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# The California Inheritance and Gift Tax Before and After AB 2092 (Dedder) Chapter 634, Statutes of 1980

Assembly Revenue and Taxation Committee

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# THE CALIFORNIA INHERITANCE AND GIFT TAX

BEFORE AND AFTER

AB 2092 (DEDDEH)

CHAPTER 634, STATUTES OF 1980



SEPTEMBER 25, 1980

PREPARED BY

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TO THE

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# CALIFORNIA'S INHERITANCE AND GIFT TAX

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## CALIFORNIA'S INHERITANCE AND GIFT TAX

### PREFACE

In October 1979, this Committee released a report entitled "California's Inheritance Tax", as background material for special hearings on the need for reform and reduction of the inheritance tax.

Since that time, the Legislature has enacted and the Governor has signed Assembly Bill 2092, which exempts spouses from tax, expands exemptions for other beneficiaries, and makes a number of other changes relative to valuation, payment and administration.

With these recent changes due to take effect January 1, 1981, it is appropriate to update the previous report to present the inheritance and gift taxes as they apply to transfers both before and after that date. This updated report presents an overview of the tax, and a discussion of how the tax operates, with comparisons to federal law.

This report was prepared by Bob Leland, staff consultant to the Committee. The assistance of Myron Siedorf and Roy Gill of the State Controller's Inheritance and Gift Tax Division is gratefully acknowledged.

# CALIFORNIA'S INHERITANCE AND GIFT TAX

## GLOSSARY OF TERMS

The following is a glossary of basic inheritance tax terminology.

Beneficiary. A person who receives property from the estate of the decedent; the transferee.

Clear Market Value. Net value of the estate after subtracting deductions and exclusions.

Community property. Generally, all property acquired by a husband and wife during marriage, other than by gift or inheritance, while residents of California.

Corpus. The principal of an estate, as opposed to subsequent income or interest.

Decedent. The person who died and left the estate; the transferor.

Deductions. A reduction in the market value of an estate. Includes debts of decedent, expenses of last illness and funeral, taxes, and costs of administration. (For more detail see page 18.)

Donee. Recipient of an inter vivos transfer; the transferee.

Donor. Grantor of an inter vivos transfer; the transferor.

Estate. The net of assets and liabilities left by a person at death; may include property which is real or personal, tangible or intangible.

Exclusions. Represents reductions in the value of property subject to tax. Exclusions act to entirely exclude from inheritance tax certain types of transfers that would have been taxed otherwise in the highest tax brackets. Exclusions provided by law are the marital exclusion, insurance exclusion, charitable exemption, intangibles exemption, war risk insurance exemption, armed services exemption, and pension exemption. (For more detail, see pages 15-17.)

Exemptions. Exemptions enter into the actual computation of inheritance tax and have the effect of exhausting part of the lowest tax brackets. Tax is computed on the value of property in excess of exemptions at the same rate that would have been applicable had the exemptions not been allowed. The specific exemption is the only true exemption. (For more detail, see pages 18-21.)

Inter vivos transfers. Transfers made during lifetime.

Joint tenancy. An interest in property owned by two or more persons in equal share, title to which was created by a single document which expressly declared the interest to be joint tenancy. The main characteristic of joint tenancy is the "right of survivorship" which means that at the death of a joint tenant his or her interest passes to the surviving joint tenant or tenants equally and is not subject to probate.

Life estate. An interest or estate in property, the duration of which is measured by the life of one or more designated persons according to standard life expectancy tables. The older the person, the smaller the value of the life estate, and vice versa. A life estate may be created in real or personal property by either an inter vivos or testamentary transfer.

Pick-up Tax. An additional tax levied by the state against an estate which pays less inheritance tax than the maximum amount allowable as a credit against the federal estate tax by the federal estate tax law for death taxes paid to a state. The pick-up tax is in the amount of the difference between the state inheritance tax due and the federal "maximum state death tax credit". (For more detail, see pages 23-25.)

Power of appointment. A power or authority given to a donee to dispose of property, or an interest therein, which is vested in a person other than the donee of the power. A power may be either "general" or "limited" in nature. (For more detail, see pages 14-15 and 19.)

Probate. The legal process before the appropriate judicial authority of determining questions on issues arising in matters concerning the administration of estates of decedents dying either with or without wills.

Quasi-community property. Property acquired by husband and wife during their marriage while residing outside California which would have been community property if acquired in California.

Remainder. The amount of estate that remains after the value of the life estate is computed, i.e., corpus minus life estate equals remainder. The younger the person to which the life estate accrues, the smaller the remainder, and vice versa.

Remaindermen. The beneficiaries to which the remainder of an estate accrues.

Separate property. Property belonging to one spouse acquired prior to marriage or acquired by gift or inheritance during marriage.

Specific exemption. The exemption to which each transferee is entitled with respect to all property received by him or her from the decedent. The specific exemption allowed is that in effect at the time of the decedent's death, depending on the transferee's relationship to the decedent.

Survivor's contribution. Amount of surviving joint tenant's contribution to joint tenancy property which is excluded from tax. The survivor's contribution is deducted from the gross value of the joint tenancy property in determining the net amount taxable to the survivor.

Testamentary Transfer. Transfers effected by a will upon the death of a person.



# CALIFORNIA'S INHERITANCE AND GIFT TAX

## AN OVERVIEW

Of the two basic forms of "death tax", California levies the inheritance tax. An inheritance tax is a tax upon the right to receive or inherit property, and is measured by the market value of the transferred property. However, rather than apply a tax on the total value of the estate, as with an estate tax, the inheritance tax is measured by the share of the decedent's estate which passes to each beneficiary, and the rates and exemptions vary according to the relationship of the beneficiary to the decedent.

The complement to either form of death tax is the gift tax, which applies to lifetime transfers. Without a gift tax, a death tax might be legally avoided altogether simply by having an estate turned over to the beneficiaries via lifetime transfers prior to death.

### Rationale for the Tax

There are four principal reasons historically cited as the rationale for death taxes.

- Anti-Concentration of Wealth. Many of the largest fortunes are composed primarily of inherited wealth, some of which has been passed on for several generations. Progressive rates under a death tax provides a means for "leveling" wealth, and achieving a certain effect of redistribution.
- Taxation of "Windfall" Receipts. Recipients of windfalls are perceived to have more ability to pay a tax than other persons who receive payments of a regular or recurring nature. The one-time and often "surprise" aspects of inheritances lead to this notion of a "windfall".
- Periodic Tax on Capital. The inheritance tax provides for a once-in-a-generation tax on family wealth. In this it acts as a substitute for a "net wealth tax" on the living (which many foreign countries have turned to, but which is precluded in the U.S. by the constitutional prohibition on unapportioned direct federal taxes).
- Minimizing of Economic Effects. It has been argued that there are fewer adverse effects on savings and investment to raising a given amount of revenue by a death tax, as opposed to raising it from the

living by the income tax. Use of a death tax results in a more balanced revenue system, as opposed to increasing another existing tax (sales, income, corporate, excises) by a comparable amount.

An inheritance tax takes into account the circumstances of the recipient, rather than those of the decedent, which is opposite to that of an estate tax. Under the inheritance tax those beneficiaries closest in kin to the decedent pay the least amount in death taxes. This is consistent with a long policy tradition of "family protection" in California death taxation.

Inheritance taxation also treats two similar beneficiaries, each of whom receives an identical inheritance, in the same way, while under an estate tax, similar beneficiaries' tax burden would vary based on the size of the overall estate from which their inheritance was derived.

Finally, the inheritance tax goes farther in promoting redistribution of wealth. By not taxing small inheritances (regardless of the size of the estate itself), the inheritance tax favors the breaking up of estates into smaller pieces than does the federal estate tax which, except for spouses and orphans, does not consider who inherits the estate or how much they inherit.

#### Evolution of the Law

California first levied the inheritance tax in 1893, and the gift tax in 1939. A detailed history of the evolution of both taxes may be found in Chapter 2.5 of Title 18 of the California Administrative Code (pages 657-669, and 700.151-700.155). Major law changes in recent years have been as follows:

- In 1975, under AB 343 (Kapiloff), Chapter 942, the deceased spouse's one-half interest in community property passing to the surviving spouse subject to tax for the first time since 1961.\* Prior to January 1, 1976, such community property was exempt from tax, but thereafter, there was no distinction made between community, quasi-community and separate property for inheritance tax purposes. As a trade-off, the specific exemption for spouses was raised from \$5,000 to \$60,000.
- In 1977, AB 302 (Assembly Revenue and Taxation Committee), Chapter 1079, brought conformity to three of the major tax policy changes of the 1976

\*Prior to 1961, where the husband was the decedent, his one-half interest in community property was taxable to the surviving wife, and the surviving wife had a \$24,000 exemption. Community property passing to a surviving husband, however, was not subject to the tax.

Federal Tax Reform Act: the "unified" inheritance and gift tax base, carryover basis at death, and the generation-skipping transfer tax. (Two major changes not conformed to in AB 302 were adoption of a counterpart to the "federal minimum marital deduction", and the new "unified credit". Congress subsequently first delayed and then repealed, the carryover basis provisions, and California followed suit in 1980.) These changes took effect on September 26, 1977.

- In 1980, AB 2092 (Deddeh), Chapter 634, substantially reduced inheritance and gift taxes for all beneficiaries. Spouses were given a total exemption, and the exemptions to other beneficiaries were increased between 200 to 1,000 percent. Special use value provisions for farms and closely-held businesses were adopted in conformity to federal law, as were the 10 or 15 year deferred payment plans at reduced interest rates. Any taxpayer with reasonable cause was allowed to postpone payment for up to 10 years. The former prohibition on distributing estates before the tax is paid was repealed. These tax changes were made effective with respect to deaths and gifts occurring on or after January 1, 1981, and the various administrative changes apply to all open estates starting on that date.

#### State Fiscal Effect

Inheritance tax revenues have been growing rapidly in recent years (just over 300 percent in the last 10 years), primarily due to the rapid inflation since the mid-70's which has driven up incomes and the property values of the family home in particular, and which quickly eroded the benefit of existing exemption levels. Total inheritance and gift tax revenues are estimated to be approximately 2.8 percent of 1980-81 state general fund revenues.

Based on 1976-77 data, prior to AB 2092 California ranked first among the states in total inheritance and gift tax revenues, with a tax burden per \$1,000 personal income of 180 percent of the national average. If AB 2092, which reduces tax collections by about 27 percent, had been fully effective in that year, California would have ranked 12th, with a burden of 131 percent of the national average--see Table 4 on page 11. (Note: 100 percent = national average.) Appendix I shows the composition of estates--pre-AB 2092--as the result of a 1980 Department of Finance study of 1978-79 inheritance tax collections.

Table 1 below shows the actual and projected inheritance and gift tax revenues from 1970-71 to 1980-81, before AB 2092.

TABLE 1

INHERITANCE AND GIFT TAX COLLECTIONS 1970-71 TO 1980-81  
(in millions)

Fiscal Year	Inheritance Tax		Gift Tax	
	Revenue	%Change	Revenue	%Change
1970-71	\$173.8*	13.9%	\$12.1	7.8%
1971-72	200.4*	15.3	18.0+	48.7
1972-73	238.7*	19.1	21.5	19.0
1973-74	214.3	-10.2	16.6	-22.4
1974-75	226.7	5.8	15.4	- 7.0
1975-76	299.4#	32.1	16.5	6.3
1976-77	303.4	1.3	63.5**	385.5
1977-78	351.7	15.9	13.4	-78.9
1978-79	402.2	14.4	14.7	9.7
1979-80	475.9	18.3	16.0	8.8
1980-81	530.0"	11.4	17.0"	6.25

\* Effective December 8, 1971, new legislation accelerated the delinquency date for inheritance tax payments from two years after the date of death to nine months. In addition, the 5% discount provision for payment of inheritance tax within six months after the date of death was repealed.

