

Memorandum No. 6

A.C.R. 33, which was sponsored by Assemblyman McFall, was adopted by the 1955 Session of the Legislature and is Resolution Chapter 205. It recites that it would be helpful to taxpayers and tax administrators if the California inheritance and gift tax laws and the federal estate and gift tax laws "could, insofar as possible, be made to conform" and then provides that it be

Resolved by the Assembly of the State of California, the Senate thereof concurring, That the California Law Revision Commission is directed and authorized to study and analyze the provisions of the California inheritance and gift tax laws and the federal estate and gift tax laws, and on the basis thereof to determine what might be done in order to bring the California laws into closer accord with the federal; and be it further

Resolved, That in making such study, analysis and determination, the California Law Revision Commission shall consult with the Inheritance and Gift Tax Division of the State Controller's Office and with any other public or private groups or individuals who might be interested; and be it further

Resolved, That the California Law Revision Commission shall submit a report on the subject of its study, analysis and determination made pursuant to this resolution, together with a draft of any proposed legislation in the matter, not later than the tenth legislative day of the 1956 Budget Session.

You will remember that we made an analysis of this matter and prepared a memorandum for you prior to the meeting of March 18 and 19 in which these points were made:

(1) There is a basic substantive difference between the California inheritance tax and the federal estate tax which results in very different rate structures. It would require a major revision, changing the California tax to an estate tax, to achieve conformity in this respect.

(2) There is a basic procedural difference between the California inheritance tax and the federal estate tax in that the former is assessed and collected in the course of probate proceedings while the latter is not. It would require a major revision of the California law to achieve conformity in this respect.

(3) There are a number of relatively minor differences between the California inheritance tax and federal estate tax, many if not most of which involve the taxability at death of certain inter vivos transfers. Conformity could be achieved in these areas without a major revision. Whether it should be achieved is, however, largely a matter of policy.

(4) There is considerable difference between the California and federal gift tax laws with respect to rates (federal rates are figured on the basis of total gifts while California rates are figured on the basis of the relationship to donees) and exemptions. Conformity here would require a very substantial revision of California law.

(5) There are other less important differences between the California and federal gift tax laws, with respect to whether certain kinds of transactions are gifts, etc. Here conformity could be achieved without a major revision.

There are several problems to be considered by the commission in connection with Res. Ch. 205:

1. Shall the commission take this primarily as a drafting assignment, presenting a number of possibilities to the Legislature without recommendation or shall it treat the matter as one as to which its judgment is to be exercised in the usual way? The fact that the questions involved are primarily questions of policy may be relevant here.

2. Shall we plan to retain a research consultant for this study? My recommendation is that we do. If we do, what shall we pay? Any suggestions?

3. Shall the commission determine now what general scope the study and report shall take - e.g. that it shall be limited to the relatively narrow areas indicated in points 3 and 5 above and other problems of like nature - or shall this matter be determined after a preliminary survey and report by the research consultant?

4. Shall our consultation with the Inheritance and Gift Tax Division of the Controller's Office begin now, prior to retaining a research consultant? If so, shall this be done by the committee appointed for this project or by the Executive Secretary?

5. Shall we contact any interim committee or committees of the Legislature to let them know about the assignment, solicit their views, and keep them informed about our progress? (See Memorandum No. 8 dealing with the general problem of liaison with the Legislature)

6. Shall we make an effort at this time to advise interested groups about the commission's assignment and solicit their views? If so, what groups should be included: the State Bar? some or all local bar associations? such organizations as the Commonwealth Club? accountants' organizations? others?

Respectfully submitted,

John R. McDonough, Jr.
Executive Secretary

JRM:li

FEB 10 1955

Memorandum to the Law Revision Commission

Subject: Revision of the Inheritance and
Gift Tax Laws.

Assembly Concurrent Resolution No. 33 would, if adopted, direct the California Law Revision Commission "to study and analyze the provisions of the California inheritance and gift tax laws and the federal estate and gift tax laws, and on the basis thereof to determine what might be done in order to bring the California laws into closer accord with the federal; ...". This memorandum reports a preliminary survey of the major differences between the Federal and the California tax laws and the probable nature and scope of a revision made pursuant to Assembly Concurrent Resolution No. 33.

A. Inheritance Tax

Basic Substantive Difference. There is a basic difference between the Federal estate tax and the California inheritance tax. The Federal tax is imposed upon the estate of decedent at the time of death; the California tax is imposed on the transfer of the estate to those persons who, by virtue of the decedent's will or the laws of succession, acquire it. Under the Federal law the tax is assessed on the estate as a unit; under the California law the tax is assessed on the series of separate transfers to individual legatees.

