlation should start with the present income tax rules as a basis, the argument being that the former approach will tend to send the trust device into limbo. Platt, \textit{supra} note 56. Wales, \textit{supra} note 56 has answered this argument.

\textsuperscript{61} A minor argument against integration is mentioned \textit{infra}, p. 174.

\textsuperscript{62} The term \textit{inheritance} is here intended to include acquisitions by devise, bequest or intestacy.

\textsuperscript{63} The term \textit{donor} is here intended to include a decedent.

\textsuperscript{64} The term \textit{dispositions} is here intended to include \textit{inter vivos} gifts and property transferred by bequest, devise or intestacy; and the term \textit{acquisitions} is intended to include all acquisitions of money or property by these methods.

\textsuperscript{65} The term \textit{donee} is here intended to include \textit{inter vivos} transferees by gift, and heirs, next of kin, devisees and legatees.
matter from whom. Tax liability for a particular year would be computed in the same way as under the existing gift tax law, \(^6\) \textit{i.e.,} by first computing a tax at current rates on the aggregate taxable acquisitions of the taxpayer during the taxable year and prior years and then deducting from this figure the tax at current rates on the taxpayer's aggregate taxable acquisitions in prior years.

This method far more effectively than the present system or the alternatives previously discussed approaches the assumed underlying objective of death duties, \textit{i.e.,} the prevention of undue concentration of wealth, since the tax will always be least on those who have previously received least and most on those who have previously received most. No tax would be imposed on the donor or his estate. Instead each beneficiary of an inheritance or a gift will be subject to a progressive tax on his cumulative acquisitions by inheritance or gift. Thus, if a son receives a gift of $100,000 from his father in 1950 and a gift or bequest from his mother of $100,000 in 1951, the tax on the second $100,000 acquisition will be at higher rates than the tax on the first acquisition because of the cumulative feature. Donors and decedents will thus have an inducement to transfer their property to those who have previously received or inherited least; and a large family would be left with more (after taxes) than a small family. This is not to say that the accessions tax would necessarily make for a considerably wider distribution of wealth directly. In other words, apart from the benefit to larger families, the accessions tax by itself might not, to any significant extent, spur parents into leaving property to other than children. However, if they did leave their property only to their offspring, the tax would be higher than if they also conferred their bounty on others and the general fisc would be the gainer.

Besides impelling, to a greater degree than the other methods, the optimum distribution of a decedent's wealth, the accessions tax possesses certain other advantages. It equalizes the tax consequences of gratuitous transfers during life with transfers at death and thus overcomes perhaps the major fault of the existing system. Overlapping of gift and estate taxes ceases to be a problem. Contemplation of death problems likewise disappear as do some of the problems that arise in attempting to correlate the income, estate and gift levies. Under the accessions tax coordinating provisions are somewhat less essential for the reason that under the procedure outlined below no donee or legatee is subject to accessions tax until he actually receives the trans-

\(^6\) \textit{Int. Rev. Code} § 1001.
ferred property.\textsuperscript{67} No trustee (qua trustee) is taxed; only the beneficiaries of the trust are taxed and only if and when they come into possession. Finally an accessions tax reduces to a significant degree the discrimination which will be present under all of the other methods except the inheritance tax in favor of property settled in trust.

Under an accessions tax embodying the features suggested herein with respect to settled property the discrimination against outright transfers would be materially diminished. The proposal with respect to settled property is this: The tax on the principal of the trust would not be payable until termination of the trust. To make up for this delay in payment of tax on the principal, there would be paid by the trustee, as accessions tax on the income beneficiary's right to receive the income, that proportion of the annual trust income which the tax that would be payable were the property left outright to the income beneficiary bears to the principal of the trust.\textsuperscript{68} This would have the effect of making the Government a partial income beneficiary of the trust. For example, if the trust at the date of creation were worth $1,000,000 and the tax payable on an outright gift or bequest of that amount to the first income beneficiary would have been $325,000, 32½% of the annual income of the trust would be retained by the trustee and paid over to the Government as accessions tax on the beneficiary's right to receive the income. The remainder of the income would be subject to income tax in the hands of the beneficiary. Thus, if the annual income of the trust were $40,000, 32½% of this sum, or $13,000, would be paid over as accessions tax; the remaining $27,000 would be distributed to the beneficiary and would, to the extent that it consisted of taxable income, be subject to income tax at his brackets.