+ Law amended, effective January 1, 1972, to require filing of quarterly gift tax returns rather than annual returns filed on or before April 15 of year following the year in which gifts were made.

# As of January 1, 1976, the interest rate for all delinquent inheritance taxes was increased from 6% to 12% per annum. This applied to prior delinquencies on which interest had been accruing at 6% as well as delinquencies occurring after that date. The extraordinarily large percentage increase in revenue from the prior year was due to accelerated payments resulting from the increase in the interest rate on delinquent tax.

\*\* Federal Tax Reform Act of 1976 made substantial changes in federal estate and gift tax laws, effective January 1, 1977, resulting in large volume of gifts, also subject to state gift tax, made prior to January 1, 1977. Thus, California benefited from taxpayer actions taken as a result of the federal law.

" Department of Finance estimates.

Source: State Controller

AB 2092 when fully effective will reduce inheritance tax revenues by about 27 percent below what they would otherwise have been. The effect on gift tax revenues is significant but unknown. Since the inheritance tax is not due until 9 months after the date of death, there is virtually no projected effect in the 6 months of 1980-81 during which AB 2092 will be in effect. Table 2 below shows the estimated revenue reduction by AB 2092 from the levels of collection which it is estimated would have occurred in the absence of AB 2092.

TABLE 2  
 INHERITANCE TAX REDUCTIONS BY AB 2092  
 (in millions)

	<u>1980-81</u>	<u>1981-82</u>	<u>1982-83</u>
Pre-AB 2092 Estimated Collections	\$530	\$610	\$700
AB 2092 Effect	<u>- 1</u>	<u>-117</u>	<u>-173</u>
Net Collections	\$529	\$493	\$527

Source: Department of Finance

The State Controller estimates a net on-going admin-istrative savings of over \$1 million annually due to elimination or transfer to the state of the various county treasurer functions.

Other States

Some form of death tax is levied in the District of Columbia and all states except Nevada, and has been since 1931. Death taxes constituted a high of 8.6 percent of all state tax collections in 1913, but was down to 1.6 percent in 1979. Total state death and gift tax collections were slightly more than \$1.8 billion in 1977-78.

As Table 3 shows, there are 31 inheritance taxes, and 8 estate taxes (Rhode Island is the only state to levy both an estate and inheritance tax). All but Nevada also levy a "pick-up tax", with this being the sole form of death tax in 12 states (for further explanation of the pick-up tax, see page 23 ). The gift tax is imposed in 13 states.

Nevada, the only state now with no death tax of any kind, is prohibited from even levying a pick-up tax by its Constitution. In 1979, however, the Nevada legislature approved a proposed amendment to the state constitution to authorize a pick-up tax. The Nevada constitution requires the amendment to be approved again by the 1981 legislature before being submitted to the electorate.

In the last four years, 6 states (Arizona, Colorado, North Dakota, Utah, Vermont and Virginia) repealed their inheritance or estate tax (all but Colorado were the estate form) and kept only a pick-up tax. Oregon switched from a combination estate-inheritance to an estate only, but that tax is scheduled to phase out by 1987 to a pick-up tax only. The states of Mississippi, South Dakota and West Virginia added pick-up taxes.

TABLE 3

STATE DEATH AND GIFT TAXES: 1980				
STATE	INHERITANCE	ESTATE	PICK-UP	GIFT
Alabama			X	
Alaska			X	
Arizona			X	
Arkansas			X	
California	X		X	X
Colorado			X	
Connecticut	X		X	
Delaware	X		X	X
Florida			X	
Georgia			X	
Hawaii	X		X	
Idaho	X		X	
Illinois	X		X	
Indiana	X		X	
Iowa	X		X	
Kansas	X		X	
Kentucky	X		X	
Louisiana	X		X	X
Maine	X		X	
Maryland	X		X	
Massachusetts		X	X	
Michigan	X		X	
Minnesota	X		X	X
Mississippi		X	X	
Missouri	X		X	
Montana	X		X	
Nebraska	X		X	
Nevada				
New Hampshire	X		X	
New Jersey	X		X	
New Mexico			X	
New York		X	X	X
North Carolina	X		X	X
North Dakota			X	
Ohio		X	X	
Oklahoma		X <sub>1/</sub>	X	X <sub>1/</sub>
Oregon		X <sub>1/</sub>	X	X <sub>1/</sub>
Pennsylvania	X		X	
Rhode Island	X	X	X	X
South Carolina		X	X	X
South Dakota	X		X	
Tennessee	X		X	X
Texas	X		X	
Utah			X	
Vermont			X	
Virginia			X	
Washington	X		X	X
West Virginia	X		X	
Wisconsin	X		X	X
Wyoming	X		X	
D.C.	X		X	

1/ Oregon: The estate and gift tax will be phased out by 1987.

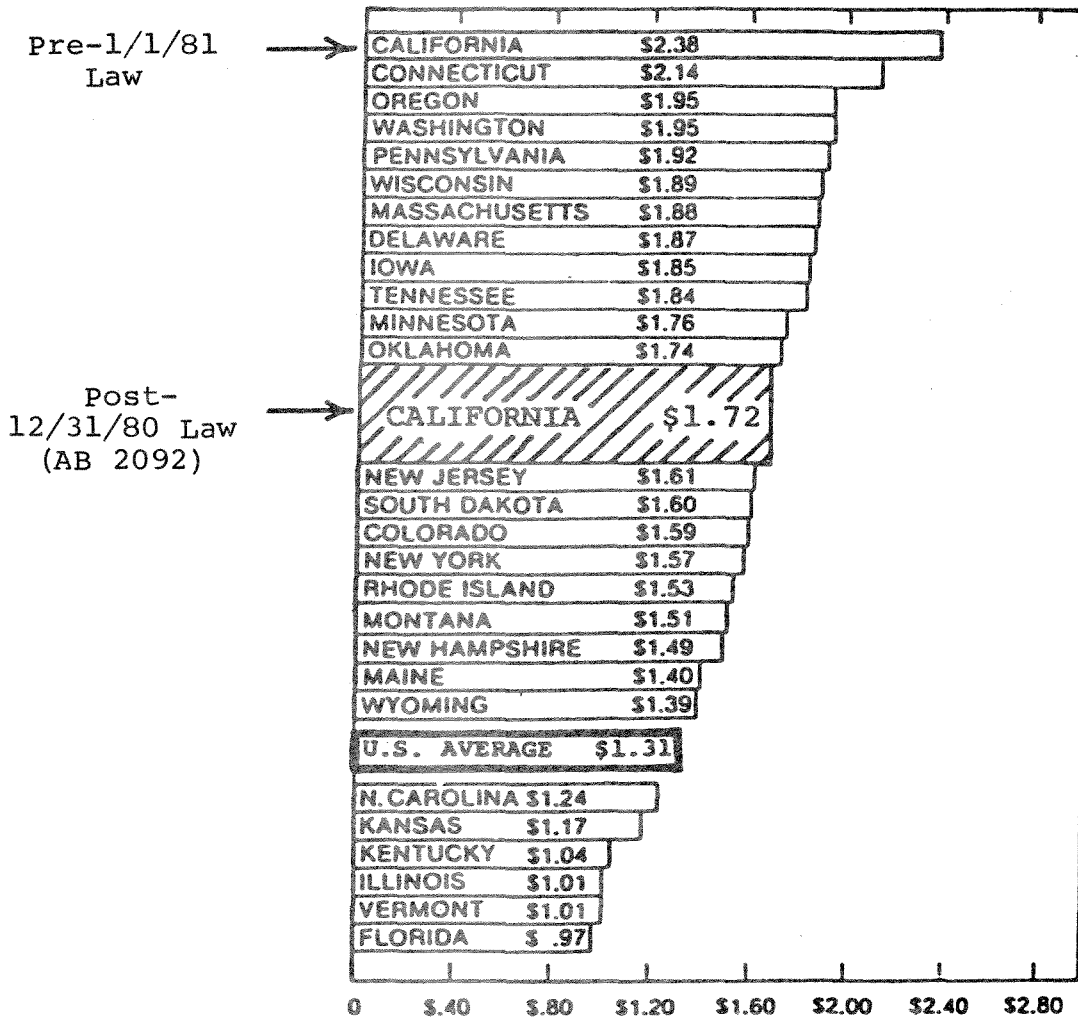
Source: Federation of Tax Administrators,  
Tax Administrators News, June 1980

TABLE 4

REVENUE OF STATE AND LOCAL GOVERNMENT  
FROM DEATH AND GIFT TAXES  
PER \$1,000 OF PERSONAL INCOME  
FISCAL YEAR 1976-1977

MODIFIED TO REFLECT 27% REVENUE REDUCTION FOR CALIFORNIA

IF AB 2092 HAD BEEN FULLY EFFECTIVE IN 1976-77



Source: original chart from California Tax Study,  
Conrad Jamison, Security Pacific Bank

## CALIFORNIA'S INHERITANCE AND GIFT TAX

### COMPUTATION AND ADMINISTRATION

#### Basic Steps

There are basically 4 steps to computing the inheritance tax for a given beneficiary:

1. Determine the "market value" of (a) all transfers to the beneficiary which are subject to the inheritance tax plus (b) the date-of-gift value of all net lifetime gifts not otherwise subject to the inheritance tax made after 1976 by the decedent to that beneficiary.
2. Subtract allowable deductions, to obtain "clear market value".
3. Apply a "tentative tax" from the appropriate rate schedule (depending on the class of beneficiary) to the "clear market value" less applicable exemptions.
4. Subtract from this tentative tax the aggregate amount of gift tax previously paid with respect to gifts made by the decedent during his or her lifetime and after 1976 to that beneficiary. The difference is the amount of inheritance tax due.

The various aspects of the inheritance tax are outlined in greater detail below, and a sample computation is shown on pages 21-22.

#### Unified Tax Base

Both the federal estate tax and the California inheritance tax provide for a "unified" estate tax (in the case of federal law) or inheritance tax (in the case of California law) and gift tax. With unification under California law, gifts made by the decedent after 1976 during his or her lifetime are aggregated with transfers subject to the inheritance tax for the purpose of determining the tax rates that shall apply to the transfers subject to the inheritance tax. The lifetime gifts do not, themselves, generate an inheritance tax. They do, however, consume the exemption (credit, under federal law) and the lower tax brackets. The net effect is to place transfers subject to the inheritance tax in a higher tax rate bracket in those cases where the decedent, during lifetime after 1976, made gifts subject to gift tax.



Only those donees who receive both lifetime gifts subject to gift tax and death transfers subject to inheritance tax experience the higher tax rates resulting from a unified tax base, since the tax is computed separately for each beneficiary under the inheritance tax. If a particular beneficiary of a death transfer did not receive any lifetime gifts, there is nothing to aggregate in the inheritance tax computation as to that beneficiary.

