

BEFORE THE HOUSE FINANCE COMMITTEE
of the
GENERAL ASSEMBLY OF PENNSYLVANIA

October 26, 1989

HEARINGS ON HOUSE BILL NO. 921

Testimony Presented By Joseph C. Bright, Jr.

Author, Pennsylvania Taxation (Shepard's/McGraw-Hill 1987)

Representing Section On Real Property, Probate and
Trust Law, Pennsylvania Bar Association, and Section On
Probate and Trust Law, Philadelphia Bar Association

Mr. Chairman and Members of the Committee:

I am grateful for the opportunity to testify before the Committee with respect to House Bill No. 921.

The bill is the result of a recommendation of the General Assembly's Joint State government Commission. It will exclude from Inheritance Tax transfers to a surviving spouse, thus eliminating what is sometimes referred to as the Widow's Tax. The Pennsylvania and Philadelphia Bar Association groups support the Commission's recommendation and urge that the Committee report favorably on the bill. In support of the bill, we offer three points.

° The imposition of any tax on transfers to a surviving spouse is bad tax policy.

° Pennsylvania stands alone by imposing the harshest widow's tax of any jurisdiction -- state or federal -- in the nation.

° House Bill No. 921 provides an appropriate remedy and workable solution to the problem.

I. Pennsylvania Tax Treatment of
Surviving Spouses Is Bad Tax Policy

Pennsylvania's death tax on surviving spouses is bad tax policy, for two fundamental reasons.

First, a death tax on a surviving spouse runs contrary to the principle -- now almost universally accepted -- that a husband and wife should be treated for tax purposes as one economic unit. For many years, the Internal Revenue Code for federal income tax purposes has treated a husband and wife as a single economic unit, and the Code for federal estate and gift tax purposes recently has adopted the same view. In Pennsylvania, neither of the other two transfer-type taxes -- the Realty Transfer Tax and the Sales and Use Tax -- is imposed on a gratuitous inter-spousal transfer. Furthermore, our new Divorce Code treats most assets as marital property to which both spouses have some claim, regardless of how title is held. All of these statutes reflect a common judgment: A husband and wife are a partnership; technicalities of title should not prevail over economic reality; and therefore it is inappropriate for the government to levy a toll on property which is transferred within the partnership. The same rationale applies to transfers at death.

Second, a tax on marital transfers does not further the often-stated social purpose of a death tax. A death tax is frequently justified as a check on the unrestricted

perpetuation of wealth from generation to generation in our society. This purpose is not furthered in the slightest by taxing transfers between spouses. There is no inter-generational transfer in leaving property to a surviving spouse.

Pennsylvania does not tax property jointly owned by a husband and wife. However, the exclusion is not an adequate substitute for an exemption for interspousal transfers. There are a number of important family and financial reasons why spouses may not want property titled jointly. For example, in farm communities, a farm and farm equipment are often passed from father to son with the wife receiving only a life interest in trust. The farm and farm equipment may also be titled in a husband's name for ease in arranging financing. Similarly, ownership interests in a small business are often held in one spouse's name. An automobile is usually titled in only one name to avoid potential vicarious liability attaching to an innocent spouse.

Requiring Pennsylvania property to be titled jointly may frustrate the use by Pennsylvania citizens of estate and gift tax advantages available under federal law. Federal tax law gives every person a lifetime transfer exemption of about \$600,000. If a spouse must title property jointly to avoid Pennsylvania's widow's tax, the exemption is effectively lost for one of the two spouses. Moreover, jointly-held property is not eligible under federal law for a full step-up in basis at the death of the first spouse, thus risking the imposition

on the surviving spouse of an unnecessary capital gains tax in the future.

Perhaps most important, separately held property may be essential to achieve laudable family objectives. Today, it is not unusual for an individual to remarry, perhaps later in life after the death of a first spouse, or perhaps after a divorce. The result may be a family in which the remarried individual has children from the first marriage, children from the second marriage, and step-children. Often, such an individual desires both to provide for the lifetime needs of the second spouse and to ensure that all of his or her children share in the remainder of the estate, including children from a first marriage. These objectives cannot be achieved if property is titled jointly. There is no good reason why Pennsylvania should impose a tax penalty on pursuing such natural, common sense family objectives.

