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ness judgment embodied in state corporation statutes.¹⁰⁹ The Business Corporations Act Drafting Committee of the General Statutes Commission will submit a bill for adoption by the 1973 North Carolina General Assembly making shareholder agreements to arbitrate future disputes enforceable.¹¹⁰ If the Committee's recommendation is passed, it could afford the far-sighted shareholder-incorporator some further protection when faced with a deadlock. Even then, however, the effect of such a statute is less than certain because some courts have held that if a dispute is not justiciable at law or in equity, it is not arbitrable, even under an arbitration statute.¹¹¹

Since they constitute the essential resort for deadlocked corporations, the North Carolina corporate deadlock provisions are very much in need of revision. Such revision should (1) eliminate the existing impediment to dissolution where deadlock is caused by high vote requirements,¹¹² (2) adopt a compulsory buy-out provision,¹¹³ and (3) enact the Drafting Committee's provisional director proposal.¹¹⁴ These revisions would provide a unified and rational three-step program of relief from which the court could choose the appropriate remedy to apply in any deadlock situation and would be in keeping with North Carolina's tradition as an innovator in close corporation legislation.¹¹⁵

CHARLES E. MURPHY, JR.

State Adoption of Federal Taxing Concepts—An Approach Offering Simplification of State Income, Death, and Gift Taxes

I. INTRODUCTION

Recently the Vermont General Assembly drastically altered both its concept and method of computing the death and gift taxes it sought to impose on those estates and donors within its taxing domain. In

¹⁰⁹Note, 56 VA. L. REV., *supra* note 60, at 280.

¹¹⁰H. 366, § 20, 1973 N.C. General Assembly, *reprinted*, Clifford (Appendix).

¹¹¹Note, 56 VA. L. REV., *supra* note 60, at 280.

¹¹²See text accompanying notes 23-33 *supra*.

¹¹³See text accompanying notes 79-88 *supra*.

¹¹⁴See note 103 *supra*.

¹¹⁵O'Neal, *Developments in the Regulation of the Close Corporation*, 50 CORNELL L.Q. 641, 646 (1965).

repealing its old inheritance tax law and replacing it with an estate-taxing scheme, this state legislature announced:

This chapter is intended to conform the Vermont inheritance tax laws with the estate and gift tax provisions of the United States Internal Revenue Code, except as otherwise expressly provided, in order to simplify the taxpayer's filing of returns, reduce the taxpayer's accounting burdens, and facilitate the collection and administration of these taxes.¹

In making this important change in its taxing laws, Vermont joined a small minority of states² that have adopted the federal estate and gift tax laws as the basis for computing their own death and gift taxes. Although this legislative action cannot be described as representing a trend with respect to the death- and gift-taxing schemes of the various states, comparable steps have been taken by a large majority of the states in the area of personal income taxation. At present thirty-four states have enacted legislation wherein their personal income tax tracks the federal income tax laws—that is, the federal income tax laws are used as a basis for determining an individual's state income tax liability.³ This proportionately high number of states becomes even more significant when it is recognized that six states have no personal income tax of any type.⁴ Only ten other states, including North Carolina, have not considered or have rejected⁵ the use of this federal tracking notion in their personal income tax laws.

The basic premise of this comment is that legislative action similar to Vermont's, whether for death, gift, or personal income taxes, is highly desirable and should be carefully considered by state legislatures as a serious alternative to their present taxing schemes. Discussion will center on the advisability of such a change in state death and gift taxes

¹Vt. STAT. ANN. tit. 32, § 7401(a) (Cum. Supp. 1972).

²See text accompanying notes 75-77 and 104-23 *infra*.

³See notes 20-25 and accompanying text *infra*. One of these states, Pennsylvania, had this type of taxing scheme rendered unconstitutional under the state's constitution. See text accompanying notes 35-39 *infra*. It should also be noted that of these thirty-four states, some do not have a general personal income tax, but rather one of a very limited nature. See note 25 *infra*.

Although the taxing systems of the District of Columbia are discussed in this comment, for the sake of clarity, and general reference to the various "states" does not include the District of Columbia.

⁴These states include Florida, Nevada, South Dakota, Texas, Washington, and Wyoming.

⁵A personal income tracking tax bill was introduced in the North Carolina General Assembly in 1971 but was not passed. See text accompanying note 32 *infra*.

rather than in state income taxes.⁶ The reasons for this emphasis are threefold. First, as already indicated, a decided majority of states have adopted tracking schemes for state income taxes; many have done so as recently as three or four years ago.⁷ These statutes provide valuable models for states considering comparable legislation.

Secondly, the recently enacted Federal-State Tax Collection Act of 1972 has provided an important incentive to encourage states to adopt personal income taxes that track the federal income tax.⁸ Although this federal legislation will probably encourage rapid change in state income taxes in the next few years, there is no similar incentive for states to reform their death and gift taxes.

Thirdly and perhaps most importantly, the adoption of tracking legislation for a state's death taxes will often require a more dramatic and fundamental change than comparable revision of a state's income-taxing scheme. This is because the change will usually involve a major modification in the concept and purposes of a state's death tax, since in most instances a state would be changing from an inheritance to an estate tax.

While the emphasis of this comment will be on state death taxes, many of the advantages of a tracking scheme are the same whether death or income taxes are involved, so the basic patterns of state income tax tracking statutes will also be discussed. Additionally, such discussion offers some general statutory guidance to a legislature considering adopting such a scheme. However, unlike the approach taken with respect to death taxes, no specific proposals for adoption will be considered.

Finally, an introductory word about state gift taxes. The purpose of such taxes is, of course, the same as that of the federal gift tax, namely to prevent the avoidance of death taxes.⁹ In spite of this, only sixteen of the fifty states levy gift taxes¹⁰ although all but one impose some type of death tax.¹¹ Among these sixteen states the gift tax provisions usually closely parallel the death tax provisions, in accordance

⁶Unless otherwise specifically indicated, all references to income taxes refer to personal income taxes.

⁷See dates in note 25 *infra*.

⁸See text accompanying notes 40-49 *infra*.

⁹An additional purpose of the federal gift tax is to prevent the avoidance of income taxes. C. LOWNDES & R. KRAMER, *FEDERAL ESTATE AND GIFT TAXES* 564 (2d ed. 1962).

¹⁰See notes 70, 72, 74, 75, 88, 108, 113, and 123 and accompanying text *infra*.

¹¹See note 63 and accompanying text *infra*.

with their purpose of serving as a chaperone to the death taxes. Accordingly, a change in a state's death taxes should be accompanied by a similar change in its gift taxes. However, considering the relatively small number of states that presently levy a gift tax, one should note at the outset that the suggested patterns for reform of death and gift taxes set out in this comment should not be taken to mean that a state considering reform and presently without a gift tax should likewise feel compelled to adopt a comparable gift tax. A state simply may have never wanted to bother with a gift tax, and this attitude is no hindrance to considering reform of its death tax.¹²

II. FEDERAL INFLUENCE IN THE STATE INDIVIDUAL INCOME TAX AREA

A. Background and Current State Legislation

The influence of federal policy on state taxing statutes has been much more pronounced in the income tax area than in either the death or gift tax area. One reason for this may be that converting from an independent state taxing scheme to one tracking the federal tax laws does not involve an accompanying change in the philosophy underlying the tax. A second and possibly more pervasive reason is that a state's

¹²This comment necessarily must assume that the reader is familiar with the federal income, estate, and gift tax laws. With respect to the federal income tax laws, it is assumed that the reader understands usage of the terms "federal gross income," "adjusted gross income," and "taxable income." With respect to the federal gift tax laws, it is assumed that the reader is familiar with the various exemptions and exclusions available to a donor, the marital deduction, and the split-gift election.

With respect to the federal estate tax laws, for the sake of clarity and the avoidance of any unnecessary misunderstanding concerning the proposals set forth in this comment, the following diagram should adequately serve to represent the meanings of the italicized terms as used both in common tax parlance and in this comment (the section references are to the INT. REV. CODE OF 1954):

Beginning with	<i>gross estate</i> (inclusions via §§ 2033-2044)
minus	§§ 2053 and 2054 deductions
equals	<i>adjusted gross estate</i> . This
minus	§§ 2055 and 2056 deductions
equals	<i>net estate</i> . This
minus	the sixty thousand dollar exemption (§ 2052)
equals	<i>taxable estate</i> . This
times	applicable rates (§ 2001)
equals	tentative tax liability. This
minus	any allowable credits (via §§ 2011-2015)
equals	<i>federal estate tax liability</i> .

income tax is the dominant revenue raiser¹³ and hence deserves priority over a state's death and gift tax laws. Whatever the reason, tracking legislation as reflected in state income tax laws provides useful background for suggesting change in death and gift tax laws.

It was once a very common practice for state legislatures to enact statutory provisions that would closely follow the principles and terminology found in the various federal income tax acts that have been enacted by Congress since 1918. Although this type of legislation does not constitute "tracking" as that term is used in this comment, it does in rudimentary fashion provide some sort of precedent and rationale for a state to convert to a tracking system. Minnesota had such an income tax from 1933¹⁴ until 1961 when it adopted a tracking scheme.¹⁵ Some of the merits of this type of paralleling statute are noted in the following passage:

Experience of tax administrators as well as taxpayers through the past twenty years [1933 to 1953] . . . has, for the most part, demonstrated that the framers of the Minnesota act were wise in following the federal law. Certainly the adoption of the federal law as construed by the federal courts initially eliminated a great deal of the litigation normally required in the interpretation and application of any new tax law. Through the years multiplicity of litigation has been diminished by the fact that an interpretation by the federal courts has often been acceptable as interpretative of the Minnesota law to the Minnesota tax administrators and taxpayers alike. The desirability of maintaining uniformity between the federal and state income tax laws is demonstrated further by the fact that in virtually every session of the legislature the Minnesota law has been amended to conform to certain changes made in the federal law.¹⁶

¹³In 1963 death and gift tax collections accounted for only 2.7% of total state revenue collections, as compared to 13.4% coming from personal income tax collections. THE ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, TAX OVERLAPPING IN THE UNITED STATES 1964, 20 (1964).