It will be noted that under this method no income beneficiary pays accessions tax unless and until he receives the income, and similarly the remainderman of the trust would not pay tax until the trust terminated and his tax would depend upon the value of the trust property and his accessions tax brackets at that time.\textsuperscript{69} It will also be noted

\textsuperscript{67} For instance, a trust the income of which is taxable to the grantor under \textsc{int. rev. code} § 167 would not attract accessions tax until the income or corpus actually passed to some person other than the grantor.

\textsuperscript{68} In \textit{A Proposal for an Accessions Tax}, 1 \textsc{tax l. rev.} 25, the writer advocated at page 36, \textit{et seq.}, a different and much more complex method of determining the accessions tax on the income beneficiaries. It is believed that the method proposed herein is far simpler and just as equitable.

\textsuperscript{69} Where the trust assets consist of wasting assets, \textit{i.e.}, property subject to depreciation or depletion, no deduction would be allowed in applying the applicable percentage
that a transfer in trust fares no worse than an outright transfer. Thus, if in the example stated, the income beneficiary had received an outright gift or bequest of $1,000,000, he would at once owe an accession tax of $325,000 so that only the income from $675,000 would flow to him. Taking away from an income beneficiary as accessions tax 32½% of the income from a $1,000,000 trust, is ordinarily the equivalent of allowing him to keep the income from $675,000 of the trust fund free from accessions tax. Similarly, the tax on the next taker will be the same whether the original transfer was outright or in trust.

An alternative but more complex method of measuring the percentage of the trust income payable to the Government as accessions tax on the income beneficiary would be on the basis of the value of the income beneficiary's interest at the date he first becomes entitled to that interest. For instance, suppose that a decedent left a $1,000,000 trust fund, income payable to B for life, remainder to C. Assume further that B, at the date of the decedent's death, was 60 years old. Using Table A in the Estate Tax Regulations, the value of B's interest would be roughly $375,000. Assume further that B's accessions tax on $375,000 would be $100,000. The percentage of the trust income to be paid to the Government would then be 10% ($100,000/$1,000,000). Although the alternative method seems fairer because it takes into account the number of years the income bene-

of income which measures the accessions tax; while, for purposes of measuring the income beneficiary's income tax, the deduction otherwise allowable for depreciation or depletion would be reduced by the percentage of income payable as accessions tax. To illustrate, assume that the trust estate consists of a patent valued at $1,000,000 with a remaining life of 10 years and that the full royalties are to be paid to X for life, remainder to Y. Assume further that if X had received the patent in fee simple, he would have been subject to an accessions tax of $325,000, and that the annual royalties amount to $150,000. For purposes of measuring accessions tax, the 32½% will be applied against the income without deducting amortization. Hence the annual accessions tax will be 32½% of $150,000, or $48,750. For purposes of measuring income tax, the $100,000 of annual depreciation that would otherwise be allowable will have to be reduced by 32½% so that only 67½%, or $67,500, would be allowable as depreciation. X's net taxable income would thus be $33,750, i.e., $150,000 royalties less $48,750 accessions tax and less $67,500 of depreciation. This will produce precisely the same result as if X had received the patent outright (and had sold the percentage of it necessary to meet his accessions tax); and seems to be the appropriate treatment with respect to wasting assets left in trust. To the extent that such assets are consumed during the term of the income beneficiary, a transfer in trust is sufficiently similar to outright transfer to be treated as such.

70 U. S. Treas. Reg. 105, § 81.10(i).
ficiary will be entitled to the income, the first suggested method is simpler: it avoids the necessity of resorting to tables based on life expectancies and assumed interest rates.

It may be useful to demonstrate the consequences of the proposal for treating trust settlements by using the example given on page 155 supra, and for convenience that example is repeated here. The husband leaves an estate of $1,000,000 to his widow for life, then to his son for life and then to his grandson. Under the present scheme and the present rates of estate tax, the grandson will ultimately receive $675,000 (assuming no change in market values between the deaths of husband and son). In the meantime the widow and later the son

Furthermore, later outright acquisitions by the income beneficiary would not be subject to what might seem an unfairly high rate. If the alternative method of measuring the income beneficiary's accessions tax were not adopted, it could be provided that for purposes of taxing subsequent outright acquisitions, mere income interests previously acquired are not part of the cumulative total of taxable accessions. Although this might require an upward adjustment of the percentage of trust income payable as accessions tax to the Treasury every time the income beneficiary acquired a taxable outright accession, the number of required adjustments would ordinarily be few.

