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VIRGINIA WEALTH TRANSFER TAX—PROPOSED ALTERNATIVES

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House Resolution 34, which was approved by the House of Delegates during the 1977 session of the Virginia General Assembly, observed that Virginia's inheritance\(^1\) and gift\(^2\) tax laws have remained essentially unchanged for more than 50 years\(^3\) and commissioned a study of those laws "in light of recent developments."\(^4\) The proponents of House Resolution 34 no doubt had the 1976 amendments to the federal estate and gift tax laws\(^5\) fresh on their minds. But in addition to the federal changes, several of the states have altered their approach to transfer taxation in recent years. These changes expand the options available to Virginia and allow Virginia to draw on the experience of her sister states in assessing those options.

Before any study may be begun, it should be pointed out that any system of wealth transfer taxation must be judged against four basic standards. The first is revenue production. The second standard is fairness. If there is a principle of American taxation which is most espoused it is that the burden of taxation should be allocated according to the ability to pay. And so the fairness of a tax is generally judged by its progressiveness: a tax rate which increases as the tax base also increases. The third standard, predictability, is particularly important with respect to transfer taxes. Lawyers and taxpayers spend a great deal of time and effort planning lifetime and testamentary transfers of property with any number of goals in mind: minimizing tax liability, controlling the use of property after its transfer, distributing property according to personal preference,

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etc. Tax considerations play an important role in the achievement of all of these goals and it is axiomatic that planning becomes a meaningless exercise unless the results are relatively predictable. Finally, a transfer tax must be judged by its administration. The ideal tax would be easily collected and enforced with as little expense and effort as possible for the government and taxpayers alike.

This article will first analyze current Virginia law in light of the standards just listed. There will follow two alternative estate tax proposals and a discussion of how the proposals measure up against the stated standards. The relative merits of the possible forms which an estate tax might take, including the two proposals, will be addressed. And finally, a recommendation for the repeal of the Virginia gift tax in conjunction with the adoption of either of the proposed estate taxes will be made.

I. CURRENT VIRGINIA LAW

Virginia's inheritance and gift taxes should not be changed simply for the sake of change. Before alternatives are explored the present tax should be judged against the standards of revenue production, fairness, predictability, and administration.

Wealth transfer taxes generally do not produce substantial revenue. For example, the federal government collected less than $5 billion in fiscal year 1976 from the estate tax, compared to the total federal collections of $302 billion. In fiscal year 1976 Virginia's $19 million from inheritance and gift taxes accounted for only 1.5 percent of all Department of Taxation revenue collections. It has even been suggested that if raising revenue were the only reason for death taxes, they would not be worth it. And so the level of revenue per se is not a factor in judging the Virginia inheritance and gift tax. On the other hand, consistent revenue production, at whatever level, is very important within an approved budget period, and will be discussed in that context.

7. Id. at 130.
While Virginia's inheritance tax incorporates a graduated rate schedule, the tax is not nearly as progressive as other death taxes. This raises the question of fairness in the Virginia scheme. For example, any property in excess of $5,000 passing to a Virginia Class A beneficiary is subject to tax under the Virginia inheritance tax, whereas the value of a gross estate must exceed $134,000 for persons dying after 1977 before federal estate tax liability obtains. After 1980, a federal gross estate of $175,625 will escape taxation. Of course, the Virginia inheritance tax exemption becomes more important as the number of beneficiaries of a decedent increases. On the other hand, the inheritance-tax exemption decreases for Class B and Class C beneficiaries. All variables taken into consideration, it is sufficient to say that a very large number of smaller estates in Virginia subject to Virginia inheritance taxes are not even required to file a federal return. Nor does the progressiveness of the Virginia tax compare favorably to other states. A 1974 study concluded that a large majority of the other states with an inheritance tax have more progressive rate structures than Virginia.

It is said that nothing is certain but death and taxes. In Virginia that truism still applies to death. However, the taxes which arise from death are anything but certain. Part of this failure of predictability in the Virginia inheritance tax is characteristic of inheritance taxes in general. An inheritance tax is a tax on the privilege of receiving property from the estate of a decedent. As such, a beneficiary of a decedent's estate is taxed only on the property received and not until it is received. This feature of an inheritance tax can present any number of problems. A beneficiary may receive an interest in property which amounts to something less than absolute ownership. Unless actuarial tables are applicable, it may be impossible to determine accurately the value of such an interest. A remainder interest which does not vest in a beneficiary until after an event other than the death of the decedent is not taxable until such vesting. The difficulty is compounded when a beneficiary of a remainder interest is not identifiable at the time of the death of the decedent. In all of these cases, the Department may effect a settlement "as it

Taxpayers are generally anxious to reach a settlement and bring matters relating to an estate to a conclusion. The Department, too, would rather settle a tax on a future interest than keep a file open for generations. But in spite of this mutuality of interests, settlement is not always possible. A trust with particularly broad discretion for distribution by the trustee would present a wide range in the potential amount of tax due depending on the relation of the ultimate distributees to the decedent. A settlement in the interest of the Commonwealth would ipso facto be contrary to the interest of the taxpayer. In such cases wisdom matching Solomon's cannot make a settlement satisfactory to all parties, and the ideal of a certain amount of tax due on a certain date is simply not attainable.