Under prior state and federal law, by making most kinds of lifetime gifts, a transferor could take advantage of both the gift tax exemptions and primary rates, and the inheritance tax exemptions and primary rates, thereby minimizing the total tax on the transfers of property to a beneficiary.

### Property and Transfers Subject to Tax

The gross estate includes all of the property in which the decedent has ownership. In addition to the obvious things such as money, securities, real estate, personal and business assets and so forth which passes by will or laws of succession, the gross estate includes property in which the decedent has a joint ownership interest, such as transferred property where the decedent has retained a life estate or a reversionary interest, or property in which the decedent has retained certain powers of appointment. Joint tenancy property, although it avoids probate, is subject to inheritance tax, except for the amount of the surviving joint tenant's contribution to the property.

Property subject to tax is dependent upon the residence of the decedent. Generally, all real and tangible personal property located in California is subject to our inheritance tax; real and tangible personal property located outside the state is not subject to the tax. Treatment of intangible property (stocks, bank accounts, etc.) varies depending on residence.

Generally, only property transferred at death is subject to the inheritance tax, however, certain lifetime transfers are included which serve the same purpose as a transfer at death. These transfers are:

- Transfers "in contemplation of death" (federal law dropped the contemplation of death requirement in 1976, and instead automatically subjected all gifts made within three years of death to the federal estate tax).
- Transfers with a reservation of life income or interest, transfers with reservation of the power to revoke or control, and "advancement" transfers (where the heir receives the gift in lieu of his share of the decedent's estate).

- The gift or exercise of a "power of appointment".

Powers of Appointment. A general power of appointment is a power which may be exercised in favor of the person holding the power, his estate, his creditors, or the creditors of his estate. The person holding a general power of appointment over property has rights in the property which are equivalent to absolute ownership. A general power of appointment held at death is subject to the tax.

A limited power of appointment is a power to appoint the property to one or more of a stated class of persons (usually one or more of the children and/or grandchildren) which does not include the holder of the power. That is, the person possessing a limited power of appointment may not appoint the property subject to the power to himself, his estate, his creditors, or the creditors of his estate. The power normally lasts until the person granted the power dies. A limited power is usually associated with a trust instrument (often called "A-B" trusts\*) in which the surviving spouse is given a general power of appointment or a power of revocation over the A trust and a life estate, plus a limited power of appointment over the B trust (remainder). Unlike a general power, a limited power of appointment is not subject to the tax upon the death of the donee of the power.

Under AB 2092, all inheritances by a spouse are exempted from tax except the gift of a limited power of appointment. If it were not for this exception, the property subject to a limited power would not be subject to tax on the death of the first spouse to die; and it would not be subject to tax upon the death of the donee spouse possessing the limited power. It would therefore pass through the estates of both spouses without tax. Thus, the exception for the limited power of appointment was placed in AB 2092 to prevent this "loophole" from occurring.

Under AB 2092, a surviving spouse will be taxed upon receiving a power to appoint to any one or more of a class of potential beneficiaries (typically, children and/or grandchildren) excluding the spouse. However, it should

\*Normally, the A trust is composed of the survivors's one-half interest in the community property and/or that portion of the decedent's estate which qualifies for the federal marital deduction. The survivor is given a life estate and general power of appointment, or power of revocation, over the A part, in order to qualify the A part for the federal marital deduction (i.e., avoid the terminable interest limitation on the federal marital deduction). The beneficiaries of the B part may either be designated outright, or a limited power may be used.

be noted that by reason of a provision of the Revenue and Taxation Code (Section 14124) although the tax is computed as if the property subject to the limited power was going to the surviving spouse, the spouse is not personally liable for the tax and the tax is to be paid from the corpus of the trust.

As previously noted, normally when a spouse is given a limited power of appointment the spouse is also given a life estate in the property subject to the power. The value of the life estate (as determined by standard life tables and present value computations at 6 percent interest) will be excluded under AB 2092, and only the remainder interest over which the surviving spouse has a limited power of appointment will be subject to inheritance tax. Under pre-AB 2092 law, both the life estate and limited power were taxable to the spouse, after the marital exclusion and \$60,000 specific exemption. (For further information on this issue, see "Exemptions" section on page 18.)

### Exclusions

There are seven exclusions from inheritance tax. Although 6 of them are actually called "exemptions" in the statutes, they are treated as exclusions for purposes of this report because all have the same tax effect. All seven provisions have in common the effect of reducing the amount taxable in the highest rate bracket by diminishing the amount of the property subject to tax.

Insurance. Life or accident insurance payable to named beneficiaries is excluded from tax to the extent of \$50,000, but if the insurance proceeds are left to the estate as a whole rather than an individual, then it is all taxable. There is no comparable Federal provision. The \$50,000 limit applies whether there are one or more policies; and if there are more than one beneficiary, the \$50,000 is prorated among them in proportion to the amount of insurance payable to each.

Charitable. State law exempts from tax transfers to government agencies or non-profit groups operated solely for religious, charitable, scientific, literary or educational purposes. The charitable group may be one created in the decedent's will.

Intangibles. Intangible personal property of a decedent residing at the time of his death in a territory or another state of the United States is exempt from the inheritance tax.

War Risk Insurance. California law exempts all proceeds of any Federal war risk insurance policy of a veteran of World War I or World War II payable to the estate of the veteran.

Armed Services. There is an exemption applicable to transferees who are dependents of servicemen who die as a result of service-connected disease or injury suffered in U.S. military service in World War II or the Vietnam War.

Public Pensions. Death benefit payments and return of employees' contributions made under a public pension or retirement system to a named beneficiary or to the estate of a deceased employee are not subject to tax. There is no comparable Federal provision. (Federal law provides an exemption for retirement benefits, including annuities, under certain types of private qualified retirement plans for employees and self-employed individuals.)

Marital Exclusion. For decedents dying before January 1, 1981, property in an amount equal to one-half the value of the total estate is excluded if transferred to a spouse.\* For example, assume a \$1 million estate with \$500,000 going to the spouse and \$500,000 going to other beneficiaries. In such a case the exclusion is the full amount received by the spouse (one-half of the total estate) and not one-half of the amount which the spouse receives (i.e., \$250,000).

As noted previously, AB 2092 provides that for decedents dying on or after January 1, 1981, no property transferred to the spouse of the decedent is subject to tax, except that the value of any property of the decedent over which the spouse has a "limited power of appointment" does remain subject to tax. This is in effect a 100 percent marital exclusion.

(Federal law provides an alternative approach to treatment of spouses, called a "marital deduction", which attempts to equalize the federal estate tax treatment of residents of community property states and non-community property states. In general, the principle of the deduction is that the greater of \$250,000 or one-half of the "adjusted gross estate" is exempt from taxation to the extent that it is transferred to the surviving spouse. If no property is transferred to the surviving spouse, there is no marital deduction.)

(In a community property state such as California, however, the "adjusted gross estate" for purposes of federal tax is basically the normal adjusted gross estate, minus the decedent's community property interests. A minimum exemption is still allowed, but not the entire \$250,000, as this minimum is also reduced by the decedent's share of the community property.)

\*Prior to 1976, community property inherited by the spouse was excluded from tax, as was one-half of any quasi-community property, while property up to one-half the value of separate property was exempt. The exemption came off the lower tax rate brackets while the exclusion came off the top.

(The result of this reduction is that total community property estates of \$250,000 or less transferred to a spouse will be completely exempt from the federal estate tax (\$125,000, or one-half of the community property, is excluded, while the remaining \$125,000 is exempted by the marital deduction, which is \$250,000 minus the decedent's one-half share of community property in the amount of \$125,000). Total community property estates up to \$500,000 will receive some declining benefit (the \$250,000 "minimum" minus the one-half community property of \$250,000 equals zero, so there is no marital deduction benefit for community property estates, above the one-half share of community property, at this level).)

### Valuation of Property

Generally, the value of property for inheritance tax purposes is its fair market value at date of death. Valuation is made by an inheritance tax referee appointed by the court (see later section on Administration of the Tax).

The market value is the price that a willing buyer would pay to a willing seller of property, neither being under any compulsion to buy or sell. For valuation of real property, recognized appraisal methods are used taking into consideration all relevant facts and circumstances acceptable. Assessed value for ad valorem taxation purposes is not normally regarded as reliable evidence of market value, especially after Proposition 13, where value standards other than fair market value (acquisition value, base year value) are employed.

The valuation date is the date of the transferor's death, regardless of whether the transfer was made during life or at death. (California law has no counterpart to that provided in Federal law for an optional or alternative valuation date of six months after death.)

The regulations for determination of market value are generally the same for both state and federal law. However, certain disparities in the rules, as well as judgmental differences in making value determinations, may result in different California and federal values for the same item of property.

Starting with estates of decedents dying on or after January 1, 1981, California will allow "special use valuation" of real estate devoted to farming or a closely-held business, in conformity with federal law. This allows the estate to elect valuation based on current use of the property rather than fair market value ("highest and best use"), provided the value of the family farm or business is at least 50% of the estate, passes to a qualified heir and was used as the farm or business during five of the last eight years prior to death. The special use valuation cannot reduce the taxable value of the estate by more than \$500,000. If the heir who receives the real property transfers it to

nonfamily members or converts it to nonqualified use during the 15 years following the death, there is a recapture of the tax.

### Deductions

The inheritance tax is based on the "clear market value" of the property, which is market value less various deductions.

A deduction may not be taken unless the debt, obligation, or expense actually reduces the amount of the inheritance or transfer. It is not necessary that the amount to be deducted be physically paid at the time of deduction, but it must be an obligation of the decedent or his estate, and subsequently paid by the estate or the transferee. State tax deductions generally conform closely to Federal law, and are as follows:

- (1) bona fide, legally enforceable debts of the decedent;
- (2) reasonable expenses of funeral (given station in life of decedent and community custom) and of the decedent's last illness if unpaid at death;
- (3) state and local taxes which at date of death are a lien on property inherited;
- (4) expenses of administering the estate, including that of attorney's fees, executor or administrator commission, and the inheritance tax referee fees.
- (5) casualty losses to property which occur after decedent's death and before either the date of order fixing the tax, or a year after death, whichever is earlier.

### Exemptions

Exemptions are distinguished from deductions in that they are a part of the tax computation itself. The statutes provide that exemptions have the effect of exhausting a part of the lower tax brackets, thus throwing the balance of the property's clear market value into higher brackets. They differ from exclusions, which come off the top brackets first. There is only one true "exemption", and that is the specific exemption.

(The statutes refer to special treatment accorded charities, intangible property and others as "exemptions", but since they have a tax effect of exclusions, these provisions were addressed in that earlier section.)

Specific Exemptions. There are three different "classes" of beneficiary, and each class has a "specific exemption". A description of each class and the exemption is shown Table 5. Note that AB 2092 increases the level of exemptions with respect to decedents dying on or after January 1, 1981; the lower exemptions continue to apply to tax computations arising from estates of decedents who die through December 31, 1980.