It has been suggested to the writer by Professor Stanley S. Surrey of the University of California that the tax on the income beneficiary, instead of being collected out of the annual income as it accrues, should be payable immediately out of the corpus of the trust when the beneficiary first acquires his interest. For instance, in the example given in the text, if B's average bracket for the receipt of $1,000,000 was 40%, the Government would take $400,000. B would then receive without further accessions tax the income from $600,000. When B died C would pay tax based on C's bracket on the remaining $600,000. This would reach the same result as if the property had been left outright. Professor Surrey points out that this result would be wrong if the property had been left to B for one year and then the remainder to C, and goes on to explain:

The difference between the two situations is that we can assume the life estate is the equivalent of an outright bequest if the life tenant is in the generation succeeding the generation of the decedent. Where this is not so, either because the life tenant is in the same generation as that of the decedent or because the term of the estate taken is limited, as in the above example, to one year, then our premise for treating the transfer as two outright bequests falls. This can be met by a property previously taxed credit using a sliding scale based on 20 or 30 years. Thus, in the one-year case, C would get a credit equal to % of the tax paid by B. In the life tenant case, if B lived only 10 years, C would get a credit of % of the tax paid.

If it were desirable to make the tax on settled property precisely the same as if the property had been given in fee to the income beneficiary, Professor Surrey's suggestion would be suitable. The difficulty with the suggestion is that it imposes equal taxes on things which are not equal. It would not be equitable completely to eliminate any tax differentiation between an outright transfer of property and a transfer in trust. The use of property for life or for a shorter period is not the equivalent of complete ownership and ought not to be taxed as such. To tax limited and future estates as if they constituted fee estates would tip the scale the other way and in substance amount to tax discrimination in favor of outright transfer.
would be receiving the income from $675,000 which income would ordinarily be subject to income tax. However, if the husband were to leave his property (after deducting death duty) outright to the widow, who in turn left it outright (after again deducting death duty) to the son, who in turn left it outright (after deducting a third death duty) to the grandson, the latter would ultimately receive only $409,000, and in the meantime the son would be receiving the income from only $583,000. If we assume that the rates under an accessions tax would be the same as the present estate tax rates, and that each transferee had not previously received any other accessions, the series of outright devolutions described above would result in the same tax under the accessions tax as under existing law—for the sole reason that in each devolution there is only a single transferee—but the consequences of the transfer in trust would be much different as shown by the following tabulation:

Accessions tax on trust interests, assuming:

(1) Present estate tax rates are applicable to each person’s accessions.
(2) Trust fund yields a 4% return.
(3) Each beneficiary has received no previous taxable accessions.
(4) Each income beneficiary lives his normal expectancy (indicated below).
(5) Ages of income beneficiaries at date they come into possession of interest: Widow—60; son—40.

Tax, assuming Government’s share of income (representing accessions tax on income beneficiary) is measured by tax that would be payable were property left outright to income beneficiary:

<table>
<thead>
<tr>
<th>Interest Taxed</th>
<th>Amount of Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Widow—32½% of $40,000 (4% of 1,000,000)</td>
<td>$208,000</td>
</tr>
<tr>
<td>Annually = $13,000</td>
<td></td>
</tr>
<tr>
<td>Expectancy: 16 years</td>
<td></td>
</tr>
<tr>
<td>$16 \times $13,000</td>
<td>$208,000</td>
</tr>
<tr>
<td>Son—32½% of $40,000 (4% of 1,000,000)</td>
<td>$390,000</td>
</tr>
<tr>
<td>Annually = $13,000</td>
<td></td>
</tr>
<tr>
<td>Expectancy: 30 years</td>
<td></td>
</tr>
<tr>
<td>$30 \times $13,000</td>
<td>$390,000</td>
</tr>
</tbody>
</table>