The lack of predictability of the Virginia inheritance tax is also attributable to the skeletal nature of the Virginia statute itself. The cornerstone of the statute is the general rule of section 58-152 that Virginia taxes "the shares of the respective beneficiaries in all property within the jurisdiction of this Commonwealth." Presumably, only property otherwise specifically excluded would escape taxation. But life insurance proceeds payable to a named beneficiary are exempt from inheritance tax. The policy and practice of the Department produce this result rather than any legislative or judicial directive.

The uncertainty of the Virginia inheritance tax can be traced not just to the statute, but to the relatively few judicial and administrative interpretations of that statute as well. The problems posed by this uncertainty are mitigated by the generally fair and consistent treatment of taxpayers by the Department; but, no sound system of taxation should ultimately be founded on the benevolence of the administrator.

Consistency among taxing jurisdictions is a corollary to predictability. The frustration of effective estate planning caused by contradictory treatment of property by the federal government and a state government can be just as great as that caused by a vague or incomplete statute. There are many examples of such inconsistencies to

Virginia estates. The treatment of a principal residence jointly owned by spouses is different for the two taxes.\textsuperscript{14} Railroad retirement and civil service survivor benefits and annuities are taxable under the federal estate tax\textsuperscript{15} but excluded for purposes of the Virginia inheritance tax.\textsuperscript{16} The federal government allows a marital deduction\textsuperscript{17} and Virginia does not. The federal estate tax gives favorable treatment to the property of a decedent which has been subject to estate tax within the ten years prior to the decedent's death,\textsuperscript{18} while the Virginia tax favors such property only if the property was previously taxes within two years of death.\textsuperscript{19} There are more examples. The point is that intelligent planning becomes difficult, and in some cases impossible, in the face of so many important instances of contrary tax treatment by the federal and state taxing statutes.

The administrative difficulties presented by the Virginia inheritance tax are closely related to the problems with respect to predictability. Because the tax is levied against the transferee rather than the transferor, a separate calculation is required for each beneficiary of an estate. If the estate includes future interests and a settlement with the Department is not reached, then the levy of the tax must be delayed until the interest becomes vested and the tax certain. This could mean that a file would remain open for years after a decedent's death. If a decedent grants a trustee authority to make discretionary distributions with respect to the corpus of the trust a return would have to be filed upon each invasion of the corpus.

The requirement that the personal representative of every decedent whose gross estate exceeds $1,000 must file a return\textsuperscript{20} obviously increases the administrative burden of the Department. The benefits derived by Virginia are not concomitant to the burden, particularly when the additional burden borne by smaller estates is considered. For example, a gross estate of $50,000 with a net value of $40,000 after debts and administrative expenses, left in equal shares to two children of the decedent will produce gross revenue to Vir-

\begin{itemize}
  \item \textsuperscript{14} VA. CODE ANN. § 58-153 (Repl. Vol. 1974); I.R.C. § 2040.
  \item \textsuperscript{15} I.R.C. § 2039.
  \item \textsuperscript{16} VA. CODE ANN. § 58-153 (Repl. Vol. 1974).
  \item \textsuperscript{17} I.R.C. § 2056.
  \item \textsuperscript{18} I.R.C. § 2013.
  \item \textsuperscript{19} VA. CODE ANN. § 58-156 (Repl. Vol. 1974).
  \item \textsuperscript{20} VA. CODE ANN. § 58-166 (Repl. Vol. 1974).
\end{itemize}
ginia of only $300. The revenue derived is insignificant to the state and probably does not cover the cost to the state of processing the return. Moreover, the preparation of the inheritance tax return is technically demanding and time consuming, and its burden is relatively greater on the smaller estates least able to bear it.

The 1976 changes in the federal estate tax will indirectly increase the administrative burden of Virginia's inheritance tax. Because the new unified credit translates into a $175,625 exemption after 1980, far fewer federal returns will be required to be filed. Consequently, Virginia will be less often able to rely upon the federal audit procedure with respect to the valuation of property. The cost to Virginia of valuing property of smaller estates will increase, and again, those are the very estates from which Virginia receives the least revenue.

II. Proposals

Two alternative schemes of death taxation for Virginia are proposed to address the disadvantages of the present inheritance tax just recounted. The proposed alternatives are set out in their entirety in the appendix. Simply stated, the tax from Alternative I would be 25 per cent of the amount of the federal estate tax liability of the decedent's estate. Vermont enacted a similar death tax in 1970. Under Alternative II, the tax would be equal to the amount of the credit allowed by section 2011 of the Internal Revenue Code for state death taxes paid. This latter tax is referred to as a "pick-up" tax and has been adopted by Alabama, Alaska, Arkansas, Florida, Georgia, New Mexico, and Utah. It is also proposed that the Virginia gift tax be repealed in conjunction with the adoption of either of the proposed death taxes.