¹⁴Abdnor, *Notable Differences in State and Federal Income Tax Statutes*, 38 MINN. L. REV. 1 (1953).

¹⁵Ch. 213, art. IV, § 1, [1961] Minn. Sess. Laws 325. Minnesota's present income tax law is found in MINN. STAT. ANN. § 290.01 (1962), *as amended*, (Cum. Supp. 1973). It should be noted that here and in all subsequent statutory citations, only the provisions of the statutes that contain their identifying characteristics as discussed in the text are cited. Thus, for income tracking provisions, the statutory citation is to that part of the state's income tax act that identifies it as a tracking statute. Similarly, citations to state inheritance tax laws are to the provisions of that statute that identify it as an inheritance tax as contrasted to an estate tax.

¹⁶Abdnor, *supra* note 14, at 2. This same attitude was also shared by the Minnesota Supreme Court. See *State v. Stickney*, 213 Minn. 89, 91-92, 5 N.W.2d 351, 352 (1942).

In spite of the advantages of this type of paralleling income tax, it is not without its drawbacks. The experiences of two pioneers in income tax tracking statutes, Kentucky and Iowa,¹⁷ are worth noting. In reviewing the history of Kentucky's income tax, a writer noted:

From 1936 to 1954 the state law defined gross income and authorized specific deductions for the purpose of ascertaining net income. During this period the legislature made several changes in the gross income concept and in deductions. It patterned several of these modifications after the federal law but usually with significant time lags. The 1952 legislation offers an example of the difficulty of amending the state law to conform with the federal definition. The 1952 legislature intended conformity with the federal with respect to gross income of decedents. As a result of 1951 federal legislation which was not reflected in the 1952 state amendment, the General Assembly, in effect, departed from the federal practice.¹⁸

Similarly, a writer in Iowa in 1955 observed:

It was well-known that for several years the points of difference between the federal income tax law and the Iowa income tax law had been steadily increasing. No longer was it possible for many taxpayers to prepare their federal return and then to simply copy off the figures onto appropriate Iowa schedules in preparing their state return. The straw that broke the camel's back was the Internal Revenue Code of 1954—the first major overhaul ever attempted by Congress and one which left the federal and Iowa laws hopelessly apart.¹⁹

In shifting from an independent definition of income to the simpler approach of adopting the federal tax law by reference, one available method is to make the state income tax liability a certain percentage of the federal income tax liability. This approach, representing the most complete integration with the federal tax, is employed by Alaska,²⁰ Nebraska,²¹ Rhode Island,²² and Vermont.²³ Vermont, for example,

¹⁷See dates in note 25 *infra*.

¹⁸Lockyer, *History of the Kentucky Income Tax*, 43 KY. L.J. 461, 475 (1955).

¹⁹Miller, *The New Iowa Income Tax Law*, 41 IOWA L. REV. 85 (1955).

²⁰Although Alaska was a territory at the time it adopted a tracking income tax, it took this important step before any state did. Ch. 132, § 1, [1951] Alaska Sess. Laws 443-44. This method of taxation was upheld in *Alaska Steamship Co. v. Mullaney*, 180 F.2d 805 (9th Cir. 1950). Alaska's present statute is found in ALASKA STAT. § 43.20.010 (1962).

²¹NEB. REV. STAT. §§ 77-2714 to -2716 (1971). *Id.* § 77-2715(1) provides in part:

The tax shall be a flat percentage of, for each resident individual, the taxpayer's adjusted federal income tax liability for the taxable year, and for each non-resident individual,

levies a tax equal to twenty-five percent of an individual's federal income tax liability; this latter figure is then reduced by any percentage of the taxpayer's federal adjusted gross income that is not Vermont income.²⁴

A second alternative is to adopt a tracking tax that stops short of accepting the federal income tax liability as the base upon which to compute state income tax liability. Twenty-nine states presently use this type of tracking scheme.²⁵ The general approach of these states has been

the taxpayer's adjusted federal income tax liability for the taxable year which is attributable to income derived from sources within this state.

An attempt to have this method of taxation held unconstitutional as an unlawful delegation of legislative power was rejected in *Anderson v. Tiemann*, 182 Neb. 393, 155 N.W.2d 322 (1967).

²⁴R.I. GEN. LAWS ANN. § 44-30-2 (1956), *as amended*, (Supp. 1972).

²⁵VT. STAT. ANN. tit. 32, § 5811 (1970), *as amended*, (Cum. Supp. 1972); *id.* tit. 32, §§ 5820, 5822 (1970).

²⁴*Id.* tit. 32, § 5822 (1970). Although Vermont employs a tax equal to a flat percentage of an individual's federal income tax liability, this tax is subject to a maximum amount. *Id.* tit. 32, § 5828.

²⁵The following is a listing of these twenty-nine states along with pertinent comments. The date in parenthesis immediately after each state's name indicates either the year in which such legislation was adopted or when it first became effective. This is given to convey to the reader the great amount of recent activity in this area. These twenty-nine states include: (1) Colorado (1964), COLO. REV. STAT. ANN. §§ 138-1-2(2), -1-10 (Supp. 1965), *as amended*, (Supp. 1967), *as amended*, (Supp. 1969); (2) Connecticut (1969), CONN. GEN. STAT. ANN. §§ 12-505 to -506a (1972), *as amended*, (Cum. Supp. 1973). Although Connecticut's income tax is a tracking tax, it is a limited investment income tax, taxing only dividends and gains from the sale or exchange of capital assets; (3) Delaware (1970), DEL. CODE ANN. tit. 30, § 1105 (Supp. 1970); (4) Georgia (1970), GA. CODE ANN. § 92-3107 (Cum. Supp. 1972); (5) Hawaii (1957), HAWAII REV. STAT. § 235-1 to -3 (1968), *as amended*, (Supp. 1972); (6) Idaho (1959), IDAHO CODE § 63-3002, -3022 (Cum. Supp. 1972). *Id.* § 63-3002 provides in part:

It is the intent of the legislature by the adoption of this act, insofar as possible to make the provisions of the Idaho act identical to the provisions of the Federal Internal Revenue Code relating to the measurement of taxable income, to the end that taxable income reported each taxable year to the internal revenue service shall be the identical sum reported to this state, subject only to modifications contained in the Idaho law

....

(7) Illinois (1969), ILL. ANN. STAT. ch. 120, §§ 1-102, 2-202 to -203 (Smith-Hurd Cum. Supp. 1972). In *Thorpe v. Mahin*, 43 Ill. 2d 36, 250 N.E.2d 633 (1969), it was held that adoption by reference of certain terms of the Internal Revenue Code did not constitute an unconstitutional delegation of legislative power; (8) Indiana (1963), IND. ANN. STAT. §§ 64-3203a (Cum. Supp. 1972); (9) Iowa (1955), IOWA CODE ANN. § 422.4 (1971), *as amended*, (Cum. Supp. 1972); (10) Kansas (1967), KAN. STAT. ANN. §§ 79-32, 109, -32, 117 (1969), *as amended*, (Cum. Supp. 1972); (11) Kentucky (1954), KY. REV. STAT. ANN. § 141.010 (1970); (12) Maine (1969), ME. REV. STAT. ANN. tit. 36, § 5121-5122 (Cum. Supp. 1970); (13) Maryland (1967), MD. ANN. CODE art. 81, § 280 (1969), *as amended*, (Cum. Supp. 1972); (14) Massachusetts (1972), MASS. ANN. LAWS ch. 62, §§ 1-2 (Cum. Supp. 1972); (15) Michigan (1967), MICH. STAT. ANN. §§ 7.557(102), (130) (1971); *id.* § 7.557 (112), *as amended*, (Cum. Supp. 1972); (16) Minnesota (1955), MINN. STAT. ANN. § 290.01 (1962), *as amended*, (Cum. Supp. 1973); (17) Missouri (1973), MO. ANN.

to adopt certain federal definitions of tax concepts—such as gross, adjusted gross, or taxable income—and then use this concept as a base for computing the state income tax. With this type of tracking scheme, taxpayers filing state income tax returns need only copy the figure representing the adopted federal base from their federal tax returns and then make any modifications required by state law.

An example of this type of statute is the Oregon income tax. The taxable income of an Oregon resident is “his entire federal taxable income as defined in the laws of the United States, with the modifications, additions and subtractions provided in this chapter.”²⁶ In Delaware the taxable income of a resident is defined as his “federal adjusted gross income” with the modifications set forth in the Delaware statute.²⁷ This latter approach of utilizing federal adjusted gross income is by far the most frequently employed tracking scheme.