73 Prior to the 1948 Act, this amount would have been $332,000, the difference being accounted for by the marital deduction allowed under the 1948 Act to the husband’s estate.
74 Prior to the 1948 Act, this amount would have been $468,000. See note 73 supra.
75 If we desired to raise the same amount of revenue, it would probably be necessary to increase the rates. See note 46 supra.
Grandson—remainderman . . . . . . 325,000
Total accessions tax (over a period of 46 years) $923,000
Under existing law, the Government would have
collected a tax of $325,000.76

Under the alternative method, whereby the Government’s share
of income (representing accessions tax on the income beneficiary) is
measured by the tax that would be payable were the income bene-
"ficiary taxed merely on value of his right to income, the results would
be as follows:

<table>
<thead>
<tr>
<th>Interest Taxed</th>
<th>Amount of Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Widow-aged 60—Value of Life Interest77—</td>
<td></td>
</tr>
<tr>
<td>9.415 X $40,000</td>
<td>$377,000</td>
</tr>
<tr>
<td>(4% of $1,000,000) =</td>
<td></td>
</tr>
<tr>
<td>Tax on $377,000 =</td>
<td>106,000</td>
</tr>
<tr>
<td>Government would receive</td>
<td></td>
</tr>
<tr>
<td>annually 10.6% (106,000/1,000,000)</td>
<td>4,240</td>
</tr>
<tr>
<td>of $40,000 =</td>
<td></td>
</tr>
<tr>
<td>Expectancy: 16 years</td>
<td></td>
</tr>
<tr>
<td>16 X $4,240</td>
<td>$67,840</td>
</tr>
<tr>
<td>Son-aged 40—Value of Life Interest78—</td>
<td></td>
</tr>
<tr>
<td>15.093 X $40,000 =</td>
<td>$604,000</td>
</tr>
<tr>
<td>Tax on $604,000 =</td>
<td>182,000</td>
</tr>
<tr>
<td>Government would receive</td>
<td></td>
</tr>
<tr>
<td>annually 18.2% (182,000/1,000,000)</td>
<td>7,280</td>
</tr>
<tr>
<td>of $40,000 =</td>
<td></td>
</tr>
<tr>
<td>Expectancy: 30 years</td>
<td></td>
</tr>
<tr>
<td>30 X $7,280</td>
<td>218,400</td>
</tr>
<tr>
<td>Grandson—remainderman</td>
<td></td>
</tr>
<tr>
<td>. . . . . . . . . . . . . . 325,000</td>
<td></td>
</tr>
<tr>
<td>Total accessions tax</td>
<td></td>
</tr>
<tr>
<td>. . . . . . . . . . . . . . $611,240</td>
<td></td>
</tr>
</tbody>
</table>

If the property declined in value during the existence of the trust,
the accessions tax on the later income beneficiaries and the remain-
dee might be less, but property tends to increase in value rather than
decline, and hence the tax on the future interests would probably be
greater than the figures given above.

76 The Government would also have had the use of $325,000 for 46 years whereas
under the accessions tax it would have had the use of $13,000 for 46 years, $26,000 for
45 years, $39,000 for 44 years and so on. If there had been 3 outright distributions, total
tax collections under existing law would have been $591,000, and the Government would
have had the use of $145,000 for 46 years and $271,000 for 30 years; but the Govern-
ment for the last 30 years would have collected smaller income taxes than under the
accessions tax. Prior to the 1948 Act, the dollar amounts in the preceding sentence would
have read respectively $668,000, $325,000 and $207,000.

77 Based on Table A of U.S. Treas. Reg. 105, § 81.10(i).
78 Based on Table A of U.S. Treas. Reg. 105, § 81.10(i).
From the income tax viewpoint, under existing law Widow would pay income tax for 16 years on $27,000 (assuming a 4% rate on $675,000); and assuming that all of the income is subject to tax and that Widow has no other income, her annual income tax would be $9900. Son (making the same assumptions) would pay the same income tax for 30 years. Under the accessions tax as proposed by the writer, the income tax would, in the example given (not using the alternative proposal) be precisely the same for the reason that while the trust principal of $1,000,000 remains intact (barring fluctuations in value) until termination of the trust, the beneficiary only receives that proportion of it which he would have received had $325,000 tax been payable at the time the trust was set up. But if the alternative proposal were used the income tax collections would be greater for the reason that the beneficiary would receive a greater proportion of the trust income. (The portion of the income going to the Government as accessions tax would be lower.) Thus the increased income tax collections under the alternative method would make up to a substantial extent the decreased accessions tax collections under the alternative method.