The revenue effect of any change in the Virginia death and gift

24. ALASKA STAT. §§ 43.31.011 to .430 (1962).
taxes can be viewed from both a short term and a long term perspective. If any change were made effective during a biennium for which the budget has already been established, it would be very important that the change have no adverse effect on the revenue of the state. On the other hand, if any change were made effective far enough in advance so as not to affect current planning, there would be room for adjustment in a $3.7 billion budget to take account of a prospective change in revenue from a tax that produces less than $20 million. Such an adjustment would likely be something less than a rending process in view of the projection that in fiscal 1981 the Virginia general fund collections will have increased by almost $600 million over the collections expected in fiscal 1978.30

Alternative I as drafted, with its 25 per cent rate applied against the federal tax, is designed to maintain existing levels of revenue and could therefore be made effective immediately. Of course, nothing precludes a different rate or effective date for Alternative I. But since the Alternative II tax, as will be explained, does not have the flexibility to match the revenue production of the current tax, at least in the short run, Alternative I is drafted to do so.

Assuring that any new Virginia wealth transfer tax produces revenue for the state at levels which the old tax would have produced is much like hitting a moving target. As Table 1 indicates, revenue from Virginia’s inheritance and gift tax over the past 10 years has fluctuated substantially. But if continuity of revenue is a goal of any new system of taxation, Alternative I is theoretically the best to achieve such a goal. Since Alternative I is simply a percentage of the federal estate tax liability, it is reasonable to assume that a ratio, the numerator being the amount of Virginia inheritance and gift tax revenue collected over a period of time and the denominator being the amount of federal estate tax paid by Virginia decedents over the same period of time, could be converted to a percentage which would generate the desired level of revenue. Of course, the longer the period of time over which the data for the ratio would be collected, the greater the chance that in the long run the revenue produced by the new tax would match what would have been col-

lected by the old tax. Table 2 lists the relevant data over the past ten years and demonstrates that if Virginia had collected 24.8 percent of the amount of federal estate tax paid by Virginia's decedents' estates during that period of time the state's revenues would have matched what was actually collected. It is suggested, therefore, that a single rate of 25 percent, incorporated in Alternative I and applied against the federal estate tax liability, would maintain Virginia's revenue from wealth transfers.\(^{31}\)

Alternative I maintains the essence of section 58-162 of the Virginia inheritance tax, which provides that the minimum tax shall be the amount of credit allowed against the federal estate tax liability by Internal Revenue Code section 2011 for state death taxes paid. For those cases in which the maximum allowable section 2011 credit would exceed the tax otherwise calculated, the result is additional revenue for the state without increasing the overall tax burden of the taxpayer since the increased payment to Virginia would have been paid to the federal government in any event.

If Virginia were to resort to Alternative II there would be a revenue loss, at least in the short run. Since the section 2011 credit serves as a minimum tax under current law\(^{32}\) the revenue loss would

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31. The denominator of the ratio which produced the 25 percent rate for Alternative I represents federal estate tax paid by Virginians before the 1976 amendments to that tax. The report prepared by the Joint Committee on Taxation includes estimates of the revenue effect of those amendments. General Explanation of the Tax Reform Act of 1976, 94th Cong., 2d Sess. 597 (1976). The report projects that in the short run (through 1981) the new unified credit and the increased marital deduction will decrease revenue more than the new rule which carries over to a beneficiary the decedent's basis in capital assets will increase revenue. But in the long run (18 to 20 years) the report predicts that the revenue gain from the carryover of basis change will become more significant and produce a net increase in revenue. Obviously, a change in the federal estate tax collections will have a bearing on the revenue Virginia would derive from Alternative I. But the projections contained in the Joint Committee's report have not been taken into account in calculating the Alternative I rate for a number of reasons. First, they are only projections and subject to error or unforeseen circumstances. Second, the projections are not constant, but rather vary with each year. Any compensating factor in the Alternative I rate would likewise have to vary, thus reducing the simplicity of Alternative I. Third, the projected increase in revenue from the new basis rule is actually a gain from the income tax rather than the estate tax. Since Virginia's income tax conforms to the federal income tax, Virginia will benefit from this revenue increase no matter at what level the Alternative I rate is set. Finally, if experience proves the Alternative I rate to be too high or too low, its adjustment by the General Assembly would be a simple matter.

be the extent of the excess of the inheritance tax over the section 2011 credit on any given return. The amount of the loss can be estimated: The fiscal 1973 inheritance tax revenue to Virginia was $15,073,000. In calendar year 1973, section 2011 credits reported on federal returns filed by Virginians amounted to $7,132,000. The difference, $7,941,000, is not an exact calculation of the revenue loss. Obviously the fiscal and calendar years do not match. Moreover, the $15,073,000 includes revenue from those returns for which the section 2011 credit exceeded the Virginia inheritance tax, and the revenue from such returns would not be lost under Alternative II. On the other hand, the 1976 federal amendments increasing the marital deduction and creating the unified credit will have the effect of decreasing the credit allowed by section 2011 for smaller estates, thereby decreasing revenue to those states with a pick-up tax. All factors considered, a good estimate is that Alternative II would cut Virginia death tax revenues approximately in half.