The New York Legislature expressed some of the reasons underlying its decision to adopt a tracking scheme:

The legislature hereby finds and declares that the adoption by this

STAT. § 143.091, .121 (Cum. Supp. 1973); (18) Montana (1955), MONT. REV. CODES ANN. §§ 84-4901, -4905 (1966), *as amended*, (Cum. Supp. 1971). For some of the problems that can result when less than exact draftsmanship and understanding are involved in converting from an independent to a tracking system of taxation, see Bennet, *Montana's Adoption of the Federal Definition of Income*, 23 MONT. L. REV. 105 (1961); (19) New Hampshire (1970), N.H. REV. STAT. ANN. § 77-B:1 (1970). Although New Hampshire's income tax is a tracking tax, it is a “Commuter's Income Tax,” taxing only the income of residents that is earned outside of New Hampshire; (21) New Jersey (1961), N.J. STAT. ANN. § 54:8A-36 (Cum. Supp. 1972). Although New Jersey's income tax is a tracking tax, it is a “Commuter's Tax,” taxing only the income of New Jersey residents working in adjacent states and residents of adjacent states working in New Jersey; (21) New Mexico (1961), N.M. STAT. ANN. § 72-15-6 (1961). This tracking income tax has been amended several times, and the present tracking income tax is found in *id.* § 72-15A-2 (Supp. 1971); (22) New York (1960), N.Y. TAX LAW § 612 (McKinney 1966), *as amended*, (McKinney Cum. Supp. 1972); (23) North Dakota (1967), N.D. CENT. CODE §§ 57-38-01, -01.1, -01.2, -29 (1972). *Id.* § 57-38-01.1 provides in part:

It is the intent of the legislative assembly to simplify the state income tax laws . . . by adopting the federal definition of taxable income as the starting point for computation of state income tax by all taxpayers and providing the *necessary adjustments thereto to substantially preserve and maintain existing exemptions and deductions.*

(emphasis added); (24) Ohio (1972), OHIO REV. CODE ANN. §§ 5747.01, .05 (Page Supp. 1971); (25) Oklahoma (1971), OKLA. STAT. ANN. tit. 68, §§ 2353, 2358 (Cum. Supp. 1972); (26) Oregon (1969), ORE. REV. STAT. § 316.007, .062 (1971); (27) Virginia (1972), VA. CODE ANN. §§ 58-151.01, .013 (Cum. Supp. 1972); (28) West Virginia (1961), W. VA. CODE ANN. §§ 11-21-1 to -7, -10 to -12 (1966); *id.* §§ 11-21-4a, -4b, -8, -9, *as amended*, (Cum. Supp. 1972); *id.* §§ 11-21-4c to -4d; (29) Wisconsin (1965), WIS. STAT. ANN. § 71.02 (1969), *as amended*, (Cum. Supp. 1972).

²⁶ORE. REV. STAT. § 316.062 (1971).

²⁷DEL. CODE ANN. tit. 30, § 1105 (Supp. 1970).

state for its personal income tax purposes of the provisions of the laws of the United States relating to the determination of income for federal income tax purposes will (1) simplify preparation of state income tax returns by taxpayers, (2) improve enforcement of the state income tax through better use of information obtained from federal tax audits, and (3) aid interpretation of state tax law through increased use of federal judicial and administrative determinations and precedents.²⁸

The Hawaii tracking statute is very explicit about the deference to be shown to federal authorities in interpreting state income tax questions. It provides:

It is the intent of this chapter . . . to conform the income tax law of the State as closely as may be with the Internal Revenue Code in order to simplify the filing of returns and minimize the taxpayer's burdens in complying with the income tax law. The rules and regulations, forms and procedures adopted and established under this chapter shall conform as nearly as possible, and unless there is good reason to the contrary, to the rules and regulations, forms and procedures adopted and established under the Internal Revenue Code.²⁹

B. North Carolina

The advantages of a tracking tax are as obvious as they are numerous. Presently North Carolina must be listed among the minority of states that use their own independent definitions of gross, adjusted gross, and net income.³⁰ This situation could change this year if a proposed bill receives favorable treatment in the North Carolina General Assembly.³¹ This bill provides for the adoption of the federal ad-

²⁸Ch. 563, § 1, [1960] N.Y. Laws 1746.

²⁹HAWAII REV. STAT. § 235-3(a) (1968).

³⁰N.C. GEN. STAT. §§ 105-140, -141, -141.3 (1972).

³¹S. 240 and H. 303, 1973 N.C. General Assembly. These two identical bills were introduced on February 7, 1973 by State Senator McNeill Smith and State Representative E. Lawrence Davis. A description of the bills can be found in 1973 INSTITUTE OF GOVERNMENT, LEGISLATIVE BULLETIN 212-13.

The sponsors of the bills noted:

There are more than 60 variations in the terms and provisions between the federal and State income tax laws which cause much inconvenience and expense to the people, but do not offer any real advantages to justify such inconvenience and expense.

...
This [bill] would not only save the taxpayer time and money, but would also permit a ready exchange of information between the federal and State revenue service. This ready exchange is not now possible. It would reveal errors and omissions far more

justed gross income as the base upon which North Carolina's personal income tax will be computed.

Whether North Carolina will adopt this or a similar tracking scheme remains uncertain. Although the General Assembly did not pass a somewhat similar tracking bill that was introduced in the 1971 regular session,³² it had some experience in the tracking area in 1967 when it extensively revised the North Carolina Corporation Income Tax Act.³³ That legislation gave North Carolina a corporate income tax that tracks the federal corporate income tax laws.³⁴ Perhaps that precedent will influence the General Assembly also to adopt tracking for personal income taxes.

C. *A Caveat*

It is important to recognize that by adopting a tracking system a state incorporates by reference all of the federal income tax law. This will include, unless specifically excluded, all of the "tax preferences" that are presently found in the Internal Revenue Code. This aspect of tracking created serious constitutional problems in Pennsylvania, one of the thirty-four states that have adopted income tracking statutes.

Shortly after Pennsylvania adopted a tracking statute based on federal taxable income in 1971,³⁵ the Pennsylvania Supreme Court in *Amidon v. Kane*³⁶ held that the built-in inequalities and tax preferences

quickly and produce better compliance with the law and more public revenue which would otherwise be lost to the State.

A simpler form would also promote cooperation between the federal and State revenue services and sharing in auditing of returns, reduce the separate training programs now required, reduce the number of personnel and quantity of paper work, and thus reduce the total cost of administering and collecting the income tax.

Press Release distributed by State Senator McNeill Smith and State Representative E. Lawrence Davis. See also News and Observer, Feb. 8, 1973, at 7, col. 1.

³²H. 1105, 1971 N.C. General Assembly. This bill was introduced in the North Carolina House of Representatives on May 27, 1971, by then State Representative McNeill Smith. A description of the bill can be found in 1971 INSTITUTE OF GOVERNMENT, LEGISLATIVE BULLETIN 855-56.

³³Ch. 1110, § 3, [1967] N.C. Sess. Laws 1684.

³⁴N.C. GEN. STAT. § 105-130.3 (1972), which reads in part:

Every corporation doing business in this State shall pay annually an income tax equivalent to six percent (6%) of its net income or the portion thereof allocated and apportioned to this State. The net income or net loss of such corporation shall be the same as "taxable income" as defined in the Internal Revenue Code in effect on the effective date of this Division, subject to the adjustments provided in G.S. 105-130.5.

³⁵No. 2, § 301(q), [1971] Pa. Laws 43-44 (this pagination is to the law in its unbound form).

³⁶444 Pa. 38, 279 A.2d 53 (1971).

in the federal taxable income concept served to render this federal tax base, when adopted by Pennsylvania, unconstitutional under the state's uniformity clause, which requires that "[a]ll taxes shall be uniform, upon the same class of subjects"³⁷ Although the court based its decision on this one provision in the state's constitution, the impression conveyed is that the court also felt its holding was dictated in a broader sense by the general notions of equity and fairness. If the decision is followed by other state courts, the whole tracking concept could of course be put into serious jeopardy. This possibility, however, seems unlikely since the decision reaffirmed an earlier Pennsylvania holding³⁸ that the state legislature could enact no graduated individual income tax or individual income tax granting personal exemptions that would comport with the state's uniformity clause. If the case is not so followed, any of its possible implications with respect to tracking could be mitigated by future congressional action aimed at reforming the federal income tax laws.³⁹

D. "Piggybacking" and the Future

Congress recently enacted the Federal-State Tax Collection Act of 1972.⁴⁰ This legislation amended the Internal Revenue Code of 1954 by adding provisions which allow "piggybacking"—that is, the federal collection and administration of state individual income taxes. Congress's decision to make this collection service available to the states was influenced by the large number of states that already have tracking income taxes.⁴¹ This collection program could become effective as early as 1974 for states that choose to take advantage of it.⁴²

³⁷PA. CONST. art. VIII, § 1. After this judicial action, the Pennsylvania General Assembly quickly stepped in and repealed the tracking income tax and replaced it with one that did not track the federal tax. No. 93, § 3, [1971] Pa. Laws 2 (this pagination is to the law in its unbound form). This taxing statute is presently found in PA. STAT. ANN. tit. 72, §§ 7301-7361 (Cum. Supp. 1972).

³⁸Kelley v. Kalodner, 320 Pa. 180, 181 A. 598 (1935).

³⁹The implications of the case are discussed in Halby, *Is the Income Tax Unconstitutionally Discriminatory?*, 58 A.B.A.J. 1291 (1972).

⁴⁰Pub. L. No. 92-512, §§ 201-204, 86 Stat. 936-45 (codified at INT. REV. CODE OF 1954, §§ 6361-6465, 6405(e), 7463(a), (f)). The act discussed in the text was title II of public law number 92-512. Title I of this same public law was the State and Local Fiscal Assistance Act of 1972, popularly known as the Revenue Sharing Bill. Pub. L. No. 92-512, §§ 101 to 109, 121 to 123, 141 to 144, 86 Stat. 919-36 (codified at 31 U.S.C.A. §§ 1221 to 1228, 1241 to 1243, 1261 to 1263 (Cum. Supp. 1973); INT. REV. CODE OF 1954, §§ 6017A, 6687).

⁴¹S. REP. NO. 1050, 92d Cong., 2d Sess. 18 (1972).

⁴²Pub. L. No. 92-512, § 204, 86 Stat. 945.