This basic difference between the two taxes results directly in different rate structures. The amount of the Federal estate tax is determined solely by the value of the decedent's property at the date of

death. The amount of the State inheritance tax is determined by the value of the property which passes to the particular legatee and also by the relationship between the legatee and the decedent. Thus, the California inheritance tax on \$55,000 passing to a nephew will be less than the tax on the same amount passing to a next door neighbor. But the Federal estate tax would be the same.

It is clear that California's rate structure and system of classifying transferees cannot be brought into closer accord with the Federal system without changing from an inheritance tax to an estate tax. Yet it seems unlikely that a revision involving such a major policy change is contemplated by the Concurrent Resolution. The Resolution should perhaps be clarified on this point.

Basic Procedural Difference. Another basic difference between the Federal estate and the California inheritance tax laws is the procedure for return and assessment. Under the Federal procedure the estate tax is collected by the Internal Revenue Service in substantially the same manner as the Federal income tax. Under California procedure it is the Probate Court which determines and imposes all inheritance taxes as a part of the administration of the decedent's estate. The Federal and the California procedures are completely different and cannot be brought into closer accord without eliminating the role of the Probate Court and providing for collection of the tax by the Franchise Tax Board by a method generally similar to that which it employs in collecting the State income tax. However, here again

it is doubtful that the Concurrent Resolution contemplates a revision involving such a major policy change and clarification of the Resolution may be desirable.

Differences Possibly Susceptible of Elimination. Although the basic difference between an estate tax and an inheritance tax presents an insurmountable obstacle to complete substantive conformity between the Federal and the California law, there are nevertheless some problems which arise under both systems. It appears that most of these overlapping problems involve the taxability of certain inter vivos transfers: (1) transfers reserving a life estate or income for life; (2) revocable transfers; (3) life insurance; (4) transfers taking effect at death, and (5) powers of appointment. Although both the Federal and the State laws tax all these transfers, the two laws differ with respect to which of the more complicated transactions fall into the taxable categories. As to these matters the California inheritance tax law could be brought into closer accord with the Federal estate tax law.* Whether it is desirable that they conform in these matters is, of course, a question of policy. One relevant factor may be that the present California rule as to several of these matters is more favorable to the taxpayer than is the Federal rule; as to a few, the Federal rule is more favorable. Another may be that since the basic differences between

* There is some question, however, whether the taxation of powers of appointment under an inheritance tax system can be made to conform to their taxation under an estate tax system.

the two taxes exist there is relatively little to be gained from uniformity with respect to a few matters of detail - in contrast to the income tax situation where substantial accord between Federal and State law can be and has been achieved.

B. Gift Tax

Difference in Rates and Exemptions. Both the Federal and the California gift tax laws impose a tax on the transfer of property for less than full and adequate consideration. There is, therefore, no basic substantive difference similar to that between the Federal estate tax and the California inheritance tax.

However, there is a major difference between the Federal and the California gift tax laws in the method of determining rates and exemptions. The Federal rates are determined by the total value of all gifts, but the California rates are determined by both the value of the gifts and the relationship of the donee to the donor. Furthermore, under the Federal law, donors are given only one life-time exemption which is reduced by gifts to anyone. Under the California law, each donor has a life-time exemption for each donee and the amount of the exemption is determined by the relationship of the donee to the donor.

It seems doubtful that the Concurrent Resolution contemplates a revision which would conform the California law to the Federal law in these

respects. The Resolution should perhaps be clarified on this point.

Differences Possibly Susceptible of Elimination. There are several differences between the Federal and the California gift tax laws which could be eliminated without making major policy changes. Some of these differences involve the question of whether certain specific types of transactions are technically gifts: (1) transactions between spouses changing the character of jointly held property, (2) creation, release, exercise, or failure to exercise powers of appointment, (3) transfers to spouse pursuant to divorce decree or property settlement arrangement. The Federal law and the California law also differ as to gifts of certain kinds of future interests which may be reduced by the exemption.

Whether it is desirable that the Federal and the State laws should be in conformity as to these matters is again a question of policy for the Legislature. The determination of that question will certainly be influenced by the decision taken on the Federal estate and California inheritance tax law question. Revision of the gift tax law should accompany any revision of the inheritance tax law so that the two laws can be coordinated and dovetailed. However, without revision of the inheritance tax law, it seems doubtful that revision of the gift tax law alone would be worthwhile.

Respectfully submitted,

John R. McDonough, Jr.
Executive Secretary