Alternative I, being a direct function of the federal estate tax liability, would be quite progressive. Alternative II is even more progressive than Alternative I since the section 2011 credit increases more rapidly with the size of an estate than does the federal estate tax. Yet Alternative II places no greater absolute burden on larger estates than Alternative I or the current inheritance tax.

The progressiveness of both proposed taxes when compared to the current inheritance tax is most pronounced with respect to smaller estates. Assuming an estate avails itself of the maximum marital deduction under federal law, after 1980 no federal estate tax would be payable unless the adjusted gross estate exceeds $425,000. The same would be the case for the state death tax if either of the proposed taxes were adopted. In contrast, the present Virginia inheritance tax is payable by a Class A beneficiary to the extent that his share exceeds $5,000. Table 3 compares the tax liability under

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35. In any given taxable year the number of Virginia returns for which the section 2011 credit exceeds the inheritance tax is likely to be small, and the amount of that excess in the aggregate should likewise be insignificant. See REPORT OF THE REVENUE RESOURCES AND ECONOMIC COMMISSION TO THE GOVERNOR AND THE GENERAL ASSEMBLY OF VIRGINIA, S. DOC. NO. 13, at 57-60 (1974).
the present and proposed death taxes. Assuming no marital deduction, Table 3 shows that the current inheritance tax for the lower brackets is higher than the tax for those brackets under either of the alternatives. Since Alternative I is intended to maintain existing levels of revenue, relief to the lower brackets is balanced by a greater relative tax for the higher brackets. When a maximum marital deduction is assumed, the inheritance tax again is more burdensome to smaller estates than either of the alternatives.

Either of the proposed taxes would eliminate the uncertainty of the Virginia inheritance tax. The tax would be a simple computation based on the federal estate tax liability or the section 2011 credit. Since the new tax would be an estate tax, it would be based on the value of the decedent's interest in certain property at the time of his death. The difficulties characteristic of an inheritance tax, that is, valuation of future interests and the identification of beneficiaries, would disappear. So too would the vagaries of the Virginia inheritance tax concerning life insurance. The treatment of property would not vary for purposes of state and federal death taxes.

It follows that the proposed taxes would be more easily administered by the Department. First, the audit of Virginia death tax returns would be reduced to a verification of line 19 on the federal return and a calculation of 25 per cent of that amount, or, in the case of Alternative II, a verification of line 13 on the federal return. Second, the number of returns to be processed by the Department would be greatly decreased. For example, 17,600 inheritance tax returns and 5,700 gift tax returns were filed in Virginia in 1976, contrasted with only 4,900 federal estate tax returns filed by Virginia estates. If either of the proposed taxes had been in effect in 1976, the Department would have had to audit an impressive 80 per cent fewer returns. The difference will be even greater in years to come since the number of inheritance and gift tax returns is sure to increase whereas the Internal Revenue Service projects that the 1976 estate tax amendments will reduce the number of federal es-

tate tax returns from Virginia to a mere 3,500 by 1980.\textsuperscript{38} The personnel costs for those auditors who now review inheritance tax returns could be eliminated, or those auditors could be diverted to the income tax division for added revenue production from that tax. Third, any resolution of a technical or legal dispute on the federal level would be determinative for Virginia, with a resulting saving of administrative and judicial review.

Alaska\textsuperscript{39} and New Mexico\textsuperscript{40} formerly had a death tax similar to Virginia's, that is, an inheritance tax with the minimum tax being the amount of the section 2011 credit allowed on the federal return. And so when those states changed to a pick-up tax in 1970 and 1973, respectively, they expected a revenue loss to the extent of the excess of the inheritance tax over the section 2011 credit for any particular return. Alaska and New Mexico made the change despite the anticipated revenue loss primarily because of the administrative simplicity of the pick-up tax.\textsuperscript{41} It is no doubt true that only because the death tax represents such a small share of state collections are states willing to sacrifice a cut in revenue for administrative ease. Put another way, the smaller the amount of revenue realized from a tax, the more important administrative efficiency becomes.

Any simplification of the Virginia death tax calculation and reduction of the number of returns required to be filed would also relieve those personal representatives and others preparing the Virginia return, who now must contend with a 12-page inheritance tax return capped off by a seemingly straightforward, yet confusing and misleading, rate table. The change to either of the proposed taxes