Since the specific exemption of \$60,000 for spouses no longer exists, there is no specific exemption applied toward amounts subject to a limited power of appointment (nor any marital exclusion of one-half of a separate property estate inherited by the spouse). There are four reasons for this:

- Any life income applying to a spouse from a trust is exempt from tax completely. While before the exemption was \$60,000, it is now unlimited with respect to any life estate or outright transfer. Only the remainder subject to a limited power, if any, is taxable.
- The tax on a limited power is deducted from the corpus of the estate (i.e., the entire estate), not from the spouse's share (life estate) alone. The impact on the spouse is thus limited to the extent that the entire estate upon which this life income is paid is reduced by the tax.
- The extent to which a spouse is affected is the same whether the trust uses a limited power or distributes the remainder directly to designated beneficiaries--the only distinction is whether the tax is computed on the basis of the spouse or the remaindermen, as the tax comes out of the corpus of the estate in any event. In fact, depending on the beneficiary class of the remaindermen involved, a tax based on the spouse (using the limited power) may be less than if no limited power is used.
- If the \$60,000 exemption was continued with respect to limited powers only, property could escape tax for two successive estates as illustrated by this simple example:

Assume a \$160,000 estate, with a \$100,000 life estate to the spouse and a \$60,000 remainder subject to limited power. With a \$60,000 exemption there would be no tax on the limited power upon the first transfer. Then, upon subsequent gift or death of the spouse, such property is exempt from tax again, this time by the nature of the limited power itself. It is this double escape from tax that the Legislature was seeking to avoid.

TABLE 5

CLASS OF BENEFICIARY		LEVEL OF SPECIFIC EXEMPTION	
		Estates thru 12/31/80	Estates after 12/31/80
A	Spouses	\$ 60,000	0*
	Minor Child (includes adopted)	12,000	\$ 40,000
	Adult Child (18 and over), Grandchild, Parent, Grandparent (by blood or adoption)		
	Mutually Acknowledged Child	5,000	20,000
	Decendent of Mutually Acknowledged Child		
	Orphan Under Age 18	5,000 <sup>+</sup>	10,000 <sup>+</sup>
B	Brother, Sister (excludes brothers or sisters-in-law)		
	Nephew or Niece (by blood or adoption)	2,000	10,000
	Wife or Widow of Son, Husband or Widower of Daughter		
C	Strangers in Blood		
	Relationships Not Specified Above (e.g., in-laws, aunt or uncle, cousins)	300	3,000

\* There is no longer any specific exemption for spouses, however, this has been replaced by a total exclusion for spouses, as described on pages 16 to 17.

<sup>+</sup> Through 12/31/80 the exemption is \$5,000 times the number of years the orphan is under the age of 21, for a range of \$20,000 if the orphan is 17 to \$105,000 if the orphan is newly born. Under AB 2092 the \$5,000 multiplier is doubled. (Federal law is still \$5,000, and applies to orphans under age 21, rather than 18, the age of majority in California.)



(In the area of exemptions, California law is at substantial variance from federal estate tax law. Federal law provides a single credit for each estate, the benefits of which are effectively prorated among the various beneficiaries. The 1976 Federal Tax Reform Act provided a 5 year phase-in to a level of credit which in 1981 will be equivalent to an exemption (in California terms) of \$175,625, as follows:

<u>Year of Death</u>	<u>Federal Credit</u>	<u>Equivalent Amount As an Exemption</u>
1977	\$30,000	\$120,667
1978	34,000	134,000
1979	38,000	147,333
1980	42,500	161,563
1981 and after	47,000	175,625

(Note that when combined with the \$250,000 federal marital deduction, the \$175,625 credit in 1981 means that a total estate of up to \$425,625 can pass to a spouse free from federal tax. There is, however, no limit under state law post-AB 2092 on the amount that can pass outright to a spouse, free of state tax.)

#### Tax Rates

There are three different sets of rates applicable to the three classes of beneficiary. These rates are graduated by taxable amount of inheritance, as follows:

TABLE 6

<u>Taxable Amount of Inheritance</u>	<u>Class of Beneficiary &amp; Rates</u>		
	<u>A</u>	<u>B</u>	<u>C</u>
\$ 0 to \$ 25,000	3%	6%	10%
25,000 to 50,000	4	10	14
50,000 to 100,000	6	12	16
100,000 to 200,000	8	14	18
200,000 to 300,000	10	16	20
300,000 to 400,000	12	18	22
over 400,000	14	20	24

Sample Computation. The following illustrates the process of determining the "tentative" and "final" tax. This example is not necessarily sound estate planning, but it does show all the various computation steps. For the sake of simplicity, assume a parent has assets valued at \$200,000 and wishes to leave all of the property to one adult child. This parent chooses to make a lifetime gift of \$100,000 in a single year (during 1981) and a subsequent bequest at death (during 1985) of the remaining \$100,000.

To simplify this illustration, normal inheritance tax deductions applicable are not included. The computations (which reflect the law under AB 2092) are as follows:

TABLE 7

<u>GIFT TAX</u>	
\$100,000	gross gift
<u>-3,000</u>	annual gift tax exemption
97,000	net taxable gift
<u>-20,000</u>	specific exemption
\$ 77,000	taxable amount, commencing at the primary or "bottom" rates (NOTE: \$3,000 annual exemption is subtracted off the "top" rate; the specific exemption is subtracted from the "bottom" rate)
3,970	Gift Tax, computed as follows: \$5,000 @ 3%; \$25,000 @ 4%; and \$47,000 @ 6%.
<u>INHERITANCE TAX</u>	
\$100,000	clear market value of bequest
<u>+97,000</u>	prior net gift
197,000	
<u>-20,000</u>	specific exemption
\$177,000	amount subject to "tentative tax" (NOTE: specific exemptions is subtracted from the "bottom" rate)
\$ 11,910	"Tentative Tax", computed as follows: \$5,000 @ 3%; \$25,000 @ 4%; \$50,000 @ 6%; and \$97,000 @ 8%.
<u>-3,970</u>	Tax on Prior Net Gift
\$ 7,940	<u>INHERITANCE TAX</u>

## Credits Against Inheritance Tax

There are two credits allowable against the inheritance tax as computed.

Gift Tax Credit. Under "unification" (see page 12 ), gifts made after 1976 are included in the inheritance tax computation with a deduction for the appropriate gift tax as previously illustrated. Certain gifts made before 1977 may also be subject to inheritance tax, in which case a credit is allowed against the inheritance tax for the gift tax paid on the includable gift.

Tax Paid on Prior Transfers. A credit is allowable where property is transferred to the decedent by a prior decedent, if the two deaths occur within 5 years, and if an inheritance tax was paid in the prior estate. Both the transferee and the "present" decedent must be (have been) Class A beneficiaries.

### "Pick-up" Tax

The Federal Estate Tax Law provides for a "maximum state death tax credit" to offset a theoretical amount of death taxes paid to any state levying an inheritance or estate tax. This credit is a function of the federal estate tax and bears little or no relationship to the amount of California inheritance tax actually charged beneficiaries. The formula used to compute this credit is shown in Table 8.

If this federal tax credit exceeds the actual sum of California inheritance tax payable by all beneficiaries to the state, an "additional tax", as it is termed in the statute, is assessed by the state against the estate as a whole in order to pick up the full amount of the credit allowable by the federal government. The amount of additional tax imposed is equal to the difference between the maximum allowable state death tax credit and the inheritance tax. If no normal inheritance tax is due, the amount of additional tax is equal to the amount of the maximum allowable state death tax credit.

This procedure is optional with each state and requires a state to enact a statute to generate this revenue; the funds are not allocated from the federal government as a form of revenue sharing. States exercising this option--the District of Columbia and all states except Nevada--are said to levy a "pick-up" tax, i.e., they are picking up revenue that would otherwise have gone to the federal government, as the estate credits against their federal tax liability any state "pick-up" tax paid, up to the allowable maximum, as defined in the formula.

Thus, the combined state and federal death tax burden is not increased. The taxpayer is going to pay the same total tax whether the state levies the "pick-up" tax or not,

TABLE 8

## STATE DEATH TAX CREDIT

Estates of Decedents Dying After 1976

Taxable Estate After Deducting \$60,000 ("adjusted taxable estate")		Credit = Col. A amount + Col. B % of amount by which "adjusted taxable estate" exceeds amount in Col. C		
From	To	(A)	(B)	(C)
\$ 0	\$ 90,000	\$ 0	.8%	\$ 40,000
90,000	140,000	400	1.6	90,000
140,000	240,000	1,200	2.4	140,000
240,000	440,000	3,600	3.2	240,000
440,000	640,000	10,000	4.0	440,000
640,000	840,000	18,000	4.8	640,000
840,000	1,040,000	27,600	5.6	840,000
1,040,000	1,540,000	38,800	6.4	1,040,000
1,540,000	2,040,000	70,800	7.2	1,540,000
2,040,000	2,540,000	106,800	8.0	2,040,000
2,540,000	3,040,000	146,800	8.8	2,540,000
3,040,000	3,540,000	190,800	9.6	3,040,000
4,040,000	5,040,000	290,800	11.2	4,040,000
5,040,000	6,040,000	402,800	12.0	5,040,000
6,040,000	7,040,000	522,800	12.8	6,040,000
7,040,000	8,040,000	650,800	13.6	7,040,000
8,040,000	9,040,000	786,800	14.4	8,040,000
9,040,000	10,040,000	930,800	15.2	9,040,000
10,040,000	and over	1,082,800	16.0	10,040,000

but if the state does take advantage of the federal provision, then it is the state that receives this amount of revenue rather than the federal government.

At the present level of state inheritance tax collections, very little "pick-up" tax revenue is actually generated, under \$1 million based on the Department of Finance study of 1978-79 estates. This is because the value of estates is increasing and the federal credit remains static. Over time, California would theoretically receive no pick-up tax at all.

However, with the passage of AB 2092, estates which pay no inheritance tax due to the increased exemptions and total marital exclusion will generate some additional pick-up tax revenues. As noted above, this has no impact on the taxpayers involved, but it does mean that the state will not have a net revenue loss comparable to the amount of tax relief provided, due to the existence of the federal credit.

If the entire inheritance tax was eliminated, but the pick-up portion of the tax was retained, California would continue to receive about 20 percent of the inheritance tax revenues that would otherwise be collected, as each estate would generate a pick-up tax equal to the maximum allowable state death tax credit.

#### "Generation Skipping Transfer" Tax

This is a separate death tax, not previously discussed. It was adopted in 1977 in AB 302 as a "pick-up" tax, i.e., the California tax is equal to the full allowable federal credit for state generation-skipping transfer (GST) taxes which is applied to the federal GST tax, the same as the federal credit for state death taxes generally, discussed in the previous section. No revenue has yet been collected under this tax. Federal law is quite complex and controversial, and regulations for administering the tax have not been completed by the IRS.

The purpose of this tax is to prevent death taxes from being deferred for extended periods of time by use of long-term trusts for the benefit of successive generations of beneficiaries. In order to close off this possibility, the Federal law would impose a tax each time the interest or power of a successive generation terminates. Thus, the tax may arise even though no death has actually occurred. The generation-skipping transfer tax requires a separate return, and is measured by adding property back to the aggregate taxable transfers of a "deemed transferor", who is a member of the generation skipped (usually a beneficiary of the trust). The tax is imposed as though the deemed transferor had owned the property and made the transfer which gives rise to the tax, although in fact the deemed transferor will at most have had an interest in the property and in no case will actually have owned it and made such a transfer.

## Administration of the Inheritance Tax

The inheritance tax law is administered generally by the State Controller, who maintains an Inheritance and Gift Tax Division. The Controller appoints a panel of independent "inheritance tax referees" (at least one per county). The probate court appoints one inheritance tax referee for each particular estate from this panel. There are no California inheritance tax returns, per se. The state tax is not a self-assessing tax. The representatives of the decedent must file various forms with the inheritance tax referee who is assigned to their case by the superior court having jurisdiction, and the referee makes his report to that court. Ordinarily, the tax is determined by the court in the course of the probate administration of the estate.