The collection program was recommended to Congress in 1965 by the Advisory Commission

The over-all effect of the federal bill is to encourage, although not to mandate,⁴³ standardization of the various state individual income tax laws. This standardization is to be achieved by requiring states that specifically request this collection service to conform their income taxes to the federal income tax. In order to have income taxes that do so conform, it is necessary that a state have an income tax that tracks the federal income tax laws. This bill, however, allows for only two types of tracking statutes to qualify for "piggybacking."⁴⁴ The first is a state income tax that uses the federal taxable income as the tax base to which a state's own rates are applied.⁴⁵ This type is presently represented by the Oregon statute.⁴⁶ The second type of statute allowed by the bill is represented by the Alaska statute,⁴⁷ that is, a state tax that is a flat

on Intergovernmental Relations. ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, FEDERAL-STATE COORDINATION OF PERSONAL INCOME TAXES 27 (1965). See also ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, ACIR STATE LEGISLATIVE PROGRAM 15-62-21 (1969).

The Senate report on the bill notes:

It is felt that a Federal collection system of State individual income taxes . . . will add to the overall efficiency of administration and provide the States with additional revenue for a number of reasons which may collectively be described as relating to efficiency of administration. Such reasons include eliminating the duplication of effort by State and Federal tax administrators, eliminating unnecessary recordkeeping by taxpayers, establishing uniform treatment for individual taxpayers at both the State and Federal levels, providing for faster collection of withheld income taxes, and freeing the State courts from individual income tax controversies.

S. REP. NO. 1050, 92d Cong., 2d Sess. 43 (1972). The report also notes:

It is contemplated that most taxpayers in States in the piggyback system will fill out only one form 1040 for both Federal and State individual income taxes, although a separate schedule will be required for the State computation. It is intended that in the interest of simplicity for taxpayers, the Internal Revenue Service will provide a separate schedule for each State in the system.

Id. at 44.

⁴⁴The Senate report on the bill notes:

It should be emphasized that this system is entirely voluntary for the States. . . . [T]his . . . bill merely offers a simplified and less expensive method for carrying out a policy determined by a State, e.g., a determination by the State to have an income tax and to conform that tax substantially to the Federal income tax. Nothing in the bill requires a State to have an income tax against its will; nothing in the bill requires a State to follow the Federal income tax against its will if the State prefers a different income tax system.

S. REP. NO. 1050, 92d Cong., 2d Sess. 43 (1972).

⁴⁵INT. REV. CODE OF 1954, § 6362(b), (c). It should be noted that the discussion in the text relates to the taxation of residents. This same section also provides additional requirements for the taxation of nonresidents. *Id.* § 6362(d).

⁴⁶*Id.* § 6362(b).

⁴⁷See text accompanying note 26 *supra*.

⁴⁸See text accompanying note 20 *supra*.

percentage of the federal income tax liability.⁴⁸ Under both approaches a state is free to determine what rates shall be applied to the federal base, and certain specified adjustments to the federal base are also permitted.⁴⁹

III. STATE DEATH AND GIFT TAXES

A. Background

After having taken a look at state income taxes, one finds it somewhat intriguing to consider the number of states that have devoted much thought and attention to reforming their income taxes and at the same time have almost entirely neglected their death and gift taxes. Several possible explanations for this neglect have already been suggested.⁵⁰ This section of the comment will explore the types of death and gift taxes presently found in the various states with emphasis on those states that have recently adopted some sort of tracking tax. As indicated earlier, several alternative guidelines for reform will be suggested.

State law has not operated completely free of the influence of federal policy since 1924 when the predecessor to the present section 2011 of the Internal Revenue Code was enacted.⁵¹ This provision provided a credit of twenty-five percent against the federal estate tax liability for death taxes actually paid to the states. This credit was increased to eighty percent in 1926.⁵² By enacting this credit Congress sought to curb the problem of interstate competition with respect to death taxes.⁵³

Before the credit was enacted some states, such as Florida, had encouraged the elderly rich to move to their states in which state death tax burdens were nonexistent. Although Congress could not directly force such states to adopt a death tax, by allowing the credit for state death taxes it indirectly accomplished this purpose.⁵⁴ Thereafter a dece-

⁴⁸INT. REV. CODE OF 1954, § 6362(c).

⁴⁹*Id.* § 6362.

It should be noted that although this bill provides for the federal collection of state income taxes on individuals, estates, and trusts, it is not applicable to state income taxes on corporations. *See Id.* § 6362.

⁵⁰*See* text accompanying note 13 *supra*.

⁵¹Act of June 2, 1924, ch. 234, § 301(b), 43 Stat. 304.

⁵²Act of Feb. 26, 1926, ch. 27, § 301(b), 44 Stat. 70.

⁵³Note, *The Gross Estate and the Death Tax Credit*, 28 WASH. & LEE L. REV. 254, 257-58 (1971).

⁵⁴*See generally* Cogburn, *The Credit Allowable Against the Basic Federal Estate Tax for Death Taxes Paid to States and State Statutes Enacted to Take Advantage*

dent dying in a state without a death tax would incur the same federal estate tax liability as a decedent dying in a state that imposed a tax, but in the latter case Congress allowed eighty percent of this federal liability to be paid with state death tax receipts. This enabled states to collect death taxes in amounts up to eighty percent of the federal estate tax liability without adding any net estate tax burden on its decedents.

When Congress raised the credit from twenty-five to eighty percent in 1926, the maximum federal estate tax rate was twenty percent.⁵⁵ Although Congress raised this maximum rate in subsequent legislation by adopting a supplementary estate tax, the credit for state death taxes remained limited to eighty percent of the 1926 (or "basic" federal estate tax) rates.⁵⁶ This confusing scheme was left unchanged by the 1954 Code revisions. Congress in that year did, however, simplify the matter of determining the credit available by combining into a single schedule of rates the 1926 "basic" tax rates and the additional tax rates it had subsequently enacted.⁵⁷

Presently the maximum federal estate tax rate is seventy-seven percent,⁵⁸ as contrasted with the maximum rate of twenty percent in 1926. Since eighty percent of the 1926 rates remains the prescribed limit of the credit, a maximum credit of sixteen percent (eighty percent times twenty percent) is presently available to offset the federal estate tax liability for state death taxes actually paid. However, Congress has never allowed a comparable credit for state gift taxes actually paid.

B. Current State Legislation

By raising the state death tax credit from twenty-five to eighty percent, Congress hoped to engender uniform systems of death taxes among the states.⁵⁹ This objective was not realized. As previously noted,

Thereof—Constitutional Difficulty and Some Suggested Solutions, 30 N.C.L. REV. 123, 124 (1952).

⁵⁵Act of Feb. 26, 1926, ch. 27, § 301(a), 44 Stat. 69.

⁵⁶THE ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, TAX OVERLAPPING IN THE UNITED STATES 1964, 149 (1964).

⁵⁷Lowndes, *An Introduction to the Federal Estate and Gift Taxes*, 44 N.C.L. REV. 1, 43 (1965).

⁵⁸INT. REV. CODE OF 1954, § 2001.

⁵⁹67 CONG. REC. 966 (1925) (remarks of Representative Burtness). The National Commission on Inheritance Taxation, which sponsored the 80% credit for state death taxes in 1925, unsuccessfully urged Congress to require states to substitute estate taxes for their inheritance taxes as a condition of eligibility for the tax credit. ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, COORDINATION OF STATE AND FEDERAL INHERITANCE, ESTATE, AND GIFT TAXES 19-20 (1961).

Congress later added further confusion to this area by increasing the estate tax rates without an accompanying increase in the state death tax credit. Consequently, much of the relative importance of this credit to state death tax revenues was severely diminished.

The over-all impact of the credit is reviewed in the following passage:

Before the enactment of the credit provision, there were those States which had full-blown inheritance tax laws. Perhaps Congress expected that these States would hold their inheritance tax laws as they were before the advent of the credit. Such was rarely the case. Most of the States which imposed death taxes before retained them thereafter and supplemented them with an additional estate tax. Some of the States which had inheritance tax laws antedating the credit retained them but did not enact any additional estate tax. A few States which had inheritance taxes theretofore repealed them and enacted estate taxes in their stead. All of those States, save one, which had no death taxes before, wrote into their law some form of death tax to take advantage of the credit allowed⁶⁰

The "additional estate tax" noted above is often referred to as either a "slack" tax, a "sponge" tax, or a "pickup" tax. Its purpose is to insure that a state will get the full advantage of the state death tax credit. The "slack" tax achieves this purpose by simply providing that the difference between the basic state death taxes owed by an estate and the available federal credit for state death taxes shall be assessed against the estate as an additional estate tax.⁶¹

Presently forty states and the District of Columbia have adopted a "slack" tax, and the majority of the states without such a tax impose death taxes that automatically insure that the state death taxes collected will at least be the same amount as the maximum available credit for state death taxes.⁶² Unfortunately, the "slack" tax is about the only

⁶⁰Cogburn, *supra* note 54, at 130-31 (footnotes omitted).

⁶¹State statutes levying a "slack" tax vary considerably both in phraseology and in their manner of operation. See Cogburn, *supra* note 54, at 131-32.

⁶²Those states without a "slack" tax include Alabama, Alaska, Arkansas, Florida, Georgia, Mississippi, Nevada, North Dakota, South Dakota, and West Virginia. States (and the District of Columbia) imposing such a tax have them incorporated in their inheritance and estate tax provisions.