\begin{flushright}
\textsuperscript{39} \textit{ALASKA STAT. §§ 43.30.010-..210} (1963) (repealed 1970).
\textsuperscript{40} \textit{N.M. STAT. ANN. §§ 31-16-1 to -25} (1953) (repealed 1973).
\textsuperscript{41} The legislative history for most state statutes is sparse at best. Any reference in the text to the \textit{raison d'etre} for a legislature's action is founded on the author's conversations with state officials and has no documentary basis.
\textsuperscript{42} Schedule K on page 11 of the Virginia inheritance tax return is a series of columns leading to the calculation of the tax due. That calculation is made by reference to the rate table on page 12. One would expect the terms of Schedule K to match the terms of the rate table, but the contrary is the case. Discovering no exact equivalence in the terms, one might then be led to think that the "net amount" of column 6 of Schedule K is the same as the "net estate" in the rate table. But no. The "value of share" column of Schedule K is actually comparable to the "net estate" columns of the rate table, and what is referred to as the "net
would also eliminate the need for much of the documentation which now must accompany the Virginia return in many cases, such as: (1) the will of the decedent; (2) the deed or will creating an estate in jointly owned property with right of survivorship; (3) Form 44-A summarizing the federal estate tax return; and (4) demonstration of the consideration furnished with respect to joint property. With the proposed taxes, all that need be appended to what would surely be a simple Virginia return would be the federal return.

It is apparent that many of the difficulties associated with the Virginia death tax are inherent in an inheritance tax and that many of the solutions to those difficulties are inherent in an estate tax. The proposed alternative taxes represent two of the three general variations of an estate tax. The three general types of estate taxes adopted by the various states are: an estate tax which "tracks" the federal tax, such as Alternative I; a pick-up tax like Alternative II; and an independent estate tax system which usually follows federal estate tax concepts but without specific reference to the Internal Revenue Code.

The advantage of Alternative I, vis-à-vis Alternative II, is its flexibility for revenue production. While Alternative I as drafted applies a flat 25 per cent rate against the progressive federal estate tax, that rate could be changed up or down at any time in order to increase or decrease death tax revenues. On the other hand, Alternative II is based solely on the section 2011 credit with no rate subject to change by the legislature. This advantage of Alternative I would be more significant if death tax revenues constituted a more substantial share of total state collections.

The attraction of Alternative II is that the state tax is no more and no less than the amount which the federal government allows as a credit against the federal estate tax. The states which have adopted a pick-up tax boast that they effectively have no state death tax burden since the tax paid to the state reduces the federal tax owed by an equal amount. Utah adopted its pick-up tax effective January 1, 1977 in large part to attract wealthy persons to reside amount" in Schedule K is equivalent to the "taxable" column of the rate table. The author is reluctant to reveal his initial confusion in working with the inheritance tax table, but does so after being reassured by other practitioners that his perplexity is shared.
in that state.\textsuperscript{43} Vermont, which provides the model for Alternative I, recently amended its estate tax so that by 1979 virtually all of Vermont's death tax revenue will be from the section 2011 credit.\textsuperscript{44} The Vermont legislature made this change knowing that in the short run there would be a revenue loss, but like Utah, the change was made to attract persons of wealth.\textsuperscript{45} If states such as Utah and Vermont are correct in their belief that a pick-up tax will eventually create a net increase in revenue by the attraction of larger estates, the advantage of Alternative I over Alternative II as a revenue producer may be illusory.

Some states, including Arizona,\textsuperscript{46} Mississippi,\textsuperscript{47} North Dakota,\textsuperscript{48} Ohio,\textsuperscript{49} and Oklahoma,\textsuperscript{50} have their own independent estate taxes. The statutes of these states define gross estate, enumerate deductions and contain their own rate schedules. Like the proposed taxes, these estate taxes eliminate the need for a separate calculation for each beneficiary and obviate the problems associated with future interests. But unlike the proposed taxes, to the extent that federal definitions and interpretations are not adopted, separate state audit staffs must be maintained. Administrative and judicial disputes will continue. Moreover, the preparation of the return becomes no less complicated for the taxpayer, and the audit of the return would be more difficult than under Alternatives I or II.

In 1958, when the Virginia Advisory Legislative Council recommended that Virginia adopt an estate tax in place of the inheritance tax, that recommendation was accompanied by the proposal that the Virginia gift tax be repealed.\textsuperscript{51} For the same reasons and more, the estate taxes now proposed could be coupled with the repeal of the gift tax without significant detriment and with some benefit.

The main function of a gift tax is to deter lifetime giving as a

\textsuperscript{43} See note 39 supra.
\textsuperscript{44} VT. STAT. ANN. tit. 32, §7442 (Supp. 1977).
\textsuperscript{45} See note 39 supra.
\textsuperscript{48} N.D. CENT. CODE §§ 57-37.1-01 to -22 (Supp. 1977).
\textsuperscript{49} OHIO REV. CODE ANN. §§ 5731.01-.51 (Page, Repl. Vol. 1974).
means of avoiding death tax liability. The Council in 1958 con-
cluded that any deterrent effect is achieved almost entirely by the
federal gift tax alone and that any consideration given state gift
taxes is little more than an afterthought to the tax planner. The
predominance of the federal gift tax compared to the state gift tax
is even more pronounced today. The 1976 federal changes included
a unified rate schedule for estate and gift taxes. The unified rates
have taken away the most significant advantage to lifetime giving,
that is, a more favorable rate for gifts. Furthermore, while the gross
federal gift tax payable has always overshadowed the state tax, the
federal tax is now even relatively higher. Since the potential federal
tax liability is so much greater than the state tax, it follows that the
federal policy discouraging inter vivos transfers will be served even
without a state gift tax.

