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AND

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PART 1

NOTE: This document has not been considered by either the Committee on Ways and Means of the House of Representatives or the Committee on Finance of the Senate. As indicated in the letters of Chairman Mills and Chairman Long, the document is being printed for information purposes only so as to make it generally available.

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TAXATION OF APPRECIATION OF ASSETS TRANSFERRED AT DEATH OR BY GIFT

Associated with the needed revision of the taxation of transfers of wealth at death or by gift is a much needed revision of the income tax treatment of appreciated property so transferred. Under present law, accumulation of wealth from ordinary income—wages, salaries, dividends, business profits—is subject to the income tax as the wealth is accumulated. Similarly, when a taxpayer sells a capital asset which has appreciated, the gain is subject to income tax. On the other hand, if a taxpayer holds an appreciated asset until he dies, the appreciation is not subject to the income tax.

As a result of this situation, there is obvious and gross inequality in the income tax treatment of people who accumulate their estates by means of untaxed appreciation or value as compared to those who accumulate out of currently taxable income. Vast portions of capital gains—$15 billion a year—fall completely outside the income tax system.

When tax liability is allowed to depend on whether or not an appreciated asset is sold or kept until death, not only is there a serious inequity in the tax law, but, particularly in the case of older people, assets become immobilized. Investors become "locked in" by the prospect of avoiding income tax completely if they hold appreciated assets until death rather than selling them. This freezing of investment positions curtails the essential mobility of capital in our economy and deprives it of the fruits of an unencumbered flow of capital toward areas of enterprise promising the largest rewards.

The Treasury recommends taxation under the income tax, in a manner similar to that of other capital gains, of the appreciation in the value of assets transferred at death or by gift. To assure equitable application of the tax, it is recommended that—

Only appreciation occurring after the date of enactment be subject to tax to remove any semblance of unfairness toward those who already hold appreciated assets in anticipation of tax-free transfer at death;

The tax on appreciation of transferred assets be allowed as a deduction for estate tax purposes;

Taxpayers be allowed a minimum basis of $60,000 with the result that no tax at all would be imposed on gains when the total value of assets transferred is $60,000 or less;

Complete exemptions be allowed for transfers between spouses or to charity;

Limited exemptions be allowed for transfers to orphan children and transfers of ordinary personal and household effects;

Net unrealized losses on business or investment property be allowed as an offset against capital gain and, subject to appropriate limitations, against ordinary income for the 3 taxable years preceding the decedent's final income tax return;

Gains on transferred assets be eligible for averaging.

The adoption of this recommendation to tax appreciation on assets transferred at death or by gift is essential to permit the reduction in estate tax rates and the removal of the limit on tax-free transfers between husband and wife which the Treasury is also recommending.

Imposition of an income tax on appreciated capital assets at death would not result in a doubling up of death taxation. A tax on the appreciation would be due under the income tax, but the amount of such tax would not enter the estate of the decedent. The base of the estate tax would thus be net of the income tax paid, as is the case for those who accumulate their estates out of ordinary income or out of capital gains realized prior to death.