West Virginia, one of the ten states without a "slack" tax, had such a tax in its taxing statute until 1972. See W. VA. CODE ANN. § 11-11-28 (1966), which provided in part: "It is the purpose of this section to impose an estate tax and to take full advantage of the credit allowed by the laws of the United States because of transfer or death taxes actually paid to this State." This statute

common characteristic shared by a great majority of the various state death taxes. Perhaps the only other similarity among the states with respect to their death taxes is the fact that all but one do impose a death tax of some sort.⁶³

The following categories will be used to classify these various state death taxes: (1) states with inheritance taxes; (2) states with their own independent estate taxes; (3) states with both estate and inheritance taxes; (4) states that rely solely on collecting the full amount of the state death tax credit as their death tax revenue; and (5) states with estate taxes that track the federal estate tax. In each category those states that also have an accompanying gift tax will be noted.

Category No. 1. Thirty-three states⁶⁴ and the District of Columbia⁶⁵ levy inheritance or succession taxes. An inheritance tax in theory is a tax imposed upon the privilege of receiving property from a decedent.⁶⁶

had been inoperative since 1935, however, when the state's Supreme Court had ruled that it was obscure. *Charleston Nat'l Bank v. Fox*, 116 W. Va. 487, 182 S.E. 91 (1935). The statute was finally repealed in 1972 by Ch. 118, § 1, [1972] W. Va. Acts 643.

⁶³Nevada, the sole exception, has in its constitution a provision stating that "[n]o inheritance or estate tax shall ever be levied" NEV. CONST. art. X, § 1. Nevada, in not having even a "slack" tax, bestows valuable tax dollars on the federal treasury at the expense of its own revenues.

⁶⁴These thirty-three states include: (1) California, CAL. REV. & TAX. CODE §§ 13306 to 13309, 13404 to 13406 (West 1970); (2) Colorado, COLO. REV. STAT. ANN. § 138-3-14 (1963); (3) Connecticut, CONN. GEN. STAT. ANN. § 12-344 (1972); (4) Delaware, DEL. CODE ANN. tit. 30, § 1322 (1953); (5) Hawaii, HAWAII REV. STAT. § 236-5 (1968); (6) Idaho, IDAHO CODE § 14-406 to -407 (1948); (7) Illinois, ILL. ANN. STAT. ch. 120, § 375 (Smith-Hurd Cum. Supp. 1972); (8) Indiana, IND. ANN. STAT. § 7-2402 (1953), *as amended*, (Cum. Supp. 1972); (9) Iowa, IOWA CODE ANN. § 450.10 (1971), *as amended*, (Cum. Supp. 1972); (10) Kansas, KAN. STAT. ANN. § 79-1501 (1969); (11) Kentucky, KY. REV. STAT. ANN. § 140.070-.080 (1970); (12) Louisiana, LA. REV. STAT. ANN. § 47:2402 (1952); *id.* § 47:2403 (Cum. Supp. 1972); (13) Maine, ME. REV. STAT. ANN. tit. 36, §§ 3462-3464 (1964); (14) Maryland, MD. ANN. CODE art. 81, §§ 149-150 (1969); (15) Massachusetts, MASS. ANN. LAWS ch. 65, § 1 (1971), *as amended*, (Cum. Supp. 1972); (16) Michigan, MICH. STAT. ANN. § 7.562 (Cum. Supp. 1972); (17) Minnesota, MINN. STAT. ANN. §§ 291.02-.03 (1972); (18) Missouri, MO. ANN. STAT. § 145.060 (1949); (19) Montana, MONT. REV. CODES ANN. §§ 91-4409 to -4410 (1964); (20) Nebraska, NEB. REV. STAT. §§ 77-2004 to -2006 (1971); (21) New Hampshire, N.H. REV. STAT. ANN. § 89:6 (1970); (22) New Jersey, N.J. STAT. ANN. § 54:34-2 (Cum. Supp. 1972); (23) New Mexico, N.M. STAT. ANN. §§ 31-16-1 to -2 (Supp. 1971); (24) North Carolina, N.C. GEN. STAT. §§ 105-4 to -6 (1972); (25) Pennsylvania, PA. STAT. ANN. tit. 72, § 2485-403 (Cum. Supp. 1972); *id.* tit. 72, §§ 2485-404 to -405 (1964); (26) South Dakota, S.D. COMPILED LAWS ANN. § 10-40-21 (1967), *as amended*, (Cum. Supp. 1972); *id.* § 10-40-22 (1967); (27) Tennessee, TENN. CODE ANN. §§ 30-1609 to -1610 (Cum. Supp. 1972); (28) Texas, TEX. REV. CIV. STAT. ANN. art. 14.02-.06 (1969); (29) Virginia, VA. CODE ANN. § 58-153 (Cum. Supp. 1972); (30) Washington, WASH. REV. CODE ANN. §§ 83.08.020-.040 (1962); (31) West Virginia, W. VA. CODE ANN. §§ 11-11-2 to -4 (1966); (32) Wisconsin, WIS. STAT. ANN. §§ 72.02-.03 (1969); (33) Wyoming, WYO. STAT. ANN. § 39-337 (Cum. Supp. 1971).

⁶⁵D.C. CODE ANN. § 47-1601 (1967).

⁶⁶Lowndes, *supra* note 57, at 3.

The amount of the tax is usually determined by the value transferred to each individual beneficiary.⁶⁷ Rates and exemptions applicable to the transferred property vary according to the relationship between the decedent and the beneficiary; the higher the tax rates, the lower are the exemptions. For purposes of applying these rates and exemptions, beneficiaries are divided into two or more classes. Rates, although usually graduated as in North Carolina,⁶⁸ may be a flat rate on the entire amount passing to a recipient in excess of applicable exemptions as evidenced in New Mexico.⁶⁹

As noted earlier, a state's gift tax is usually patterned very closely after its death tax. This is true for eight of the ten states in this category with gift taxes.⁷⁰ In these states the classes of beneficiaries are identical to those set out in the inheritance tax, and the rates are either identical with or very close to the inheritance tax rates.⁷¹ Exemptions, however, differ from those used in the inheritance tax.

Until last year Louisiana levied a gift tax that was patterned after its inheritance tax and operated exactly like those described above.⁷² In 1972 its gift tax laws were changed to conform to the annual exclusion and specific exemption provided in the federal gift tax,⁷³ and at the same time graduated rates were established that apply uniformly to all donees without regard to their relationship to the donor.⁷⁴

Another interesting step in the gift tax area was taken recently by Delaware, the tenth state in this category with a gift tax. In 1971 Dela-

⁶⁷This is true for all of the inheritance tax states but Connecticut. In Connecticut there is a single exemption for each class of beneficiaries, and the rates of the tax on the excess over each such exemption vary according to the amount transferred to a class as a whole, rather than according to the amount transferred to each beneficiary. CONN. GEN. STAT. ANN. § 12-344 (1972).

⁶⁸N.C. GEN. STAT. §§ 105-4 to -6 (1972).

⁶⁹N.M. STAT. ANN. §§ 31-16-1 to -2 (Supp. 1971).

⁷⁰These eight states include: (1) California, CAL. REV. & TAX. CODE §§ 15110-15112 (West 1970); (2) Colorado, COLO. REV. STAT. ANN. §§ 138-4-3 to -5 (1963); (3) Minnesota, MINN. STAT. ANN. §§ 292.05-.07 (1972); (4) North Carolina, N.C. GEN. STAT. §§ 105-188 (1972); (5), TENN. CODE ANN. §§ 67-2505 to -2506 (Cum. Supp. 1972); (6) Virginia, VA. CODE ANN. § 58-219 (Cum. Supp. 1972); (7) Washington, WASH. REV. CODE ANN. § 83.56.040 (1962); (8) Wisconsin, WIS. STAT. ANN. §§ 72.77-.78, .80 (1969).

The District of Columbia does not levy a gift tax.

⁷¹Colorado's gift tax rates are slightly different from its inheritance tax rates. COLO. REV. STAT. ANN. § 138-4-3 (1963). Washington's gift tax rates are 90% of the applicable inheritance tax rates. WASH. REV. CODE ANN. § 83.56.040 (1962).

⁷²This gift tax, although no longer applicable, can be found in LA. REV. STAT. ANN. §§ 47:1205 to 1206 (1970). It was amended by No. 569, [1972] La. Acts 1313-16.

⁷³INT. REV. CODE OF 1954, §§ 2503(a), 2511.

⁷⁴No. 569, §§ 1-2, [1972] La. Acts 1314-15.

ware, which previously had not had a gift tax, adopted one that tracks the federal gift tax.⁷⁵ Although Delaware, in enacting this new gift tax, directly incorporated the federal concept of taxable gifts,⁷⁶ the federal thirty thousand dollar lifetime exemption⁷⁷ was not adopted. Therefore, for purposes of the Delaware gift tax, a donor's federally taxable gifts each year are increased by the amount of the thirty thousand dollar exemption claimed. The year before this step was taken Delaware had adopted an income tax that tracks the federal income tax.⁷⁸ Only its old inheritance tax prevents Delaware from being a state that has completely adopted tracking.

Category No. 2. Six states (Arizona,⁷⁹ Mississippi,⁸⁰ North Dakota,⁸¹ Ohio,⁸² Oklahoma,⁸³ and Utah⁸⁴) have their own independent estate or transfer taxes. In contrast to an inheritance tax, which taxes the privilege of receiving property from a decedent, an estate tax is conceived as a tax imposed on the privilege of passing on property at death.⁸⁵ In these six states a tax is levied on the value of the net estate of a decedent; therefore the identity of the beneficiaries receiving the transfer (absent specific exemptions or deductions) does not affect the rate of the tax.

Most of these statutes are very similar to the federal estate tax, and many of the provisions relating to the determination of gross estate duplicate their federal counterparts. Some of these statutes provide for a marital deduction,⁸⁶ while others employ special provisions for surviving children as well as for the surviving spouse.⁸⁷

One disadvantage of such statutes as compared to tracking statutes is that they tend to be lengthy and detailed. When first written and

⁷⁵DEL. CODE ANN. tit. 30, § 1401 (Supp. 1972).