The Council further stated that if the revenue loss from the repeal
of the gift tax proved too significant the estate tax rates could be
adjusted to make up the difference. It is inconceivable that the
Virginia gift tax in its current form would become a significant
source of revenue. In any event, the single 25 per cent rate to be
incorporated in Alternative I is calculated to raise revenue sufficient
to replace both the inheritance and gift tax. It should also be noted
that lifetime giving dilutes the new federal unified credit, thus cre-
at ing greater exposure to federal estate tax liability. Since Alterna-
tive I is keyed to the federal tax liability, the state tax would like-
wise increase, further compensating for the repeal of the gift tax.

Repeal of the gift tax would have salutary effects as well. First, it
would make administration of the tax laws yet simpler and less
expensive. Second, it would make the state's wealth transfer laws
more even in their application. Gift tax laws are very difficult to
enforce. It is submitted that many taxpayers, whether deliberately
or not, unlawfully avoid gift taxes. The replacement of the gift and
inheritance taxes with a single, easily enforceable transfer tax would
be a fairer tax, particularly to those who dutifully pay gift taxes.

52. Id.
53. Id.
III. Conclusion

Virginia should repeal its inheritance tax and enact an estate tax. An estate tax is simpler from the perspective of both the government and taxpayer. Only one tax is levied per decedent rather than a multitude of taxes for each beneficiary. Since the tax is based on the total value of the property of a decedent, and not the value of shares to each beneficiary, difficult problems involving future interests and allocations of tax liability are avoided. An estate tax is also easier to administer and therefore more productive. The most often repeated defense on behalf of an inheritance tax is its ability to favor certain classes of beneficiaries, most notably close relatives of the decedent. But since the federal estate tax, which of course does not favor classes of beneficiaries, receives the lion’s share of the death tax dollar, any state’s policy to that end is defeated.

Two alternatives are proposed as the best form of an estate tax. The tax imposed by Alternative I would be an amount equal to 25 per cent of the federal tax to ensure that the level of revenue to Virginia from both inheritance and gift taxes is maintained. The tax represented by Alternative II would be equal to the credit allowed by section 2011 of the Internal Revenue Code for state death taxes paid. Adoption of Alternative II would decrease revenue in the short run, but eventually could well create an increase. A tax keyed either to the federal tax liability or to the section 2011 credit would relieve most smaller estates in Virginia which now pay inheritance tax from any death tax liability at all. Moreover, such a tax would be eminently simple to administer.

The gift tax should be repealed. Its revenue production is minimal, and can be absorbed by the estate tax of Alternative I. Its effect in deterring lifetime giving is likewise minimal, and has been further diminished by the recent changes in the federal law. The repeal of the gift tax will further simplify the task of the Department of Taxation.
Appendix

ALTERNATIVE I

ESTATE TAXES-SUBSTANTIVE PROVISIONS GENERALLY

Sec. 1. Name Of Tax. The tax imposed by this chapter shall be known as the Virginia estate tax.

Sec. 2. Definitions. The following definitions shall apply throughout this chapter unless the context requires otherwise.

(1) "Transfer" means "transfer" within the meaning of Section 2001 of the United States Internal Revenue Code of 1954, as amended or renumbered, or successor provision.

(2) "Decedent" means a deceased natural person.

(3) "Resident" means a decedent who was domiciled in the Commonwealth of Virginia at his death.

(4) "Nonresident" means a decedent who was domiciled outside of the Commonwealth of Virginia at his death.

(5) "Laws of the United States" means for any decedent's estate, the statutes of the United States relating to the federal estate tax whether enacted before or after this chapter effective for such decedent's estate.

(6) "Federal estate tax liability" means for any decedent’s estate, the federal estate tax payable by the estate under the laws of the United States after the allowance of all credits against such estate tax provided by the laws of the United States.

(7) "Federal gross estate" means "gross estate" as defined in Section 2031 of the United States Internal Revenue Code of 1954, as amended or renumbered, or successor provision of the Laws of the United States.

(8) "Virginia gross estate" means for any decedent the federal gross estate, excluding real or tangible personal property which has an actual situs outside Virginia at the time of the death of the decedent, and also excluding in the case of a nonresident intangible personal property owned by the decedent. For purposes of this chapter, a partner's interest in partnership property, real, personal or mixed, shall be considered intangible personal property.
(9) "Section 2011" means Section 2011 of the United States Internal Revenue Code of 1954, as amended or renumbered, or successor provision of the Laws of the United States.

(10) "Federal credit" means the maximum amount of the credit for state death taxes allowable by Section 2011 in respect to a decedent's federal gross estate.

(11) "State" means any state of the United States and the District of Columbia.

Sec. 3. Imposition of Tax. A tax is imposed on the transfer of the Virginia gross estate of every decedent, resident or nonresident, dying after June 30, 1978. The amount of this tax shall be measured by 25 percent of the federal estate tax liability of the decedent's estate, reduced by a percentage equal to the percentage of the decedent's federal gross estate which is not Virginia gross estate.