In an ideal system the decision to settle property in trust or to dispose of it outright would not turn upon tax consequences. Under the present system or under an integrated transfer tax system, and to some extent under an inheritance tax system (depending on the provisions with respect to limited and future estates), the decision is often or would often be made solely on the basis of tax saving. The substitution of an accessions tax would lessen the importance of the tax factor, although it would not completely eliminate it.

A comparatively minor advantage of an accessions tax over an integrated transfer tax is that it reduces the seriousness of the problem that arises when a donor, who has made large gifts to others than his immediate family, loses the bulk of his remaining wealth so that the little he has left will, when he leaves it to his family, be subjected to such high rates that the family will be left relatively destitute. For example, suppose a father, at a time when he has two millions, gives one million to his oldest child. Years later, when he dies leaving two younger children, he has only $160,000. This $160,000 under an integrated transfer tax with rates at the present level would be subject to a tax of $39,000, leaving the younger children only $121,000. Under an accessions tax the $160,000, if it were left equally to the

79 See Platt, supra note 56, at 60.
two younger children, would be subject to a tax of only $1,000.\textsuperscript{80} Presumably, under an integrated transfer tax there would be an exemption with respect to property left at death, but such exemption would necessarily have to be moderate, and while the blow would be softened somewhat, it would not be erased.

Of course, under an accessions tax, a donee-heir might have squandered or lost prior acquisitions so that later ones would not yield him much. But if he has been prodigal, the result is not wholly undesirable; and if he has been unfortunate, he at least will have had his chance.

**POTENTIAL ARGUMENTS AGAINST AN ACCESSIONS TAX—AND SUGGESTED ANSWERS**

Among the arguments that may be advanced against an accessions tax are the following:\textsuperscript{81}

(1) "The accessions tax is not markedly superior to the present estate tax in its application of the theory of ability to pay." This argument is illustrated by the example of a millionaire who inherited $100,000 and would bear a tax of only $4,800,\textsuperscript{82} while a poor person who inherited the same amount would pay the same tax. The answer to this argument is that if the millionaire had inherited his millions, the tax would be much more than $4,800; while if he had earned them that would be no reason for penalizing him.\textsuperscript{83}

(2) "The accessions tax is based upon an unreal and attenuated principle of economic accretion; the idea of actual receipt is delusively simple." An example is suggested: A donee is given a life estate plus an unrestricted power to invade principal. The thought is that the donee will be taxed only on such amounts as he chooses to receive. But why? The statute could and should provide that such a transfer be treated the same as an outright transfer. It is realized that it may be troublesome to draw the line between outright transfers and those which are not outright.\textsuperscript{84} But this difficulty already exists and

\textsuperscript{80} In these examples it is assumed that a $60,000 exemption would be allowed in each case.

\textsuperscript{81} These arguments have been presented to the writer in oral discussions.

\textsuperscript{82} If the full present exemption of $60,000 were allowed during life.

\textsuperscript{83} As indicated in note 56 supra, the notion of taxing inheritances according to the wealth of the inheritor has been tried and found wanting.

\textsuperscript{84} Where the restrictions are such that the transfer is not treated as outright, adjustments of the tax on the income beneficiary can be provided for. For example, suppose a trust for a widow of one million dollars with power in the trustee to pay principal
would continue to exist to some extent under an integrated transfer tax; the accessions tax will not aggravate it. The further question has been raised as to what should be done if a remainderman disposes of his remainder before coming into possession. If he sold it in a business transaction, the proceeds should be treated as a taxable acquisition; if he gave it away or willed it, the donee would report it as a taxable acquisition upon coming into possession. In the latter situation, the case is analogous to the rejection by a donee and the consequent acquisition by an alternative donee. In such a case only one gift or estate tax is payable.

(3) "An accessions tax based upon prevailing rates and exemptions would result in a serious decrease in revenues as compared with the present estate tax yield." This argument, in so far as it states a fact, is probably correct. But what of it? As shown earlier, the revenue aspects of death taxation are relatively insignificant. The social and economic purposes are paramount. Moreover, if revenue were important, the rates could be adjusted so as to produce equivalent revenue.