⁷⁶*Id.*

⁷⁷INT. REV. CODE OF 1954, § 2521.

⁷⁸DEL. CODE ANN. tit. 30, § 1105 (Supp. 1970).

⁷⁹ARIZ. REV. STAT. ANN. § 42-1501 (1956).

⁸⁰MISS. CODE ANN. § 9262-03 (Cum. Supp. 1972).

⁸¹N.D. CENT. CODE §§ 57-37-11, -13 (1972).

⁸²OHIO REV. CODE ANN. § 5731.02 (Page Supp. 1971).

⁸³OKLA. STAT. ANN. tit. 68, § 803 (1966).

⁸⁴UTAH CODE ANN. § 59-12-2 (Supp. 1971). Although this statute is labeled as an inheritance tax, it is in operation an estate tax. *See In re Estate of Clark*, 10 Utah 2d 427, 354 P.2d 112 (1960).

⁸⁵Lowndes, *supra* note 57, at 3.

⁸⁶*See, e.g.,* ARIZ. REV. STAT. ANN. § 42-1512(A)(4) (1956).

⁸⁷OHIO REV. CODE ANN. § 5731.09(A), (B) (Page Supp. 1971); OKLA. STAT. ANN. tit. 68, § 809 (1966); N.D. CENT. CODE § 57-37-11 (1972). North Dakota's marital deduction is 50% of the adjusted gross estate or twenty thousand dollars, whichever is less. *Id.*

codified they were often intended to conform substantially to the federal estate tax provisions then in effect. But unless changes are made periodically, the state and federal provisions have the potential of drifting further and further apart.

Of these six states only Oklahoma has a gift tax.⁸⁸ Unlike the federal gift tax rates, which are seventy-five percent of the federal estate tax rates,⁸⁹ Oklahoma's gift tax rates are the same as its estate tax rates.⁹⁰

Category No. 3. Two states (Rhode Island and Oregon) levy both an estate tax and an inheritance tax. The estate tax in Rhode Island is imposed on every decedent's net estate that exceeds ten thousand dollars in value.⁹¹ Additionally, an inheritance tax with varied rates and exemptions is assessed on the right to receive property from the decedent.⁹² Rhode Island's gift tax bears no resemblance to its inheritance tax; its rates and exemptions are equally applicable to all donees without regard to their relationship to the donor.⁹³

The Oregon death tax is unique. It grants a twenty-five thousand dollar exemption for every estate and provides graduated rates for any excess over this amount,⁹⁴ much like an estate tax. But the statute further provides that this is all that is due for property passing to a specified class of beneficiaries. However, if any property passes to persons who are not in the specified class, an additional inheritance tax is due. With this latter tax, the rates and exemptions vary according to the relationship between the decedent and the beneficiary.⁹⁵ Oregon's gift tax is patterned after its inheritance tax. The rates and classifications of beneficiaries are the same as those set forth in the inheritance tax, but the exemptions under the two taxes differ.⁹⁶

Category No. 4. Five states (Alabama,⁹⁷ Alaska,⁹⁸ Arkansas,⁹⁹

⁸⁸OKLA. STAT. ANN. tit. 68, §§ 901-909 (1966).

⁸⁹See INT. REV. CODE OF 1954, §§ 2001, 2502.

⁹⁰OKLA. STAT. ANN. tit. 68, § 902 (1966).

⁹¹R.I. GEN. LAWS ANN. §§ 44-22-1(a), -13 (1970).

⁹²*Id.* §§ 44-22-8 to -11.

⁹³*Id.* §§ 44-22-4 to -5.

⁹⁴ORE. REV. STAT. § 118.100(1) (1971).

⁹⁵*Id.* §§ 118.100(2), (3).

⁹⁶*Id.* §§ 119.051, .061.

⁹⁷ALA. CODE tit. 51, § 432 (1958).

⁹⁸ALASKA STAT. §§ 43.31.011-.031 (1962).

⁹⁹ARK. STAT. ANN. § 63-103 to -104 (1971).

Florida,¹⁰⁰ and Georgia¹⁰¹) have very simple estate-taxing statutes that are totally integrated with the federal estate tax. These statutes provide that there shall be assessed as an estate tax an amount equal to the credit allowable under the federal estate tax laws for state death taxes. Since such statutes are designed to absorb the section 2011 credit,¹⁰² none of these states have any need for an accompanying "slack" tax.

One tremendous advantage offered by this type of statute is that it is the easiest to comply with. Typically all an executor or administrator must do to comply is simply to file a duplicate of his federal estate tax return with the state's department of revenue.¹⁰³ The amount of tax due to the state is quickly computed by ascertaining the taxable estate from the federal return and then looking to section 2011(b) to determine the maximum available credit.

Since these statutes base the state's death tax on the federal credit for state death taxes, which is in turn based upon the federal taxable estate, all of the federal estate tax deductions are automatically incorporated into the state death tax, although this fact is not mentioned in the statutes themselves.

No state in this category has a gift tax.

Category No. 5. The death taxes of forty-seven states and the District of Columbia have been examined in the previous four categories. Of these, not one has a death tax that tracks the federal estate tax, and only one has a gift tax that tracks the federal gift tax. The three states remaining to be discussed—South Carolina, New York, and Vermont—have all adopted tracking estate and gift taxes. In sharp contrast to the death tax legislation of the great majority of the other states, the tracking legislation of these three states is of recent origin. Each state will be examined in turn.

In 1961 the South Carolina General Assembly repealed its inheritance tax and adopted the following provisions that track the federal estate tax:

§ 65-453 **How value of gross estate determined.**—The value of the gross estate shall be determined by including therein the value of

¹⁰⁰FLA. STAT. ANN. §§ 198.02-.04 (1972).

¹⁰¹GA. CODE ANN. §§ 92-3401 to -3402 (1961), *as amended*, (Cum. Supp. 1972).

¹⁰²INT. REV. CODE OF 1954, § 2011.

¹⁰³*See, e.g.,* ALA. CODE tit. 51, § 434 (1958). Although filing a duplicate of the federal form is required by some states, in others a duplicate federal form may be filed in lieu of the state form. *See, e.g.,* FLA. STAT. ANN. §§ 198.02-.14 (1972).

the same property as shall be included in the gross estate of the decedent for Federal estate tax purposes under §§ 2031 to 2044, inclusive, of the Internal Revenue Code of 1954 . . . except the property excluded pursuant to § 65-454 [of the South Carolina Code].¹⁰⁴

§ 65-454 **Exclusions from gross estate.**—There shall be excluded from the gross estate of every resident of this State real or tangible personal property which has an actual situs outside this State at the time of the death of the decedent.¹⁰⁵

§ 65-455 **How value of taxable estate determined.**—For purposes of the tax imposed by § 65-451 [that section of the South Carolina Code setting forth estate tax rates], the value of the taxable estate shall be determined by deducting from the value of the gross estate the exemptions and deductions allowed for Federal estate tax purposes pursuant to §§ 2051 through 2056, inclusive, of the Internal Revenue Code of 1954¹⁰⁶

§ 65-456 **Effect of property exclusions.**—If property is excluded under § 65-454, then each exemption and deduction granted under § 65-455 shall be reduced in the proportion that the value of real and tangible personal property which has an actual situs outside this State bears to the total value of the gross estate including such property.¹⁰⁷

South Carolina's apparent success with its new tracking tax was evidenced by further legislative action in 1968. South Carolina, like many other states, had previously not bothered to enact a gift tax. But in 1969 the following tracking gift tax became effective:

§ 65-574 **Taxable gifts.**—The term "*taxable gifts*" shall mean the transfer by gift which are included in taxable gifts for Federal gift tax purposes under § 2053 and §§ 2511 through 2517, inclusive, under the Internal Revenue Code of 1954 . . . less the deductions allowed in §§ 2521 through 2524, inclusive, of the Internal Revenue Code of 1954¹⁰⁸

With the enactment of these death and gift tax provisions, South Carolina has assumed a rather unique and curious position in the tracking lineup. Although it is one of a very few states that has taken such steps in both the death and gift tax areas, it presently must be listed

¹⁰⁴S.C. CODE ANN. § 65-453 (Cum. Supp. 1971).

¹⁰⁵*Id.* § 65-454 (1962).

¹⁰⁶*Id.* § 65-455 (Cum. Supp. 1971).

¹⁰⁷*Id.* § 65-456 (1962).

¹⁰⁸*Id.* § 65-574 (Cum. Supp. 1971).

among the minority of states that have not taken comparable steps in the income tax area.

New York was one of the first states to recognize the numerous benefits to be obtained when state taxes are coordinated with the federal tax laws. As early as 1930¹⁰⁹ New York shifted from its old inheritance tax to an estate tax in order to harmonize its death tax with the federal estate tax.¹¹⁰ In 1960 New York adopted an income tax that tracks the federal income tax laws.¹¹¹ This impetus in New York continued, and in 1963 the Legislature amended its tax code again, this time by enacting a federally based estate tax law.¹¹² The final step was taken in 1972. New York, which like South Carolina had not levied a gift tax previously, enacted a tax that directly incorporated the federal taxable gift concept with certain modifications.¹¹³

New York's tracking estate tax is very similar in operation to South Carolina's. The New York gross estate consists of the federal gross estate less the value of real and tangible personal property situated outside the state.¹¹⁴ Similarly, New York's estate tax deductions are the allowable federal deductions reduced by those deductions attributable to real and tangible personal property situated outside the state.¹¹⁵

New York also has a provision that is patterned after section 2013 of the Internal Revenue Code of 1954. This provision allows a credit for state death taxes paid on prior transfers¹¹⁶ and works in much the same way as its counterpart in the federal law.