(By contrast, the federal estate tax is a self-assessing tax. A tax return, listing all property and its value in which the tax is computed, is filed with the Internal Revenue Service. The return is subject to subsequent audit during which the values may be revised or the computation adjusted.)

Inheritance Tax Referee. The inheritance tax referee appointed by the court appraises all non-cash assets at their date of death market value and reports to the court the clear market value of the property transferred to each beneficiary and the amount of inheritance tax due. The referee must file his report within 60 days after receipt of the necessary information.

In 1980, there were approximately 170 referees under appointment. A fee is levied against the estate to reimburse referees for the cost of their services. They may conduct hearings and exercise the powers of a referee of the superior court.

The Courts. Upon receipt of the referee's report, the clerk of the court posts a copy of the notice and sends a copy to the Controller and to each person liable for tax stemming from that estate. The Probate Division of the court usually performs these functions. If there are no objections to the report, the court then makes its Order Fixing Inheritance Tax in the amount reported by the referee. However, an interested party objecting to a tax determination in the referee's report has a remedy in the court. Upon a hearing the court will issue the final order. Burden of proof is on the objecting party to prove the referee's report incorrect.

State Controller. The Controller has broad powers to bring suit for collection of inheritance taxes. The tax is a lien on the property included in the transfer upon which the tax is imposed. There is no statute of limitations relative to inheritance tax collections (Federal law is 3 years).

Property cannot be transferred unless a consent to transfer is obtained from the Controller; it is the Controller's responsibility to ensure that adequate security exists to pay the tax attributable to such property.

Prior to AB 2092, probate estates could not be distributed until the tax was paid in full. Effective with all estates active on January 1, 1981, the estate can be distributed before the tax is paid. This will place greater demands on the Controller to issue more and expeditious consents to transfer.

The Controller may issue refunds upon court orders or upon his own determination. The state provides interest on refunds, based each year on the "Federal Reserve rate", but not to exceed 7 percent.

The "audit function" of the Controller consists of two parts: working with the referee during the preparation of the referee's report and, if the Controller disagrees with the report, filing an objection with the court and presenting his case there. Once the tax is fixed by the court, the matter is closed unless that order is appealed.

#### Payment of Tax

The inheritance tax is due at the date of the decedent's death, and becomes delinquent if not paid within 9 months following that date. The tax is payable directly to the state. (AB 2092 eliminated the function of the county treasurers, who will no longer inspect safe deposit boxes and collect the taxes as an agent of the state, effective January 1, 1981.)

There is no prescribed period in which the inheritance tax documents must be filed, so there are no penalties for "late filing". However, if the tax is not paid prior to its delinquency date, it thereafter bears interest, generally at the rate of 12 percent per annum, until the tax plus interest is paid in full. The delinquency date is the same for both California inheritance tax and federal estate tax.

(The federal estate tax does impose penalties, up to 25 percent of the tax for late filing of returns or late payment of the tax, in addition to interest on delinquent payments charged at 90 percent of prime rate, adjusted every 2 years.)

Payment of tax may be deferred in some instances, as described below:

Reasonable Cause. For "reasonable cause", the Controller may extend the time for payment of any part of the tax for up to 10 years, provided that adequate security exists

for payment of the tax and interest. (Prior to AB 2092, deferment could be made upon a showing of "undue hardship" a provision that was used relatively infrequently. The AB 2092 test of "reasonable cause" is a more liberal standard.) Reasonable cause specifically includes the situation of a taxpayer who inherits some or all of a decedent's works of art, if that art work created by the decedent exceeds 35 percent of the total gross estate value or 50 percent of the taxable estate.

Farms and Closely-Held Businesses. Effective January 1, 1981, AB 2092 provides for deferred payment of taxes for closely-held businesses (including farms) over 10 or 15 years after the date tax would ordinarily be due and payable, in substantial conformity with federal law.

- To qualify for the 10 year provision, property must exceed 35 percent of market value of decedent's estate or 50 percent of clear-market value (after deductions). Payments may be made in up to 10 equal, annual installments. Interest runs at the lower of 12 percent or an alternate amount (initially 11 percent, revised every 2 years to 90 percent of prime rate).
- To qualify for the 15 year provision, property must exceed 65 percent of clear-market value of decedent's estate. Payments for the first 5 years are interest only (same rate as above), while the "principal" (tax owed) may be paid in up to 10 equal, annual installments thereafter, along with the remaining interest.

Certain Dwellings. Under certain circumstances the recipient of a dwelling owned and occupied by the decedent at death may pay the tax attributable to that dwelling in 5 annual installments at 7 percent interest. The option applies only for estates of less than \$500,000 in which the home constitutes at least 75 percent of the estate. Additionally, the heir must occupy the home at the time of the decedent's death and must annually declare his or her intent to maintain the home as a principal residence.

Open-Space Lands. A transferee who receives open-space land and receives insufficient liquid assets to pay the tax may offer such land to the State in payment of the tax.

Contingent and conditional transfers. Where a contingency of some kind exists, it may be impossible to determine who will be the ultimate beneficiaries and what the value of each beneficiary's interest will be. In these cases, the law provides for the tax to be computed at the highest rate possible, given the potential beneficiaries; and the tax may thereafter be modified in accordance with the occurrence of the contingency. For example, if there are two possible



beneficiaries, a brother and a friend, the tax is computed on the assumption the friend will receive the benefit, regardless of the actual probability of that eventual outcome. If the brother ultimately receives the property, the tax would be much lower due to the preferential rates and exemptions, and, upon petition, the tax may be modified to the lower amount. Thus, where the tax on a contingency is computed at the highest rate possible, the final tax determination may be postponed for many years.

However, the law further provides that the Controller may enter into an agreement to compromise the amount of tax due where the ultimate distribution is subject to a contingency or condition. Normally, the tax of a contingency is computed pursuant to a compromise agreement between the Controller and the executor, administrator or trustee, and the matter is thereby finalized.

Where the taxation of a contingent interest is not finalized by a compromise agreement, the payment of the tax computed on a high contingency may be deferred until the contingency actually occurs. A bond is posted in the amount of the tax computed at the high contingency plus the interest which will accrue during the period payment is postponed. Upon the occurrence of the contingency, the court, upon petition, will modify the order fixing inheritance tax to the amount due in accordance with the occurrence of the contingency. A payment may be made in an amount less than the tax computed on the high contingency, in which case the bond is the difference between the high contingency and the payment made; interest will accrue on only the difference between the amount of tax ultimately determined upon the occurrence of the contingency and the payment made.

#### The Gift Tax

The gift tax has been mentioned only briefly thus far, and largely in connection with the computation of the inheritance tax. Its revenue effect pales by comparison to the inheritance tax. The chief purpose of a gift tax is to provide a tax on lifetime transfers comparable to the inheritance or estate tax on transfers at death, so as to prevent evasion of the death tax. However, as noted in Table 3, only 13 of the 49 states levying a death tax have chosen to levy a complementing gift tax.

The provisions of the gift tax basically mirror those of the inheritance tax. The exemptions and rates are the same, except that the gift tax has one additional exemption--a \$3,000 annual exemption per donee for gifts from any given donor. Spouses are exempt from the gift tax, as they are from the inheritance tax, under AB 2092.

The gift tax is computed on the market value of the property at the date of gift. Separate computations are made with respect to each donee. The tax is actually figured initially on the sum of all current gifts and previous gifts on which tax was paid. Then the actual tax paid on previous gifts is subtracted, leaving the tax attributable to gifts in the current calendar quarter. Thus, the effect over time is to push calculations into the higher rate brackets.

Returns are filed by the donor with the Controller for each calendar quarter in which a taxable gift (i.e., a gift in an amount greater than the annual exclusion) is made. The returns are due by the 15th of the second month following that quarter, and filing extensions of up to 6 months are permitted upon request. Legally, both donor and donee are liable for the tax, but it is the donor who has primary responsibility to file and pay. Penalty for late filing is 5 percent of the tax; penalty for fraudulent evasion is 25 percent. Interest accrues on late payments at a rate of 12 percent per annum. Interest on refunds for overpayments based on taxpayer error is predicted on the "Federal Reserve rate", not to exceed 7 percent, and if based on the state's error, is set at 12 percent.

APPENDIX I

INHERITANCE TAX STUDY, 1978-79

This study was prepared by the Department of Finance with the assistance of the Inheritance and Gift Tax Division of the State Controller. The study is based on a stratified sample of returns approved during the 1978-79 fiscal year. The universe, sample size, and expansion factor by estate size are as follows:

Total Estate Size	Number In Universe	Number in Sample	Expansion Factor
Less than \$50,000	13,822	54	255.963
\$ 50,000 - \$199,999	21,320	139	153.382
\$200,000 - \$499,999	9,012	139	36.636
\$500,000 - \$999,999	1,838	362	5.078
\$1 million and over	748	618	1.211
	<u>46,540</u>	<u>1,419</u>	

Estates used in the survey were limited to those of persons deceased after January 1, 1976. This is because of the major law changes that went into effect at that time which changed the values of exclusions and exemptions. These figures do not reflect AB 2092, which does not become effective until January 1, 1981.

The effective tax rate for each beneficiary classification within estate size was derived by dividing the total tax assessed each beneficiary by the total inheritance received by each.

Table 1 contains summary information for all estates. Table 2 shows specific data with regard to types of property, exclusions, and taxes paid by surviving spouses. Finally, Tables 3 through 6 contain information on the value of inheritance, exemptions, and taxes for all other beneficiary types.

(NOTE: As used in these tables, "tax" refers to the tax assessed in 1978-79, not the tax actually collected in that fiscal year. Therefore, the total "tax" shown of \$336.8 million is less than the \$402.2 million actually received. Some difference is also attributable to projections made on the available sample of estates.)