Sec. 4. Additional Tax Imposed. (a) A tax in addition to the estate tax imposed by section 3 of this chapter is imposed upon the transfer of the Virginia gross estate of every decedent, resident or nonresident, when the tax as imposed under section 3 of this chapter is a lesser amount than the federal credit for residents or that portion of the federal credit as determined below for nonresidents. In any such case, the estate tax so provided for in section 3 of this chapter shall be increased by an additional tax on the Virginia gross estate so that the aggregate amount of the tax due the Commonwealth for such estate tax as provided in section 3 of this chapter and the additional tax imposed by this section shall be the maximum amount of credit allowable for residents or that portion of the maximum credit allowable as determined below for nonresidents.

(b) In the case of nonresidents the portion of the federal credit shall be computed as follows:

(1) The percentage which the Virginia gross estate bears to the federal gross estate shall be ascertained.

(2) The percentage is then to be applied to the total federal credit allowable to determine the portion of the federal credit allocable to Virginia.
Alternative II

Estate Taxes—Substantive Provisions Generally

Sec. 1. Name of Tax. The tax imposed by this chapter shall be known as the Virginia estate tax.

Sec. 2. Definitions. The following definitions shall apply throughout this chapter unless the context requires otherwise.

(1) "Transfer" means "transfer" within the meaning of Section 2001 of the United States Internal Revenue Code of 1954, as amended or renumbered, or successor provision.

(2) "Decedent" means a deceased natural person.

(3) "Resident" means a decedent who was domiciled in the Commonwealth of Virginia at his death.

(4) "Nonresident" means a decedent who was domiciled outside of the Commonwealth of Virginia at his death.

(5) "Laws of the United States" means for any decedent's estate, the statutes of the United States relating to the federal estate tax whether enacted before or after this chapter effective for such decedent's estate.

(6) "Federal gross estate" means "gross estate" as defined in Section 2031 of the United States Internal Revenue Code of 1954, as amended or renumbered, or successor provision of the Laws of the United States.

(7) "Virginia gross estate" means for any decedent the federal gross estate, excluding real or tangible personal property which has an actual situs outside Virginia at the time of the death of the decedent, and also excluding in the case of a nonresident intangible personal property owned by the decedent. For purposes of this chapter, a partner's interest in partnership property, real, personal or mixed, shall be considered intangible personal property.

(8) "Section 2011" means Section 2011 of the United States Internal Revenue Code of 1954, as amended or renumbered, or successor provision of the Laws of the United States.

(9) "Federal credit" means the maximum amount of the credit for state death taxes allowable by Section 2011 in respect to a decedent's federal gross estate.
(10) "State" means any state of the United States and the District of Columbia.

Sec. 3. Imposition of Tax. (a) A tax in the amount provided below is hereby imposed on the transfer of the Virginia gross estate of every decedent, resident or nonresident dying on or after January 1, 1980.

(b) In the case of a resident, the amount of the tax shall be a sum equal to the excess of the federal credit over the aggregate amount of all constitutionally valid estate, inheritance, legacy and succession taxes actually paid to all other states of the United States in respect of any property included in the federal gross estate (not including any such taxes paid with respect to the estate of a person other than the decedent) which qualify for the credit allowable under Section 2011 for such death taxes.

(c) In the case of a nonresident the tax imposed under this section shall be an amount equal to the federal credit multiplied by a fraction, the numerator of which is the value of the Virginia gross estate and the denominator of which is the aggregate value of the federal gross estate situate in all states.

(d) Despite the above, the tax imposed under this section with respect to a decedent who is a resident shall not be less than the amount of tax which would have been imposed under this section with respect to such decedent if a nonresident.
Table 1

VIRGINIA INHERITANCE AND GIFT TAXES COLLECTED
FISCAL YEARS 1967 - 1976

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Inheritance Taxes</th>
<th>Gift Taxes</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1967</td>
<td>$ 8,063,929</td>
<td>$ 433,902</td>
<td>$ 8,497,831</td>
</tr>
<tr>
<td>1968</td>
<td>10,377,362</td>
<td>592,346</td>
<td>10,969,708</td>
</tr>
<tr>
<td>1969</td>
<td>11,789,547</td>
<td>605,871</td>
<td>12,395,418</td>
</tr>
<tr>
<td>1970</td>
<td>13,415,925</td>
<td>643,640</td>
<td>14,059,565</td>
</tr>
<tr>
<td>1971</td>
<td>10,913,539</td>
<td>1,269,709</td>
<td>12,183,248</td>
</tr>
<tr>
<td>1972</td>
<td>15,221,041</td>
<td>951,866</td>
<td>16,172,907</td>
</tr>
<tr>
<td>1973</td>
<td>15,073,344</td>
<td>1,644,922</td>
<td>16,718,266</td>
</tr>
<tr>
<td>1974</td>
<td>18,661,959</td>
<td>1,075,419</td>
<td>19,737,378</td>
</tr>
<tr>
<td>1975</td>
<td>18,348,281</td>
<td>1,070,048</td>
<td>19,418,329</td>
</tr>
<tr>
<td>1976</td>
<td>17,487,402</td>
<td>1,612,537</td>
<td>19,099,939</td>
</tr>
</tbody>
</table>