(4) "An accessions tax would be a stimulus to the creation of trusts rather than a neutralizing factor." This argument seems to assume that the familiar trust pattern of life-estate-remainder is inherently undesirable from the viewpoint of social and economic policy—an assumption with an extremely tenuous foundation. But apart from the weakness of this premise, it is submitted that the tax incentive to the establishment of trusts and life estates would be less under an accessions tax than under the existing system or under an integrated transfer tax. The example given above—which appears to be

to the widow. The trustee makes a payment of $100,000 out of principal. The widow's accessions tax will be adjusted as follows:

Assume accessions tax originally assessed against widow was 32½% of trust income based on tax of $325,000 that would have been payable on outright transfer of $1,000,000. After invasion of $100,000, compute the tax that would be payable on an outright transfer of $900,000 superimposed on an outright transfer of $100,000. Assume it comes to $305,000. Thereafter, accessions tax on widow will be 30½% of trust income. Widow will have to treat the $100,000 received by her as an outright accession and pay tax thereon. In computing this tax, the $100,000 will be superimposed only on the widow's previous outright accessions, i.e., mere income interests would be ignored. Assuming, as we have, that there were no previous accessions of the widow, and assuming the present estate tax rates, the tax on the $100,000 accession would be approximately $20,000. Under the alternative method the adjustment would be similar.

85 Or the value computed according to the tables could be treated as subject to accessions tax and the difference between this value and the proceeds could be treated as gain or loss for income tax purposes.

86 Brown v. Routzahn, 63 F. 2d 914 (6th Cir. 1933).
a typical one—demonstrates this. It is conceivable that in some situations, depending on the number and ages of the beneficiaries, the type of property and the type of transfer, a trust settlement would be more advantageous under an accessions tax than under an estate or integrated transfer tax. But these cases would be relatively rare. In any event, one should not reject a system because a few people might abuse it.

(5) "An accessions tax does not lend itself to the allowance of a credit for death taxes paid to the states such as is allowed under the existing system." Although the allowance of this credit produces considerable complexity, the states have acquired a sort of vested interest in it, and it would be politically awkward to eliminate it. It is suggested that there be paid to the various states by the Federal Government out of accessions tax collections at least as much as they would—in effect—receive under the present system. However, the distribution to the states should be made not on the basis of the decedent's residence, as at present, but according to population. The wealth of a decedent ordinarily derives not only from the state of which he happens to be a resident, but from the people and resources of the entire country. This is not to say that the states should be precluded from levying their own death duties if they chose to do so.

SOME RELATED PROBLEMS—AND SUGGESTED SOLUTIONS

(1) To what extent, if at all, should an accessions tax be retroactive? Should it be made applicable to accessions which are reduced to possession after enactment but which originated prior thereto? Should accessions prior to enactment be aggregated with accessions thereafter to determine the applicable brackets on the later accessions? The suggested answer to both these questions is in the negative. Ordinarily, an estate or gift tax would already have been paid with respect to both the accession originating prior to enactment but

87 Mainly because of it, we have two sets of rates, the basic rates and the additional tax rates. Int. Rev. Code §§ 810 and 935.

88 The writer disagrees with the suggestion made in some quarters that the Federal Government withdraw from the death duty field and leave it to the states. Apart from the point made in the text as to the source of the decedent's wealth, the unhealthy competition between states to attract wealthy residents would certainly be undesirable. The writer would favor return to the states on the basis indicated of virtually the entire Federal death duty collection.

89 E.g., if the proposed new tax were enacted on January 1, 1951, should a remainder created before that date be taxed if the remainderman comes into possession after that date?

90 E.g., assuming enactment on January 1, 1951, should accessions in 1951 be taxed at higher rates because of accessions in earlier years?
reduced to possession thereafter and the accessions received in years prior to enactment, and it would be inequitable to impose a further tax.

(2) Should a deduction be allowed for previously taxed property analogous to that contained in existing law? Definitely, yes. Otherwise there might be an unconscionable dilution of an estate where successive deaths occurred within a short period. Under present law, if an heir dies within five years of his decedent owning property left to him by the first decedent, a deduction is allowed from the second decedent’s gross estate—subject to certain complex limitations—for the value of the property acquired from the first decedent. This provision, which is undoubtedly the most bewildering in the entire estate tax law, tends to prevent a second tax. The provision can and should be simplified.