TABLE 1  
ESTIMATED VALUE OF TOTAL ESTATE, CASH, STOCK, BONDS, OTHER PERSONAL PROPERTY,  
AND REAL PROPERTY, BY TOTAL ESTATE SIZE

All Estates

Total Estate Size	Total Estate	Cash	Stock	Bonds	Other Personal Property	Real Property
Less than \$50,000	\$387,210,072	\$168,326,386	\$27,845,191	\$10,493,715	\$49,144,128	\$130,060,686
\$ 50,000 - \$199,999	2,509,965,350	799,985,621	433,115,501	76,826,438	182,450,348	997,210,337
\$200,000 - \$499,999	2,773,735,237	577,676,209	545,694,929	169,218,357	268,988,997	1,165,596,848
\$500,000 - \$999,999	1,234,631,122	209,402,926	324,513,586	103,374,736	147,776,424	436,823,866
\$1 million and over	<u>1,475,958,217</u>	<u>134,991,325</u>	<u>553,801,859</u>	<u>209,980,480</u>	<u>161,496,311</u>	<u>409,323,972</u>
TOTAL	\$8,381,499,999	\$1,890,382,548	\$1,884,971,065	\$569,893,727	\$809,856,208	\$3,139,015,709

Total Estate Size	Total	Public Retirement	Private Retirement	Excluded Insurance	Exclusion Exemption Total	Amount of Tax
Less than \$50,000	\$387,210,072	\$547,249	\$794,765	\$16,601,248	\$78,749,320	\$15,880,712
\$ 50,000 - \$199,999	2,509,965,350	3,465,973	16,908,832	86,120,161	502,079,424	69,347,225
\$200,000 - \$499,999	2,773,735,237	270,850	46,285,338	68,658,468	405,977,858	96,028,089
\$500,000 - \$999,999	1,234,631,122	344,522	12,395,322	17,682,231	78,005,099	59,665,170
\$1 million and over	<u>1,475,958,217</u>	<u>28,683</u>	<u>6,335,400</u>	<u>7,781,539</u>	<u>31,263,066</u>	<u>95,706,429</u>
TOTAL	\$8,381,499,999	\$4,657,277	\$82,719,657	\$196,843,647	\$1,096,074,767	\$336,627,626

TABLE 2  
ESTIMATED NUMBER OF, TOTAL INHERITANCE RECEIVED BY,  
TOTAL EXCLUSIONS AND EXEMPTIONS CLAIMED BY, AND TOTAL TAX LEVIED  
ON SURVIVING SPOUSE BY TOTAL ESTATE SIZE

Total Estate Size	Surviving Spouse			
	Total Inheritance	Community Property	Quasi-Community	Separate Property
Less than \$50,000	*	*	*	*
\$ 50,000 - \$199,999	\$800,703,756	\$768,048,574	\$12,377,621	\$20,277,408
\$200,000 - \$499,999	1,389,243,921	1,201,884,185	21,882,610	165,477,712
\$500,000 - \$999,999	496,790,243	387,281,226	18,837,141	90,672,079
\$1 million and over	<u>471,172,867</u>	<u>320,788,761</u>	<u>8,127,120</u>	<u>142,257,009</u>
TOTAL	\$3,161,828,300	\$2,681,920,260	\$61,224,492	\$418,684,207

Total Estate Size	Exclusion Exemption Total	Community Exclusion	Quasi-Community Exclusion	Marital Exclusion	Insurance Exclusion	Other Exclusions	Specific Exemption
\$ 50,000 - \$199,999	\$701,092,881	\$369,873,647	0	\$6,076,688	\$36,709,068	0	\$325,142,546
\$200,000 - \$499,999	1,009,004,246	554,132,640	\$13,270,842	96,772,899	54,474,474	\$1,504,677	343,323,188
\$500,000 - \$999,999	320,738,077	191,871,801	10,197,899	59,762,841	14,372,939	0	58,905,588
\$1 million and over	<u>340,415,309</u>	<u>195,646,788</u>	<u>6,583,264</u>	<u>118,272,588</u>	<u>5,995,683</u>	<u>0</u>	<u>19,912,788</u>
TOTAL	2,375,168,027	1,315,442,389	30,052,004	280,885,016	111,552,164	1,504,677	747,284,110

Total Estate Size	Total Number	Total Inheritance	Total Exclusions and Exemptions	Total Tax
Less than \$50,000	*	*	*	*
\$ 50,000 - \$199,999	6,749	\$800,703,756	\$701,092,881	\$5,681,883
\$200,000 - \$499,999	5,972	1,389,243,921	1,009,004,246	26,010,975
\$500,000 - \$999,999	1,107	496,790,243	320,738,077	14,676,654
\$1 million and over	<u>438</u>	<u>471,172,867</u>	<u>340,415,309</u>	<u>13,684,396</u>
TOTAL	14,522	\$3,161,828,300	\$2,375,168,027	\$60,053,908

\*Insufficient sample size, however, included in total.

TABLE 3

ESTIMATED NUMBER OF MINOR, CLASS A BENEFICIARIES AND THE ESTIMATED VALUE OF MINOR'S TOTAL INHERITANCE, EXEMPTION TOTAL, TOTAL TAX, EFFECTIVE TAX RATE, AND REVENUE LOSS DUE TO THEIR EXEMPTIONS BY TOTAL ESTATE SIZE

Class A Minor Beneficiaries					
Total Estate Size	Number	Total Inheritance	Exemption Total	Total Tax	Effective Tax Rate
Less than \$50,000	*	*	*	*	*
\$50,000 - \$199,999	460	\$20,168,046	\$3,374,404	\$591,748	.0293
\$200,000 - \$499,000	110	3,203,672	1,555,931	27,953	.0087
\$500,000 - \$999,999	30	3,172,856	365,616	138,822	.0438
\$1 million and over	<u>17</u>	<u>2,886,319</u>	<u>146,910</u>	<u>275,747</u>	<u>.0955</u>
TOTAL	873	\$32,743,823	\$8,514,417	\$1,041,438	.0318

TABLE 4

ESTIMATED NUMBER OF OTHER CLASS A BENEFICIARIES AND THE ESTIMATED VALUE OF OTHER CLASS A INHERITANCE, EXEMPTIONS, TOTAL TAX, EFFECTIVE TAX RATE, AND REVENUE LOSS DUE TO THEIR EXEMPTIONS BY TOTAL ESTATE SIZE

Class A Adult Beneficiaries					
Total Estate Size	Number	Total Inheritance	Exemption Total	Total Tax	Effective Tax Rate
Less than \$50,000	12,286	\$150,901,449	\$58,932,665	\$3,198,258	.0212
\$50,000 - \$199,999	34,818	970,635,831	145,821,191	34,254,496	.0353
\$200,000 - \$499,999	11,321	673,887,596	49,625,955	35,041,163	.0520
\$500,000 - \$999,999	3,458	358,267,814	14,519,739	24,404,939	.0681
\$1 million and over	<u>1,902</u>	<u>511,187,131</u>	<u>8,612,926</u>	<u>50,805,759</u>	<u>.0994</u>
TOTAL	63,785	\$2,664,879,821	\$277,512,476	\$147,704,616	.0554

\*Insufficient sample size, however, included in total.

TABLE 5  
 ESTIMATED NUMBER OF CLASS B BENEFICIARIES AND ESTIMATED VALUE OF CLASS B  
 INHERITANCE, EXEMPTIONS, TOTAL TAX, EFFECTIVE TAX RATE, AND REVENUE LOSS  
 DUE TO THEIR EXEMPTIONS BY TOTAL ESTATE SIZE

Class B					
Total Estate Size	Number	Total Inheritance	Exemption Total	Total Tax	Effective Tax Rate
Less than \$50,000	8,191	\$71,169,488	\$12,696,021	\$3,872,208	.0544
\$50,000 - \$199,999	16,565	263,329,752	24,341,571	18,803,560	.0714
\$200,000 - \$499,999	4,873	190,280,212	9,128,153	19,507,792	.1025
\$500,000 - \$999,999	1,935	114,348,289	3,567,102	13,002,321	.1137
\$1 million and over	<u>1,073</u>	<u>112,208,386</u>	<u>1,988,918</u>	<u>15,775,260</u>	<u>.1406</u>
TOTAL	32,636	\$751,336,127	\$51,721,764	\$70,961,140	.0944

TABLE 6  
 ESTIMATED NUMBER OF CLASS C BENEFICIARIES AND ESTIMATED VALUE OF CLASS C  
 INHERITANCE, EXEMPTIONS, TOTAL TAX, EFFECTIVE TAX RATE, AND REVENUE LOSS  
 DUE TO THEIR EXEMPTIONS BY TOTAL ESTATE SIZE

Class C					
Total Estate Size	Number of Class C	Total Inheritance	Exemption Total	Total Tax	Effective Tax Rate
Less than \$50,000	7,167	\$87,973,970	\$2,150,089	\$8,600,101	.0978
\$50,000 - \$199,999	12,117	88,121,029	3,399,712	10,005,722	.1135
\$200,000 - \$499,999	6,191	124,747,014	1,978,271	15,260,470	.1223
\$500,000 - \$999,999	1,884	50,653,919	596,264	7,079,306	.1398
\$1 million and over	<u>1,904</u>	<u>90,274,602</u>	<u>577,288</u>	<u>14,768,670</u>	<u>.1636</u>
TOTAL	29,263	\$441,770,534	\$8,701,623	\$55,714,268	.1261

APPENDIX II

INDEX OF AB 2092 PROVISIONS

<u>Subject</u>	<u>Code Sec. (a)</u>	<u>Change</u>	<u>Bill Pg.No.</u> <sup>(b)</sup>
Artists: deferred payment of tax	14180	New	18
Closely-Held Businesses			
--deferred payment of tax	14181	New	18
	14182	New	25
--special use valuation	13311.5	New	6
County Treasurers: Elimination of inheritance tax functions	13314	Repealed	15
	14104	Amended	17
	14128	Amended	17
	14141	Repealed	17
	14142	Repealed	17
	14143	Repealed	17
	14144	Repealed	17
	14774	Amended	32
	14791	Repealed	32
	14792	Repealed	32
	14793	Repealed	33
	14794	Repealed	33
	14795	Repealed	33
	14798	Repealed	33
Deferred Payment			
--artists	14180	New	18
--farms/closely-held businesses			
--10 year deferral	14181	New	18
--15 year deferral	14182	New	25
--reasonable cause	14180	New	18
--undue hardship	14143.5	Amended	17
Exemptions			
--Class A beneficiaries, orphans	13801	Amended	16
	15421	Amended	33
--Class B beneficiaries	13802	Amended	16
	15422	Amended	34
--Class C beneficiaries	13803	Amended	16
	15423	Amended	34
Farms			
--deferred payment of tax	14181	New	18
	14182	New	25
--special use valuation	13311.5	New	6
Inheritance Tax Referees: funding for compensation transferred from county to state	14774	Amended	32
	14902	Amended	33



<u>Subject</u>	<u>Code Sec. (a)</u>	<u>Change</u>	<u>Bill Pg.No.</u> (b)
Interest Rates	14211	Amended	30
Limited Power of Appointment	13805	Amended	16
	15310	Amended	33
Probate: estates allowed to be distributed before inheri- tance taxes are paid	657*	Amended	3
	1001*	Amended	4
	1004*	Amended	4
	1024*	Amended	5
	1174*	Amended	5
Safe Deposit Boxes: repeal of inspection requirement	14342	Repealed	30
	14343	Repealed	31
	14344	Repealed	31
	14345	Amended	31
	14346	Repealed	32
	14347	Amended	32
Special Use Valuation	13311.5	New	6
Spouses			
--total marital exclusion	13805	Amended	16
	15310	Amended	33
--repeal of specific exemption	13801	Amended	16
	15421	Amended	34
--repeal of obsolete sections	13551	Repealed	15
	13552.5	Repealed	15
	13554	Repealed	15
	13554.5	Repealed	15
	13555	Repealed	15
	13556	Repealed	16
	13556.5	Repealed	16
	13557	Repealed	16
	15104.5	Repealed	33
	15301	Repealed	33
	15301.5	Repealed	33
	15303.5	Repealed	33

(a) Code Sections are all Revenue and Taxation Code  
except (\*) which are Probate Code.

(b) Page numbers conform to enrolled bill version which  
appears in Appendix III.