II. Pennsylvania Has the Harshest Widow's Tax in the Nation

Pennsylvania imposes on surviving spouses the worst death tax treatment of any jurisdiction -- state or federal -- in the United States. The uniquely harsh treatment suggests that something is wrong with Pennsylvania's tax policy.

Until 1981, Pennsylvania was not out of step with the rest of the country. Before then, transfers to a surviving spouse were only partially exempt from federal estate tax and

from the death taxes of most states. However, in 1981 Congress enacted an unlimited federal estate tax deduction for transfers to a surviving spouse. Since then, almost all states have amended their death tax laws to exempt interspousal transfers. As a result, Pennsylvania is now one of only four states -- and will shortly be one of three states -- to impose a death tax on a transfer to a surviving spouse.

Furthermore, the tax imposed on such transfers by Pennsylvania is significantly higher than that imposed by any other state. For example, if a decedent leaves his \$100,000 estate to his spouse, Pennsylvania is the only state to impose a tax -- \$6,000. Or, if a decedent leaves his \$500,000 estate to his spouse, 47 states impose no tax, one state imposes a tax of approximately \$4,000, another state imposes a tax of \$18,500, but Pennsylvania imposes a tax of \$30,000. (A comprehensive survey of the death tax treatment of all the states is attached to the testimony by the Joint State Government Commission.)

The imposition of the Widow's Tax in Pennsylvania often produces harsh results in particular cases. One such result is described by Neil Hendershot, Esquire, a distinguished Harrisburg lawyer, in his recent letter to the Chairman of this Committee, a copy of which is attached to this testimony.

In short, Pennsylvania is unique in its tax treatment of surviving spouses, clinging to a view of death taxation abandoned by the federal government, by almost every other

state, and indeed by our own Commonwealth with respect to other taxes and our Divorce Code. Many other states have considered and accepted the same arguments advanced here for eliminating a tax on transfers to spouses. Pennsylvania should do the same.

III. House Bill No. 921 Provides an
Appropriate and Workable Solution

House Bill No. 921 will solve the problem of the widow's tax by excluding from tax transfers of property to, or for the use of, a husband or wife of a decedent. A family farm owned by a deceased husband, retirement assets owned by an elderly decedent, and the corner pharmacy or stock in a small family business corporation -- all will pass free of Pennsylvania Inheritance Tax to a surviving spouse. Thus the double-taxation of the present law will be corrected; under current law, if assets are left by husband to wife, and then by wife to children, two 6% taxes are collected, at a combined rate of 12%.

For a variety of reasons, a person may leave assets in trust for a surviving spouse. In that case, the assets funding the trust will not be taxed upon the first spouse's death. Rather, they will be taxed at the death of the second spouse as though they belonged to the second spouse. (Obviously, if the assets have by then appreciated in value, the tax revenues will be correspondingly greater.)

If property is left in trust for the concurrent benefit of a surviving spouse and other beneficiaries -- for example, to be distributed among the surviving spouse and children -- a tax will be imposed at the death of the first spouse, as it is now. But in valuing the trust, the portion benefitting the surviving spouse will be excluded under the compromise procedures currently in the statute. In order to avoid a problem posed by a recent court decision, if a spouse in such circumstances has a right to withdraw principal from the trust, the withdrawal right will be ignored in valuing the excluded portion of the trust.

IV. Conclusion

The proposal to eliminate the widow's tax is made by the Joint State Government Commission, one of the most widely respected, bipartisan arms of the Pennsylvania General Assembly. The proposal is supported not only by the Commission, but by numerous interested groups and citizens.

The General Assembly has sound reasons to adopt the Commission's proposal. An exemption for transfers to a surviving spouse will bring Pennsylvania's death tax into line with the rest of the country and with the virtually universally accepted view that a husband and wife are a single economic unit. The exemption will remove an unacceptable burden from farmers, small business people, and persons of modest means, and will remove an incentive for elderly

taxpayers to leave the state. In particular, it will eliminate the harsh death tax treatment given to widows, unique to Pennsylvania among taxing jurisdictions.

Therefore, the Commission's proposal should be adopted and enacted into law.



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September 20, 1989

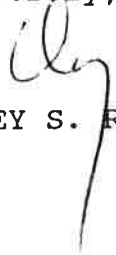
Joseph C. Bright, Jr., Esquire
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Re: Elimination of Pennsylvania Inheritance Tax
on Transfer to Surviving Spouse/House Bill 921
and Senate Bill 776

Dear Joe:

This letter will serve to confirm to you in writing that at a meeting of the Council of our Section which took place in Harrisburg on Friday, September 8, 1989, the Council unanimously approved a resolution supporting the passage of Senate Bill 776 and House Bill 921.