(3) Should transfers between husband and wife be exempted? The suggested answer is "yes." The social and economic objectives of the accessions tax (or of any death tax) would be achieved if there is a tax on the passing of property from one generation to the next generation. Ordinarily, the spouses will be of the same generation, and it would seem fair to defer the tax until the survivor dies. A step in this direction was taken in the 1948 Revenue Act which allows a "marital deduction" for both gift and estate tax purposes. In general, this permits tax-free transfers to a spouse of as much as half of a donor's estate. It would be possible to retain these marital deductions under an accessions tax. Only transfers of a character which presently qualify for the marital deduction should be exempt. If inter-spouse transfers are exempted, the need for a provision saving previously taxed property—see (2) above—will be materially lessened. To minimize abuse, tax-free transfers should be limited to spouses of the same generation, say not more than twenty years apart. Otherwise, aged seventy, by marrying aged thirty, might postpone tax for an unreasonable number of years.

(4) What should be the income tax basis of property acquired by

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91 Or property traceable to property left by the first decedent.
92 The deduction is allowed only if the prior decedent's estate paid an estate tax. The deduction is also allowed with respect to property acquired within five years by gift if the donor paid a gift tax. The allowance is operative only if the prior owner did not himself obtain the benefit of the provision with respect to the same property. Under the 1948 Act amendments, the deduction is not available with respect to property acquired from a spouse. (The deduction is denied even though the property was not included in the marital deduction.)
93 Due to the limitations, the relief is sometimes illusory.
WHAT ALTERNATIVE

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gift or inheritance? The present provision relating to property acquired by gift should be retained—it is necessary to prevent income tax avoidance—while for inherited property the basis to the beneficiary should be the value as of the date when he is entitled to receive the property. If trust property enhances in value between the date of death and the date of termination, the distributee will obtain a higher basis, but the accessions tax will be higher. For the executor or trustee the basis should be the same as the decedent's or else the value at date of death.  

(5) Transfers to charitable, educational, religious organizations, etc., should continue to be exempted as at present.  

(6) Indirect gifts: The accessions tax would apply to indirect gifts as well as direct gifts just as the gift tax law now does. Thus, a gratuitous transfer by A to Corporation X, not made in the course of business, would constitute an accession to all of the stockholders of X except A.  

(7) Gratuitous recipients of life insurance proceeds (direct or indirect) should be subjected to the tax except to the extent of the premiums contributed by them.

(8) Exemptions and exclusions: It is suggested that there be excluded annually from the donee's accessions a stated sum with respect to the amount received during the taxable year from each donor. This is required in order to avoid the necessity of reporting Christmas gifts, wedding gifts and the like. However, only one exclusion should be allowed with respect to property, such as trust income, which, instead of being distributed in one lump sum, is to be received in periodic payments extending over more than one year. This would cover the conventional life estate, a term for years, and annuity payments.

In addition to the annual exclusions per donor, each donee should

94 In A Proposal for an Accessions Tax, 1 Tax L. Rev. 25, at 41, the writer suggested that the basis to the distributee, and by implication to the executor, should be the donor-decedent's basis plus the accessions tax paid by the donee-heir. The alternative suggested in the present article seems preferable.


97 E.g., if the excludable amount were $1,000, and the taxpayer received during the taxable year $5,000 from X, $8,000 from Y and $900 from Z, his taxable acquisitions (before deducting any allowable exemption) would be $11,000.
be entitled to a lifetime specific exemption operating generally like the present $30,000 gift tax exemption. This exemption should not vary according to the degree of relationship between the donee and the donor, since it will make no difference, for accessions tax purposes, from whom the accession is received (except if inter-spouse transfers are exempted).

(9) Powers of appointment, etc. The tremendously difficult gift and estate tax problems that now cluster about powers of appointment, discretionary trusts and accumulation trusts would automatically vanish under an accessions tax, since no tax attaches until a donee actually comes into possession of income or corpus. However, as stated above, a life beneficiary who has an unrestricted power to consume principal would be taxed as if he had acquired outright ownership of the property.