APPENDIX III

TEXT OF AB 2092

AB 2092

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CHAPTER 634  
Statutes of 1980

An act to amend Sections 657, 1001, 1004, 1024, and 1174 of the Probate Code, and to amend Sections 13311, 13801, 13802, 13803, 13805, 14104, 14128, 14143.5, 14211, 14345, 14347, 14774, 15310, 15421, 15422 and 15423 of, to add Sections 13311.5, 14180, 14181, 14182, and 14902 to, and to repeal Sections 13314, 13551, 13552.5, 13554, 13554.5, 13555, 13556, 13556.5, 13557, 14141, 14142, 14143, 14144, 14342, 14343, 14344, 14346, 14791, 14792, 14793, 14794, 14795, and 14798 of, and to repeal Sections 15104.5, 15301, 15301.5, and 15303.5 of, the Revenue and Taxation Code, relating to taxation, and making an appropriation therefor, to take effect immediately, tax levy.

LEGISLATIVE COUNSEL'S DIGEST

AB 2092, Deddeh. Inheritance and gift taxes.

Under California's existing Inheritance Tax Law, a death tax is imposed in the form of an inheritance tax measured by the share of a decedent's estate passing to each beneficiary, with the tax rates varying in accordance with the amount received by each such beneficiary and in accordance with such beneficiary's relationship to the decedent. Under existing law, procedures have been established for the determination and payment of such inheritance taxes.

This bill would revise such procedures, and would generally exempt all property transferred to a spouse from inheritance and gift taxes, and would increase the exempt amounts which are exempt from these taxes.

The existing provisions of the Probate Code prohibit an order or decree distributing an estate unless all inheritance taxes have been paid or unless the State Controller has consented to the distribution.

This bill would repeal those provisions in the Probate Code prohibiting distribution unless the inheritance taxes have been paid.

This bill would appropriate \$400,000 to the Controller for the purpose of administering the act.

This bill would take effect immediately as a tax levy

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AB 2092

and shall apply in the computation of inheritance and gift taxes with respect to the computation of gifts and deaths occurring on and after January 1, 1981.

Appropriation: yes.

*The people of the State of California do enact as follows:*

SECTION 1. Section 657 of the Probate Code is amended to read:

657. (a) Upon the filing of a petition pursuant to Section 650, the court shall immediately appoint one inheritance tax referee who shall appraise the property described in the petition in the same manner provided in Section 605 and file an inheritance tax report or certification that no tax is due with the clerk of the court. Upon the filing of the inheritance tax report, the court shall enter an order fixing the inheritance tax in the same manner and subject to all other provisions of law relating to the administration of the estate of a decedent which is not subject to the provisions of this article. The filing of an inheritance tax report and the entry of an order fixing the inheritance tax under this article shall not limit the filing of additional reports and the entry of additional orders fixing the inheritance tax as to any other property of the deceased spouse giving rise to additional inheritance tax liability.

(b) The petitioner shall furnish the referee with a copy of the petition and all other necessary information and documentation as may be required by law for the referee to prepare the inheritance tax report or issue the certification that no tax is due with reference to the property described in the petition. Within 60 days after the receipt of the petition and information and documentation by the referee, as may be evidenced by an affidavit which is filed in the proceedings by the petitioner and served by mail on the referee, the referee shall make the appraisal and file the inheritance tax report or the certification that no tax is due with the clerk of the court. If the referee does not comply with the provisions of this subdivision, the court may issue any orders which may be necessary to effect compliance.

SEC. 1.3. Section 1001 of the Probate Code is amended to read:

1001. If, at the hearing, it appears that all of the allegations of the petition are true, that the estate is but little indebted and the legacy, devise or share of the estate or any portion thereof may be distributed without loss to the creditors or injury to the estate or any person interested therein, the court shall make an order requiring the executor or administrator to deliver the share, or shares, of the estate or such portion or portions thereof as the court may direct, to the person or persons entitled thereto, upon receiving from such person or persons a bond or bonds executed and payable to the executor or administrator, in such sum or sums as the court may designate, conditioned on the payment whenever required of the proportion of the debts due from the estate, not exceeding the amount of the legacy or portions of the estate so ordered to be delivered; or if the time for filing claims has expired and all claims are paid or sufficiently secured the court may so order distribution with or without bond as it may determine.

SEC. 1.4. Section 1004 of the Probate Code is amended to read:

1004. When the time for filing or presenting claims has expired and all uncontested claims have been paid or are sufficiently secured by mortgage, or otherwise, but the estate is not in a condition to be finally closed and distributed, the executor or administrator to whom authority has been granted to administer the estate without court supervision, in accordance with Article 2 (commencing with Section 591) of Chapter 8 of Division 3, may petition the court for authority to distribute a portion of the estate to the person or persons entitled thereto. Such petition need not include an accounting, provided that when the petition seeks authority to distribute to a trustee the petition shall include an accounting unless the trustee consents to the distribution without an accounting. The total amount of the property distributed under this section shall not exceed 50 percent of the net value of the estate. The clerk shall set the petition for hearing by the court and give notice thereof

for the period and in the manner required by Section 1200, but the court may order the notice to be given for a shorter period or dispensed with. If the court shall determine that all of the allegations of the petition are true, that the estate is but little indebted, that the property to be distributed does not exceed 50 percent of the net value of the estate, and that the distribution may be made without loss or injury to the estate or any person interested therein, the court shall make an order authorizing the executor or administrator to distribute the property to the person or persons entitled thereto. For purposes of this section "net value of the estate" means the excess of the value of the assets of the estate reflected by all inventories and appraisements on file with the court over the total amount of all creditors' claims filed or presented and liens and encumbrances recorded or known to the executor or administrator not reflected in any creditors' claims filed or presented, excluding death tax liens occasioned by the decedent's death.

SEC. 1.5. Section 1024 of the Probate Code is amended to read:

1024. Before any decree of distribution is made, all personal property taxes due and payable by the estate shall be paid.

SEC. 1.6. Section 1174 of the Probate Code is amended to read:

1174. Such petition, or affidavits in support thereof, may be received in evidence and acted upon by the court with the same force and effect as if the petitioner or affiants were personally present and testified to the fact set forth, and the court may render judgment thereon establishing the fact of the death, which judgment shall be prima facie evidence of the fact of the death. The presumption established by this section is a presumption affecting the burden of producing evidence.

SEC. 2. Section 13311 of the Revenue and Taxation Code is amended to read:

13311. "Market value," in respect to property included in any transfer, means the market value of the property as of the date of the transferor's death, whether

or not the transfer was made during the lifetime of the transferor.

SEC. 2.3. Section 13311.5 is added to the Revenue and Taxation Code, to read:

13311.5. (a) Certain qualified real property shall be valued based on use in accordance with this section.

(1) If—

(A) The decedent was (at the time of his or her death) a citizen or resident of the United States, and

(B) The executor elects the application of this section for purposes of the tax imposed by this part, then, for purposes of this part, the value of qualified real property shall be its value for the use under which it qualifies, under subdivision (b), as qualified real property.

(2) The aggregate decrease in the value of qualified real property taken into account for purposes of this chapter which results from the application of paragraph (1) with respect to any decedent shall not exceed five hundred thousand dollars (\$500,000).

(b) Qualified real property is as follows:

(1) For purposes of this section, the term "qualified real property" means real property located in the United States which was acquired from or passed from the decedent to a qualified heir of the decedent and which, on the date of the decedent's death, was being used for a qualified use, but only if—

(A) Fifty percent or more of the adjusted value of the clear market value of the estate consists of the adjusted value of real or personal property which—

(i) On the date of the decedent's death, was being used for a qualified use, and

(ii) Was acquired from or passed from the decedent to a qualified heir of the decedent.

(B) Twenty-five percent or more of the adjusted value of the clear market value of the estate consists of the adjusted value of real property which meets the requirements of subparagraphs (A)(ii) and (C),

(C) During the eight-year period ending on the date of the decedent's death there have been periods aggregating five years or more during which—

(i) Such real property was owned by the decedent or a member of the decedent's family and used for a qualified use, and

(ii) There was material participation by the decedent or a member of the decedent's family in the operation of the farm or other business, and

(D) Such real property is designated in the agreement referred to in paragraph (2) of subdivision (d).

(2) For purposes of this section, the term "qualified use" means the devotion of the property to any of the following:

(A) Use as a farm for farming purposes, or

(B) Use in a trade or business other than the trade or business of farming.

(3) For purposes of paragraph (1), the term "adjusted value" means—

(A) The value of the estate for purposes of this chapter (determined without regard to this section), reduced by any amounts allowable as a deduction for unpaid mortgages on, or any indebtedness in respect of, property where the value of the decedent's interest therein, undiminished by such mortgage or indebtedness, is included in the value of the estate, or

(B) In the case of any real or personal property, the value of such property for purposes of this chapter (determined without regard to this section), reduced by any amounts allowable as a deduction in respect of such property for unpaid mortgages on, or any indebtedness in respect of, property where the value of the decedent's interest therein, undiminished by such mortgage or indebtedness, is included in the value of the estate.

(c) Tax treatment of dispositions and failures to use for a qualified use are as follows:

(1) If, within 15 years after the decedent's death and before the death of the qualified heir—

(A) The qualified heir disposes of any interest in qualified real property (other than by a disposition to a member of his or her family), or

(B) The qualified heir ceases to use for the qualified use the qualified real property which was acquired (or passed) from the decedent,

then there is hereby imposed an additional tax.

(2) Amount of additional tax—

(A) The amount of the additional tax imposed by paragraph (1) with respect to any interest shall be the amount equal to the lesser of—

(i) The adjusted tax difference attributable to such interest, or

(ii) The excess of the amount realized with respect to the interest (or, in any case other than a sale or exchange at arm's length, the fair market value of the interest) over the value of the interest determined under subdivision (a).

(B) For purposes of subparagraph (A), the adjusted tax difference attributable to an interest is the amount which bears the same ratio to the adjusted tax difference with respect to the estate (determined under subparagraph (C)) as—

(i) The excess of the value of such interest for purposes of this chapter (determined without regard to subdivision (a)) over the value of such interest determined under subdivision (a), bears to

(ii) A similar excess determined for all qualified real property.

(C) For purposes of subparagraph (B), the term "adjusted tax difference with respect to the estate" means the excess of what would have been the tax liability but for subdivision (a) over the tax liability. For purposes of this subparagraph, the term "tax liability" means the tax imposed by this part reduced by the credits allowable against such tax.

(D) For purposes of this paragraph, where the qualified heir disposes of a portion of the interest acquired by (or passing to) such heir (or a predecessor qualified heir) or there is a cessation of use of such a portion—

(i) The value determined under subdivision (a) taken into account under subparagraph (A)(ii) with respect to such portion shall be its pro rata share of such value of such interest, and

(ii) The adjusted tax difference attributable to the interest taken into account with respect to the

transaction involving the second or any succeeding portion shall be reduced by the amount of the tax imposed by this subdivision with respect to all prior transactions involving portions of such interest.

(3) If the date of the disposition or cessation referred to in paragraph (1) occurs more than 120 months and less than 180 months after the date of the death of the decedent, the amount of the tax imposed by this subdivision shall be reduced (but not below zero) by an amount determined by multiplying the amount of such tax (determined without regard to this paragraph) by a fraction—

(A) The numerator of which is the number of full months after such death in excess of 120, and

(B) The denominator of which is 60.

(4) In the case of an interest acquired from (or passing from) any decedent, if subparagraph (A) or (B) of paragraph (1) applies to any portion of an interest, subparagraph (B) or (A), as the case may be, of paragraph (1) shall not apply with respect to the same portion of such interest.

(5) The additional tax imposed by this subsection shall become due and payable on the day which is six months after the date of the disposition or cessation referred to in paragraph (1).

