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10/13/60

Second Supplement to Memorandum No. 90(1960)

Subject: Study No. 38 - Inter Vivos Rights

Attached is a letter from the Inheritance and Gift Tax Division of the office of the State Controller.

The First Supplement to Memorandum No. 90(1960) should also have listed the following correction to the tentative recommendation:

On page 12, last paragraph, delete the words "or children".

Respectfully submitted,

John H. DeMoully
Executive Secretary

Alan Cranston
Controller

CONTROLLER OF THE STATE OF CALIFORNIA
Inheritance and Gift Tax Division
Sacramento

October 10, 1960

California Law Revision Commission
School of Law
Stanford, California

Attention: John H. DeMoully,
Executive Secretary

Gentlemen:

In Mr. Hickey's absence on vacation, I am replying to your letter of September 19 requesting our comment upon our proposed amendment to the gift tax law with reference to quasi-community property.

Mr. Hickey passed your proposed legislation on to our San Francisco and Los Angeles offices for comment. The only comment was from our Los Angeles office to the effect that spouses' agreements to convert quasi-community property to community property should be in writing. This comment stems from the wider problem which faces this department in all classes of oral agreement between husband and wife. You understand that we are more or less at the taxpayer's mercy in that area.

As far as the headquarters office is concerned, we have no adverse criticism from an administrative standpoint. The proposed amendments appear to carry out the intended changes quite adequately.

To carry out your basic policy more completely, however, I believe that one further amendment could be made. Our gift tax law at present does not assess a tax when community property is converted to any form of co-ownership between the spouses. This result is not expressly

provided for by any particular code provision but is a natural result because each spouse already owns one-half of the property. Where separate property is converted to joint tenancy or tenancy in common between the spouses, we tax one-half. It would seem consistent with your purposes to provide that such a conversion of quasi-community property is also exempt. It is not entirely clear to us that your present proposals so provide.

Being an administrative agency it is out of place for us to comment upon the policy behind your proposed amendments. As an individual, however, I would like to make the following criticism:

I see no reason why quasi-community property should be treated different from separate property for gift tax purposes. Admittedly California cannot convert this type of property to community during the owner's lifetime. The rights which California has given and can give to the nonacquiring spouse is considerably less than half ownership. The acquiring spouse is still the substantial owner of the property. I believe that our tax laws should follow the transfers of actual property rights and should not be based upon artificial theories.

Nor can the reason for the amendments be based upon a correlation of the inheritance and gift tax laws. Admittedly the two laws are in pari materia. They should be conformed only insofar as the substantive rights and flow of economic benefits are the same under both laws. In the case of quasi-community property, the substantive rights are different. The state can and does control the disposition of quasi-community property upon the acquiring spouse's death. It cannot and does not control the disposition of the property during the acquiring spouse's lifetime. The

state, having decreed that the non-acquiring spouse has a one-half interest in the quasi-community property upon the death of the acquiring spouse, our inheritance tax law conforms and treats the property as community. But the property, being substantially the separate property of the acquiring spouse during his lifetime, our gift tax law does and should tax it as such.

Were the basic policy merely to narrow the tax base, I could have no objections except that this should be done by way of the marital deduction concept as it has been applied in the federal gift tax law, i.e., by treating all separate property, including quasi-community property, as though it were owned one-half by each spouse. This would conform the state gift tax law to its federal counterparts. In this connection, see Resolution #22 of the Report of the Resolutions Committee of the 1960 Conference of State Bar Delegates.

Yours very truly,

ALAN CRANSTON, Controller

BY S/J. D. LEAR
J. D. Lear
Asst. Chief Inheritance Tax Attorney

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