Sincerely,


MOREY S. ROSENBLUM

MSR:sey

cc: Robert Jackson, Esquire
Sanford Rosenbloom, Esquire



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October 19, 1989

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Re: Exemption from Pennsylvania Inheritance
Tax for Spousal Transfers
Senate Bill 776 and House Bill 921

Dear Joe:

At its May Executive Committee meeting the Section on Probate and Trust Law of the Philadelphia Bar Association unanimously endorsed the Bills referenced above which provide for an exemption from Pennsylvania Inheritance Tax for spousal transfers.

In June, the Board of Governors of the Philadelphia Bar unanimously adopted Resolutions proposed by our Section supporting these Bills. Our Section has long advocated this exemption which would bring Pennsylvania into the mainstream with so many states which no longer burden a surviving spouse with payment of Inheritance Tax.

Sincerely,

EUGENE H. GILLIN

EHG:pd
enclosures

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October 20, 1989

Representative Frederick A. Trello
Room 36-E East Wing
Main Capitol Building
Harrisburg, PA 17120

Re: House Bill No. 921

Dear Mr. Trello:

I am a practicing attorney who is interested in House Bill No. 921. My practice in Central Pennsylvania largely involves estate planning and estate administration. In this capacity, over the years, I have worked with many estates subject to the Pennsylvania Inheritance Tax. I understand that House Bill No. 921 will be the subject of hearings by the House Finance Committee on October 26, 1989; and I would like to comment upon it generally.

Personally, as a lawyer and also as a citizen of Pennsylvania, I support passage of this Bill. My professional reasons for this support derive from the position of the Pennsylvania Bar Association, Section on Real Property, Probate and Trust Law, which is set forth in the most recent issue of the Fall, 1989 issue of the Section's Newsletter. I am aware of the PBA's position, since I have served as Editor of that Newsletter for the past six years, and now serve as a member of that Section's governing Council.

However, I also have personal reasons for supporting this Bill. I believe very strongly in the unity of marriage in every way -- emotionally, legally, and financially. I have never understood why Pennsylvania exacts what I consider a penalty when one spouse dies leaving assets in the sole name to the surviving spouse. The philosophy nationwide has turned from that concept, and is now embodied in the unlimited marital deduction permitted by the Federal Estate and Gift Tax system. Not only does Pennsylvania's adverse philosophy force a married couple to compromise their financial and estate planning, but it also becomes a trap for the unwary or unsophisticated.

Representative Frederick A. Trello
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I want to give you one example of the hardship created by this law. I represented a surviving spouse, who served as Executrix and sole beneficiary of her husband's estate. The decedent was an active state policeman who, in the early 1970's purchased a home while unmarried. The marriage to his wife in 1977 was a first for both, and they were lucky enough to have a son in 1985. However, he died suddenly in his sleep at the age of 48, leaving his wife, who was at least 10 years younger than him, alone with their son aged 2-1/2.

The husband left a will, which gave everything to his spouse. The assets of the Estate included the husband's house, where the family lived. He had never retitled the house since the marriage. Probably he never thought about it, or perhaps he thought that his will took care of the situation entirely.

Indeed, his will effectively transferred ownership of the house to his wife. The house was most important to her, since she suffers from a severe case of progressively degenerate muscular sclerosis, which has rendered her unable to work. The shock that awaited her in the administration of his estate was the applicability of the 6% Pennsylvania Inheritance Tax to the value of the house bequeathed to her.

During the administration of the estate, the house was valued, and tax at the rate of 6% was paid, for a tax liability of \$6,000 arising strictly because the house was titled in his name alone, although given to the spouse. This was a substantial burden. The wife, with her progressive disease, was unable to work. The child was young and demanded much care in his raising. That \$6,000 was sorely missed by the surviving spouse.

I have remembered this situation as a particularly sad case resulting from Pennsylvania's insensitive application of an inheritance tax to property passing to a surviving spouse. Personally, I hope that I will not encounter many such situations in the future. Your Committee can help my wish become a reality by approving House Bill No. 921.

Very truly yours,



Neil Hendershot

Representative Frederick A. Trello
October 20, 1989
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