The New York statute provides that final federal determinations of tax questions are conclusive unless shown to be erroneous by a preponderance of the evidence.¹¹⁷ This prompted Professor Clurman to write:

The continual adoption of Federal substantive and procedural rules by the State of New York is resulting in further simplification in the preparation of returns and will provide for greater stability and

¹⁰⁹Ch. 710, [1930] N.Y. Laws 1285.

¹¹⁰Note, *State Inheritance Taxation of Nongratuitous Transfers*, 43 N.Y.U.L. REV. 744, 745 n.7 (1968).

¹¹¹Ch. 563, § 1, [1960] N.Y. Laws 1746.

¹¹²N.Y. TAX LAW §§ 954-955 (McKinney 1966).

¹¹³*Id.* §§ 1001, 1006 (McKinney Cum. Supp. 1972).

¹¹⁴*Id.* § 954 (McKinney 1966).

¹¹⁵*Id.* § 956.

¹¹⁶*Id.* § 959. South Carolina has a comparable provision. S.C. CODE ANN. § 65-452 (1962).

¹¹⁷N.Y. TAX LAW § 961(a) (McKinney 1966). "Final federal determinations" are defined in *id.* § 961(b). The state's gift tax has a similar provision. *Id.* § 1006 (McKinney Cum. Supp. 1972).

uniformity in the determinations of questions of fact and law. It also places an increased importance and emphasis on the proper resolution of tax controversies at the Federal level to facilitate the disposition of the related state matter. In effect, a final determination by the Internal Revenue Service should in most instances provoke no more than inquiry by the state audit authorities and considerably reduce the time devoted to state audit activity. Controversy should be reduced, obviating a considerable amount of New York tax litigation.¹¹⁸

His predictions have proved true, and federal and state revenue agents presently work closely together in New York; each agency performs audits that benefit the other.¹¹⁹

Thus South Carolina and New York have adopted the same basic approach to their death taxes as that found in the majority (twenty-nine of thirty-three¹²⁰) of the state income tax tracking statutes. That is, they both have stopped short of adopting the federal estate tax liability as the base on which to compute state estate tax liability and instead have adopted the federal gross estate as the tax base. Vermont, one of the four states using the federal income tax liability as a base in its income tracking tax,¹²¹ has not. In 1969 Vermont repealed its old inheritance tax and enacted the following estate tax:

A tax is imposed on the transfer of the Vermont taxable estate of every decedent, resident or nonresident, dying after December 31, 1970. The amount of this tax shall be measured by 30 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 Vermont gross estate.¹²²

In the same year Vermont, which like South Carolina and New York had not levied a gift tax previously, also enacted a tracking gift tax equal to "30 percent of the federal gift tax liability of the taxpayer for the calendar year, reduced by a percentage equal to the percentage of all of the taxpayer's transfers by gift for the calendar year which are not Vermont gifts."¹²³

¹¹⁸Clurman, *Revised N.Y. tax law conforms to Federal determinations; eases many problems*, 18 J. TAXATION 236 (1963).

¹¹⁹Metz, *'Piggyback' Tax Collections in the Offing*, N.Y. Times, Jan. 7, 1973, § 3 (Business and Finance), at F 45, col. 1 (city ed.).

¹²⁰See note 25 and accompanying text *supra*.

¹²¹See text accompanying note 23-24 *supra*.

¹²²Vt. STAT. ANN. tit. 32, § 7442 (Cum. Supp. 1972).

¹²³*Id.* tit. 32, § 7412.

One should note that since the Vermont estate and gift taxes consist of a percentage of the federal estate and gift tax liabilities, the exemptions, deductions, and credits of the two federal taxes may be considered as exemptions, deductions, and credits for Vermont tax purposes as well.

C. Inheritance versus Estate Taxes

Many states seem unnecessarily reluctant to abandon their inheritance taxes in favor of an estate tax. For example, Delaware has tracking income and gift taxes, yet it continues to cling to its old inheritance tax.¹²⁴ Although inheritance taxes were originally designed to encourage decedents to leave their property to close relatives, the actual necessity of this device is highly questionable, since close relatives would be the natural objects of a decedent's bounty without such encouragement. Furthermore, this objective of the inheritance tax has been thwarted by the federal government's increased share of all (federal and state) death and gift tax revenues. About forty years ago the states received about seventy-five percent of these revenues. In recent years this percentage has dwindled to about twenty percent.¹²⁵ Thus the social policies that the inheritance taxes sought to further have been supplanted by the federal estate and gift tax considerations that now dominate estate planning.

The Advisory Commission on Intergovernmental Relations in a 1961 report took a strong position favoring estate taxes over inheritance taxes. The Commission noted:

Advocates of State inheritance taxation do not always recognize that an estate's aggregate tax burden is generally not affected significantly by whether the State employs an inheritance or an estate tax. Subtle differentiations in State rates and exemptions, based on the relationship between decedent and heir, tend to be neutralized because the aggregate State tax is ultimately raised to the level of the credit [for state death taxes paid], especially for large estates.¹²⁶

The Commission also stressed the following merits of an estate tax as compared with an inheritance tax: an estate tax is simpler and more productive; it avoids the complex task of ascertaining the value of life

¹²⁴See text accompanying notes 27, 75-78 *supra*, and note 64 *supra*.

¹²⁵THE ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, TAX OVERLAPPING IN THE UNITED STATES 1964, 153 (1964).

¹²⁶THE ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, COORDINATION OF STATE AND FEDERAL INHERITANCE, ESTATE, AND GIFT TAXES 19 (1961).

estates, contingent future interests, and remainders;¹²⁷ and finally the fact that an estate tax is itself quite compatible with the desire to give more favorable tax treatment to some beneficiaries through the use of exemptions.¹²⁸

Although the relationship of the beneficiaries to the decedent will ultimately determine an estate's inheritance tax liability, there are several intermediate steps that must be taken to decide what in fact will be subject to the inheritance tax in the first place. First there must be a determination as to what a decedent's "taxable estate" is as defined by the inheritance tax law. Only those things that pass through the decedent's estate are subject to any inheritance tax. This process very closely resembles the steps that one must follow in computing the gross estate for federal estate tax purposes.

This procedure may be illustrated by section 105-2¹²⁹ of the North Carolina inheritance tax statute. That section defines the limits of a decedent's "taxable estate." Many of the provisions under this section of the statute nearly duplicate the provisions of the Internal Revenue Code that determine the federal gross estate.¹³⁰ There are also deductions from the decedent's "taxable estate" for inheritance tax purposes,¹³¹ and again these closely parallel the deductions allowed in sections 2053 and 2054 of the Internal Revenue Code.

This comparison could be made with statutes of other states, but it should be clear that in many instances the property interests subject to an inheritance tax are the same interests that are reached by the federal estate tax. In view of this fact, any holdover arguments that might be asserted in support of retaining an inheritance tax seem clearly to be overshadowed by the numerous advantages offered by an estate tax that tracks the federal estate tax.

D. Some Suggested Guidelines for Reform

Two of the five categories discussed above provide valuable guidance for states considering reform of their death taxes. Category four

¹²⁷*Id.* at 50.

¹²⁸*Id.* at 20.

¹²⁹N.C. GEN. STAT. § 105-2 (1972).

¹³⁰INT. REV. CODE OF 1954, §§ 2033-2044. *See* note 12 *supra*. There are also some important differences. An example is the North Carolina contemplation of death provision found in N.C. GEN. STAT. § 105-2(3) (1972). Unlike the federal contemplation of death provision found in INT. REV. CODE OF 1954, § 2035, there is no cut-off date in the North Carolina provision.

¹³¹N.C. GEN. STAT. § 105-9 (1972).

includes those states whose death taxes simply absorb the maximum possible credit for state death taxes under the federal estate tax laws. This is the simplest type of death tax and is, in a sense, totally integrated with the federal estate tax. As was noted earlier, many states had levied death taxes long before the federal credit was introduced by Congress. A state with an old inheritance tax that produces, on the average, only slightly more revenue than could be obtained with this type of estate tax should for obvious reasons consider this as an alternative.

One should recognize, however, that this type of statute will yield no state death tax revenues if a decedent's federal net estate¹³² is less than 100,000 dollars.¹³³ Of course, a state that wants no more in death tax revenues than is available through the federal credit would find this acceptable. In addition, such a statute would substantially reduce the cost of tax administration at the state level.

Category five offers two additional patterns which might be preferable to a state's present system. One advantage of the approach taken by South Carolina¹³⁴ and New York¹³⁵—that is, the adoption of a base other than the federal estate tax liability—is that it affords a state flexibility in determining its own deductions and exemptions. South Carolina has chosen to forego this flexibility by simply providing that all federal deductions and exemptions are to be South Carolina deductions and exemptions.¹³⁶ New York has done essentially the same.¹³⁷

However, some states might wish to utilize the flexibility afforded by this type of tracking scheme to a fuller extent than have South Carolina and New York. For example, both states have adopted the federal marital deduction provided in section 2056 of the Internal Revenue Code. The marital deduction was enacted by Congress in an effort to equalize the impact of the federal estate tax upon married couples in community-property and common-law states.¹³⁸ Before it was adopted, only community-property states (through state law) enjoyed the benefit

¹³²See note 12 *supra*.

¹³³Under INT. REV. CODE OF 1954, § 2011(b), no credit is allowed until the federal taxable estate exceeds forty thousand dollars, and forty thousand dollars plus the sixty thousand dollar exemption granted to every estate by § 2052, yields a net estate of one hundred thousand dollars. See Lowndes, *supra* note 57, at 44, and note 12 *supra*.

¹³⁴See text accompanying notes 104-107 *supra*.