(10) Administration: Admittedly, an estate tax, or even an integrated transfer tax, is easier to administer than an inheritance tax or an accessions tax: the Treasury deals with one personal representative instead of (under an accessions tax) a possibly large number of donee heirs; audits one estate-tax return instead of many accessions tax returns; the valuation of interests according to actuarial tables is relatively rare, etc. But these administrative disadvantages are not at all serious and certainly they are not sufficient to outweigh the advantages of an accessions tax. The accessions tax return could be made a part of the annual income tax return. A relatively simple schedule similar to that of the present gift tax return would suffice, the due date of the return would be the same, i.e., March 15 of the year following the accession, and the due date of the tax would be

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98 In the case of a trust the income of which is to accumulate, there will be no accessions tax until the accumulations are paid over to the person entitled to them. The trustee, in the meantime, would pay income tax on the accumulations as at present. Income of estates during the period of administration would be treated as it presently is, i.e., the executor would be taxable on the income not distributed during the taxable year.

99 Provision would have to be made for collection of accessions tax at the source on gifts or bequests, etc., to non-resident aliens.

100 Under an accessions tax (as under an inheritance tax) problems relating to the apportionment of death duties amongst beneficiaries do not arise. In cases where a testator had provided that the residuary estate should pay the accessions tax against a particular legatee, the payment of the tax by the estate would constitute an additional accession to the legatee just as a payment of an employee's income tax by his employer constitutes additional income. Where a testator provided that a particular legatee should receive X dollars free of accessions tax, there would be a problem similar to those we now have when the base and the tax are interdependent.
March 15. The donor could be required to file an information return just as the donee is under the existing gift tax. This information return could be made part of the donor's income tax return. The accessions tax return could be audited together with the income tax return. The present provision with respect to liens could, without much trouble, be adapted to an accessions tax. So could the administrative provisions which are not mentioned here.

CONCLUSION

If we accept a wider diffusion of wealth as the major objective of gift and death duties, the accessions tax is far and away the best of the alternatives discussed above. It is the only one which imposes the highest taxes on those who have received most. The next choice, from the viewpoint of the assumed objective, would be the inheritance tax since, under that alternative, at least those who have received most from a particular decedent, pay most. However, an inheritance tax, like an estate tax, leaves open a broad road of avoidance by means of inter vivos gifts. This can be narrowed by supplementary gift taxes, but unless the supplementary taxes are integrated with the primary taxes, the road will continue to exist. The integrated transfer tax does erase this road of avoidance but does nothing to encourage greater distribution of wealth. From the viewpoint of administrative convenience, the order of choice would be (1) integrated transfer tax, (2) inheritance tax, and (3) accessions tax. However, the administrative difficulties of an inheritance tax or accessions tax are not unduly great. As between an inheritance tax and the integrated transfer tax, the latter seems preferable: the wider distribution towards which the former would tend would not be sufficiently great to offset the discrimination between transfers in life and those at death, and the difficulties encountered in taxing limited and future interests. On the other hand, the advantages of the accessions tax—penalty on narrow distribution, elimination of discrimination between lifetime transfers and those at death, and minimization of the discrimination

101 A form of integrated gift-inheritance tax was in force in Italy and may still be in force. Under it, lifetime gifts from a decedent were aggregated with inheritances from that decedent for purposes of measuring inheritance tax and a credit was allowed for gift tax. 1933 Report to the Joint Committee, supra note 1, p. 68. However, an integrated gift-inheritance tax, besides presenting additional administrative problems, would permit juggling to minimize tax. For example, a gift or bequest from A to C might fall in high brackets, but if A gave to B, and B later gave to C, each of these two latter gifts being in lower brackets, the aggregate tax might be much smaller.

102 1 TAX L., REV. 25 (1945).
between outright transfers and transfers in trust—are more than sufficient to justify the additional administrative burden.

After the publication of *A Proposal for an Accessions Tax*, a conference was held under the auspices of the Law School of New York University for the purpose of discussing the proposal and obtaining the views of a group of tax lawyers and other persons interested in taxation. The conference developed the fact that the most serious defect in the original proposal was the method suggested therein for taxing property settled in trust; and the consensus of those present seemed to be that if a simple and equitable method of imposing the accessions tax on trust beneficiaries could be found, the accessions tax was superior to other alternatives to the present system. It is submitted that the method suggested herein for taxing trust interests (which resulted from ideas generated at the conference) is simple and fair and that, therefore, weighing all the factors, the accessions tax should be given a trial.

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