Source: Virginia Department of Taxation Annual Report, 1975-1976
**Table 2**

CALCULATION OF RATE FOR PROPOSED ALTERNATIVE I: PERCENTAGE WHICH STATE TRANSFER TAX BEARS TO FEDERAL ESTATE TAX COLLECTED FROM VIRGINIA ESTATES

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Virginia Inheritance and Gift Taxes*</th>
<th>Federal Estate Taxes Collected from Virginia Estates**</th>
<th>Percentage (1) Bears to (2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1976</td>
<td>$19,049,939</td>
<td>$82,037,000</td>
<td>23.2</td>
</tr>
<tr>
<td>1975</td>
<td>19,418,329</td>
<td>74,799,000</td>
<td>26.0</td>
</tr>
<tr>
<td>1974</td>
<td>19,737,378</td>
<td>75,715,000</td>
<td>26.1</td>
</tr>
<tr>
<td>1973</td>
<td>16,718,266</td>
<td>77,755,000</td>
<td>21.5</td>
</tr>
<tr>
<td>1972</td>
<td>16,172,907</td>
<td>78,975,000</td>
<td>22.4</td>
</tr>
<tr>
<td>1971</td>
<td>12,183,248</td>
<td>51,294,000</td>
<td>23.8</td>
</tr>
<tr>
<td>1970</td>
<td>14,059,565</td>
<td>41,115,000</td>
<td>34.2</td>
</tr>
<tr>
<td>1969</td>
<td>12,395,418</td>
<td>52,110,000</td>
<td>23.8</td>
</tr>
<tr>
<td>1968</td>
<td>10,969,708</td>
<td>44,946,000</td>
<td>24.4</td>
</tr>
<tr>
<td>1967</td>
<td>8,497,831</td>
<td>37,241,000</td>
<td>22.8</td>
</tr>
</tbody>
</table>

Average 24.8

*Source: Virginia Department of Taxation Annual Report, 1975-1976

**Source: Commissioner of Internal Revenue Annual Reports, 1967-1976
Table 3

COMPARISON OF CURRENT VIRGINIA INHERITANCE TAX AND PROPOSED ESTATE TAXES

<table>
<thead>
<tr>
<th>Adjusted Gross Estate¹</th>
<th>Current Virginia Inheritance Tax²</th>
<th>Alternative I³</th>
<th>Alternative II⁴</th>
</tr>
</thead>
<tbody>
<tr>
<td>100</td>
<td>1</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>200</td>
<td>4</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>500</td>
<td>10</td>
<td>25</td>
<td>10</td>
</tr>
<tr>
<td>1,000</td>
<td>33*</td>
<td>66</td>
<td>33</td>
</tr>
<tr>
<td>2,000</td>
<td>100*</td>
<td>159</td>
<td>100</td>
</tr>
<tr>
<td>5,000</td>
<td>392*</td>
<td>528</td>
<td>392</td>
</tr>
<tr>
<td>10,000</td>
<td>1,068*</td>
<td>1,234</td>
<td>1,068</td>
</tr>
<tr>
<td>50,000</td>
<td>7,467*</td>
<td>7,467*</td>
<td>7,467</td>
</tr>
</tbody>
</table>

(Assuming No Marital Deduction — No Insurance)

(Assuming Maximum Marital Deduction — No Insurance)

(Amounts in $1,000's)

*These figures represent the maximum federal credit allowable under section 2011 for state death taxes paid, since the calculation of the tax otherwise yields a lesser amount.

¹ Adjusted gross estate is as determined for federal estate tax purposes. Assuming no charitable, marital or orphans deductions, this would also correspond to federal taxable estate. This chart assumes that there is no life insurance or any other property which might be taxable for federal purposes but excluded for Virginia purposes, and no property which might be excluded from the federal gross estate but taxable for Virginia purposes. Accordingly, under these assumptions, the Virginia taxable amount would equal the adjusted gross estate less federal estate tax payable (assuming the maximum $47,000 federal unified credit is available).
2. Assume entire estate passes to one Class A beneficiary. This assumption will overstate the probable tax due where the net estate passes either outright or to trust for the benefit of several descendants. This difference is less for Virginia compared with most other states as a result of the small exemptions allowed and the absence of sharp progression in the rate brackets in Virginia. For example, the tax on an adjusted gross estate of $5 million (assume no marital deduction) passing to a single descendant is $127,800, compared with $111,300 if passing to two descendants equally or $89,300 if passing to four descendants equally. This difference would become proportionately smaller for larger taxable amounts.

3. Assume the maximum $47,000 federal unified credit is available for calculating the federal tax. Further assume that the residuary estate bears the burden of death taxes so that the marital deduction is unaffected by the apportionment of such taxes to the share of the surviving spouse.