¹³⁵See text accompanying notes 114-16 *supra*.

¹³⁶See text accompanying note 106 *supra*.

¹³⁷See text accompanying note 115 *supra*.

¹³⁸See Lowndes, *supra* note 57, at 36.

that the marital deduction now extends to common-law states. There is, however, no comparable political reason for states to allow such a deduction in their estate taxes. There is no discrimination between counties that parallels the discrimination that once existed between community-property and common-law states. If the states recognize such a deduction, single decedents are unfairly discriminated against in favor of decedents with surviving spouses.

This suggestion does not conflict with the basic tracking concept. The discrimination between married and single decedents at the state level would be avoided if a state adopted as its taxing base the federal net estate¹³⁹ and then added back to this base the marital deduction that was subtracted for federal estate tax purposes. That would allow the state to incorporate the federal deductions provided for in sections 2053 (funeral and administrative expenses, indebtedness, and taxes), 2054 (losses suffered by an estate during administration), and 2055 (charitable bequests). At the same time the state would be provided with a very simple way of computing its estate tax. To this base (the net estate plus the marital deduction) the state could apply rates of its own choosing.

This same logic would also be applicable to states adopting a tracking gift tax. When Congress enacted the marital deduction for estate tax purposes, it also enacted two comparable provisions in the gift tax area. These provisions allow a marital deduction for gifts to spouses¹⁴⁰ and a split-gift election for married couples when gifts are made to donees outside the marital community.¹⁴¹ With the latter, a gift by a married person is treated, if the taxpayer so elects, as a gift half by him and half by his spouse.

These two provisions, like the marital deduction in the estate tax area, were enacted by Congress to put taxpayers in the common-law states in substantially the same position as taxpayers in community-property states. Once again there is no comparable reason for such provisions in a state gift tax. To avoid this discrimination between married and single donors at the state level, a state could simply adopt the federal definition of taxable gifts¹⁴² and then add back onto this base the amount of the marital deduction. Additionally, if a split-gift election

¹³⁹See note 12 *supra*.

¹⁴⁰INT. REV. CODE OF 1954, § 2523.

¹⁴¹*Id.* § 2513.

¹⁴²Treas. Reg. § 25.2503-1 (1972). See text accompanying note 108 *supra*, and Lowndes, *supra* note 57, at 59-61.

had been made by the taxpayer for federal gift tax purposes, a state could disallow this election for state gift tax purposes. A state could also choose either to adopt the federal thirty thousand dollar lifetime exemption,¹⁴³ to disallow any such exemption as Delaware has done,¹⁴⁴ or to set its own lifetime exemption.¹⁴⁵

The above suggestions are not intended to imply that a legislature errs if it chooses to recognize the marital deduction and the split-gift election in its estate and gift taxes. Such a course of action might well be desirable in order to simplify the payment of the tax, and additionally could indicate an intentional policy decision by the legislature and its tacit approval of the way the federal estate and gift taxes presently operate.

A state might also choose to adopt the Vermont approach¹⁴⁶ and simply assess a state estate and gift tax based on certain percentages of the federal estate and gift tax liabilities. Although such a choice would automatically eliminate the flexibility afforded by the South Carolina and New York approach, it does offer added simplicity.

When choosing any of the above patterns, a state might also consider enacting (or continuing) an accompanying "slack" tax. South Carolina, New York, and Vermont have continued to impose such taxes.¹⁴⁷ Additionally, if a state were to choose any of the above patterns, with the exception of the Vermont pattern, it might also consider the feasibility of enacting a state death tax credit paralleling section 2013 of the Internal Revenue Code for state death taxes paid on prior transfers.¹⁴⁸ Similarly, a state might consider adopting a credit that would parallel section 2012 and limiting such a credit to amounts paid to a state as gift taxes.¹⁴⁹

In deciding whether or not to adopt a tracking gift tax, a state would be well advised to consider the recent steps taken in this area by South Carolina, New York, and Vermont. None of these three states

¹⁴³INT. REV. CODE OF 1954, § 2521.

¹⁴⁴See text accompanying notes 76-77 *supra*.

¹⁴⁵If a state adopted the second or third alternative given in the text, it would be amending the federal definition of taxable gifts. See note 142 *supra*.

¹⁴⁶See text accompanying notes 122-23 *supra*.

¹⁴⁷S.C. CODE ANN. § 65-481 (Cum. Supp. 1971); N.Y. TAX LAW § 952(c) (McKinney 1966); VT. STAT. ANN. tit. 32, § 7443 (Cum. Supp. 1972).

¹⁴⁸New York and South Carolina have enacted such provisions. See note 116 *supra*. Such a credit would automatically be built into the Vermont pattern, and this is why Vermont does not have this type credit in its estate tax.

¹⁴⁹South Carolina has such a provision. S.C. CODE ANN. § 65.452.1 (Cum. Supp. 1971).

had a gift tax before they enacted their present tracking estate taxes. Similarly, Delaware adopted a tracking gift tax although it had had no gift tax in the past. Although there is of course no way of predicting that this pattern will be followed by other states, it is important to recognize that by enacting a tracking gift tax states will not be burdened by the enforcement problems that have plagued the states with traditional gift taxes.¹⁵⁰ This, in a word, is the beauty of tracking.

There is one final aspect of tracking that a state should recognize before deciding whether or not to adopt such a taxing scheme. With respect to estate taxes, a state is almost forced to adopt an exemption that is at least as large as the federal sixty thousand dollar exemption.¹⁵¹ With respect to gift taxes, a state would likewise need to adopt as a minimum the federal three thousand dollar annual per donee exclusion.¹⁵² The reason is that no federal estate tax return is required unless a decedent's gross estate exceeds sixty thousand dollars in value.¹⁵³ Similarly, no federal gift tax return is required unless a donor makes gifts exceeding three thousand dollars to any one donee in a year.¹⁵⁴

The gift tax exclusion would present no problem for many states. North Carolina's gift tax laws, for example, presently allow an annual three thousand dollar exclusion very similar to the federal exclusion.¹⁵⁵ The sixty thousand dollar exemption with respect to state death taxes deserves more detailed attention. To those acquainted with the typically lower inheritance tax exemptions, this sixty thousand dollar exemption may at first glance seem so high that it might provide an adequate reason to reject the idea of adopting a tracking estate tax. However, this sixty thousand dollar exemption is in reality no higher than the combined exemptions found in many inheritance taxes. To illustrate this point, one should consider the case of a resident husband dying in North Carolina and survived by his wife. His wife will be entitled to a ten thousand dollar exemption outright.¹⁵⁶ If she is the beneficiary of life insurance policies included in her husband's estate, she is entitled to an additional twenty thousand dollar exemption.¹⁵⁷ Furthermore, a North

¹⁵⁰THE ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, TAX OVERLAPPING IN THE UNITED STATES 1964, 153 (1964).

¹⁵¹INT. REV. CODE OF 1954, § 2052.

¹⁵²*Id.* § 2503(b).

¹⁵³Treas. Reg. § 20.6018-1(a) (1958).

¹⁵⁴*Id.* § 25.6019-1(a) (1958).

¹⁵⁵N.C. GEN. STAT. § 105-188(d) (1972).

¹⁵⁶*Id.* § 105-4(b).

¹⁵⁷*Id.* § 105-3(4).

Carolina decedent with real property held in tenancy by the entirety will have an inclusion for inheritance tax purposes of only one-half of the property's value.¹⁵⁸ Thus even if the decedent in our example had furnished all of the consideration for a sixty thousand dollar house and lot, his estate for inheritance tax purposes has an inclusion of only thirty thousand dollars. In effect, his estate enjoys an additional thirty thousand dollar exemption that is not recognized for federal estate tax purposes.¹⁵⁹

These exemptions afforded this decedent's estate total the sixty thousand dollar exemption that is available to his estate for federal estate tax purposes. Therefore this characteristic of a tracking estate tax should not be viewed as representing a major obstacle to a state considering adopting a death tracking scheme.

It could be argued that a state could adopt a tracking system and at the same time work around these limitations by requiring estates and donors to file federal returns with the state's taxing authorities regardless of whether they must do so for federal tax purposes. This is theoretically true, but such an approach would detract from both the purpose and the glamour of a tracking scheme because a state would then become directly involved in the administration and enforcement of very small estates and gifts.

IV. CONCLUSION

The prospects for continued change and reform in the area of state income taxes look especially promising because of the new incentive recently added by the congressional legislation providing for the federal collection of state income taxes. A new wave of such activity will no doubt be initiated by those states that now employ a tracking system that uses as a base something other than the federal income tax liability or the federal taxable income. To qualify for "piggybacking" these states will have to make the simple conversion from federal gross or adjusted gross income as a base to either federal taxable income or income tax liability.

Part of the rationale underlying Congress's decision to induce con-

¹⁵⁸*Id.* § 105-2(7).

¹⁵⁹INT. REV. CODE OF 1954, § 2040. Under this federal provision, a decedent holding property in tenancy by the entirety has an inclusion in his federal gross estate based upon his contribution to the property involved.

formity between state income tax laws and the federal income tax is the necessity—if “piggybacking” is to occur—for the computation of state income taxes to be a relatively simple matter. Congress does not intend for the federal collection of state income taxes to become an “undue burden” on the Internal Revenue Service.¹⁶⁰

Because of the great diversity among the state death taxes and their pronounced variance from the federal estate tax laws, it seems unlikely that Congress will provide the same incentive for reform in this area as it has done in the income tax area. Consequently, if there is any hope for future change and reform in the neglected area of state death taxes, all such hope must be focused directly on the state legislatures.

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¹⁶⁰S. REP. NO. 1050, 92d Cong., 2d Sess. 47 (1972).