(6) The qualified heir shall be personally liable for the additional tax imposed by this subdivision with respect to his or her interest unless the heir has furnished a bond which meets the requirements of subdivision (e)(11).

(7) For purposes of paragraph (1)(B), real property shall cease to be used for the qualified use if—

(A) Such property ceases to be used for the qualified use set forth in subparagraph (A) or (B) of subsection (b)(2) under which the property qualified under subdivision (b), or

(B) During any period of eight years ending after the date of the decedent's death and before the date of the death of the qualified heir, there had been periods aggregating three years or more during which—

(i) In the case of periods during which the property was held by the decedent, there was no material

participation by the decedent or any member of his or her family in the operation of the farm or other business, and

(ii) In the case of periods during which the property was held by any qualified heir, there was no material participation by such qualified heir or any member of his or her family in the operation of the farm or other business.

(d) Elections and agreements are as follows—

(1) The election under this section shall be made not later than the time prescribed by Section 14103 (including extensions thereof), and shall be made in such manner as the Controller shall by regulations prescribe.

(2) The agreement referred to in this paragraph is a written agreement signed by each person in being who has an interest (whether or not in possession) in any property designated in such agreement consenting to the application of subdivision (c) with respect to such property.

(e) For purposes of this section—

(1) The term "qualified heir" means, with respect to any property, a member of the decedent's family who acquired such property (or to whom such property passed) from the decedent. If a qualified heir disposes of any interest in qualified real property to any member of his or her family, such member shall thereafter be treated as the qualified heir with respect to such interest.

(2) The term "member of the family" means, with respect to any individual, only such individual's ancestor or lineal descendant, a lineal descendant of a grandparent of such individual, the spouse of such individual, or the spouse of any such descendant. For purposes of the preceding sentence, a legally adopted child of an individual shall be treated as a child of such individual by blood.

(3) In the case of real property which meets the requirements of subparagraph (C) of subdivision (b) (1), residential buildings and related improvements on such real property occupied on a regular basis by the owner or lessee of such real property or by persons employed by such owner or lessee for the purpose of operating or

maintaining such real property, and roads, buildings, and other structures and improvements functionally related to the qualified use shall be treated as real property devoted to the qualified use.

(4) The term "farm" includes stock, dairy, poultry, fruit, furbearing animal, and truck farms, plantations, ranches, nurseries, ranges, greenhouses or other similar structures used primarily for the raising of agricultural or horticultural commodities, and orchards and woodlands.

(5) The term "farming purposes" means—

(A) Cultivating the soil or raising or harvesting any agricultural or horticultural commodity (including the raising, shearing, feeding, caring for, training, and management of animals) on a farm;

(B) Handling, drying, packing, grading, or storing on a farm any agricultural or horticultural commodity in its unmanufactured state, but only if the owner, tenant, or operator of the farm regularly produces more than one-half of the commodity so treated; and

(C) (i) The planting, cultivating, caring for, or cutting of trees, or

(ii) The preparation (other than milling) of trees for market.

(6) Material participation shall be determined in a manner similar to the manner used for purposes of paragraph (1) of Section 1402(a) of the Internal Revenue Code (relating to net earnings from self-employment).

(7) Method of valuing farms as follows—

Except as provided in subparagraph (B), the value of a farm for farming purposes shall be determined by dividing—

(i) The excess of the average annual gross cash rental for comparable land used for farming purposes and located in the locality of such farm over the average annual state and local real estate taxes for such comparable land, by

(ii) The average annual effective interest rate for all new Federal Land Bank loans.

For purposes of the preceding sentence, each average annual computation shall be made on the basis of the five most recent calendar years ending before the date of the

decedent's death.

The formula provided by subparagraph (A) shall not be used—

(i) Where it is established that there is no comparable land from which the average annual gross cash rental may be determined, or

(ii) Where the executor elects to have the value of the farm for farming purposes determined under paragraph (8).

(8) In any case to which paragraph (7)(A) does not apply, the following factors shall apply in determining the value of any qualified real property:

(A) The capitalization of income which the property can be expected to yield for farming or closely held business purposes over a reasonable period of time under prudent management using traditional cropping patterns for the area, taking into account soil capacity, terrain configuration, and similar factors.

(B) The capitalization of the fair rental value of the land for farmland or closely held business purposes.

(C) Assessed land values in a state which provides a differential or use value assessment law for farmland or closely held business.

(D) Comparable sales of other farm or closely held business land in the same geographical area far enough removed from a metropolitan or resort area so that nonagricultural use is not a significant factor in the sales price, and

(E) Any other factor which fairly values the farm or closely held business value of the property.

(9) Property shall be considered to have been acquired from or to have passed from the decedent if—

(A) Such property is so considered under Section 1014(b) of the Internal Revenue Code (relating to basis of property acquired from a decedent),

(B) Such property is acquired by any person from the estate in satisfaction of the right of such person to a pecuniary bequest, or

(C) Such property is acquired by any person from a trust in satisfaction of a right (which such person has by reason of the death of the decedent) to receive from the

trust a specific dollar amount which is the equivalent of a pecuniary bequest.

(10) If the decedent and his or her surviving spouse at any time held qualified real property as community property, the interest of the surviving spouse in such property shall be taken into account under this section to the extent necessary to provide a result under this section with respect to such property which is consistent with the result which would have obtained under this section if such property had not been community property.

(11) If the qualified heir makes written application to the Controller for determination of the maximum amount of the additional tax which may be imposed by subdivision (c) with respect to the qualified heir's interest, the Controller (as soon as possible, and in any event within one year after the making of such application) shall notify the heir of such maximum amount. The qualified heir, on furnishing a bond in such amount and for such period as may be required, shall be discharged from personal liability for any additional tax imposed by subdivision (c) and shall be entitled to a receipt or writing showing such discharge.

(f) If qualified real property is disposed of or ceases to be used for a qualified use, then—

(1) The statutory period for the assessment of any additional tax under subdivision (c) attributable to such disposition or cessation shall not expire before the expiration of three years from the date the Controller is notified (in such manner as the Controller may by regulations prescribe) of such disposition or cessation (or if later in the case of an involuntary conversion to which an election under subdivision (h) applies, three years from the date the Controller is notified of the replacement of the converted property or of an intention not to replace); and

(2) Such additional tax may be assessed before the expiration of such three-year period notwithstanding the provisions of any other law or rule of law which would otherwise prevent such assessment.

(h) Special rules for involuntary conversion of qualified real property are as follows:

(1) (A) If there is an involuntary conversion of an interest in qualified real property and the qualified heir makes an election under this subdivision—

(i) No tax shall be imposed by subdivision (c) on such conversion if the cost of the qualified replacement property equals or exceeds the amount realized on such conversion, or

(ii) If clause (i) does not apply, the amount of the tax imposed by subdivision (c) on such conversion shall be the amount determined under subparagraph (B).

(B) The amount determined under this subparagraph with respect to any involuntary conversion is the amount of the tax which (but for this subdivision) would have been imposed on such conversion reduced by an amount which—

(i) Bears the same ratio to such tax, as

(ii) The cost of the qualified replacement property bears to the amount realized on the conversion.

(2) For purposes of subdivision (c)—

(A) Any qualified replacement property shall be treated in the same manner as if it were a portion of the interest in qualified real property which was involuntarily converted, except that with respect to such qualified replacement property—

(i) The 15-year period under paragraph (1) of subdivision (c) shall be extended by any period, beyond the two-year period referred to in Section 1033(a)(2)(B)(i) of the Internal Revenue Code, during which the qualified heir was allowed to replace the qualified real property, and

(ii) The phaseout period under paragraph (3) of subdivision (c) shall be appropriately adjusted to take into account the extension referred to in clause (i).

(B) Any tax imposed by subdivision (c) on the involuntary conversion shall be treated as a tax imposed on a partial disposition, and

(C) Paragraph (7) of subdivision (c) shall be applied—

(i) By not taking into account periods after the involuntary conversion and before the acquisition of the qualified replacement property, and

(ii) By treating material participation with respect to the converted property as material participation with respect to the qualified replacement property.

(3) For purposes of this subdivision—

(A) "Involuntary conversion" means a compulsory or involuntary conversion within the meaning of Section 1033 of the Internal Revenue Code.

(B) The term "qualified replacement property" means—

(i) In the case of an involuntary conversion described in Section 1033(a)(1) of the Internal Revenue Code, any real property into which the qualified real property is converted, or

(ii) In the case of an involuntary conversion described in Section 1033(a)(2) of the Internal Revenue Code, any real property purchased by the qualified heir during the period specified in Section 1033(a)(2)(B) of the Internal Revenue Code for purposes of replacing the qualified real property.

Such term only includes property which is to be used for the qualified use set forth in subparagraph (A) or (B) of subdivision (b)(2) under which the qualified real property qualified under subdivision (a).

(4) The rules of the last sentence of Section 1033(a)(2)(A) of the Internal Revenue Code shall apply for purposes of paragraph (3)(b)(ii).

(5) Any election under this subdivision shall be made at such time and in such manner as the Controller may by regulations prescribe.

SEC. 2.5. Section 13314 of the Revenue and Taxation Code is repealed.

SEC. 3. Section 13551 of the Revenue and Taxation Code is repealed.

SEC. 4. Section 13552.5 of the Revenue and Taxation Code is repealed.

SEC. 5. Section 13554 of the Revenue and Taxation Code is repealed.

SEC. 6. Section 13554.5 of the Revenue and Taxation Code is repealed.

SEC. 7. Section 13555 of the Revenue and Taxation Code is repealed.



SEC. 8. Section 13556 of the Revenue and Taxation Code is repealed.

SEC. 9. Section 13556.5 of the Revenue and Taxation Code is repealed.

SEC. 10. Section 13557 of the Revenue and Taxation Code is repealed.

SEC. 11. Section 13801 of the Revenue and Taxation Code is amended to read:

13801. (a) Property of the clear market value of forty thousand dollars (\$40,000) transferred to a minor child of the decedent is exempt from the tax imposed by this part.

(b) Property of the clear market value of an amount equal to ten thousand dollars (\$10,000) multiplied by the excess of 21 over the age (in years) of a child of the decedent who is under the age of 18 at the date of death of the decedent, provided the decedent does not have a surviving spouse and that such child, immediately after the death of the decedent, has no known parent, is exempt from the tax imposed by this part.

(c) Property of the clear market value of twenty thousand dollars (\$20,000) transferred to any other class A transferee, other than the spouse of the decedent, is exempt from the tax imposed by this part.

SEC. 12. Section 13802 of the Revenue and Taxation Code is amended to read:

13802. Property of the clear market value of ten thousand dollars (\$10,000) transferred to any class B transferee is exempt from the tax imposed by this part.

SEC. 13. Section 13803 of the Revenue and Taxation Code is amended to read:

13803. Property of the clear market value of three thousand dollars (\$3,000) transferred to any class C transferee is exempt from the tax imposed by this part.

SEC. 15. Section 13805 of the Revenue and Taxation Code is amended to read:

13805. None of the property transferred to the spouse of the decedent is subject to this part, except that if a limited power of appointment over any portion or all of the decedent's property is given to the spouse of the decedent, the value of such property is subject to this part; provided, however, that the value of any interest,

other than the power itself, given to the spouse of the decedent in such property is not subject to this part.

SEC. 15.2. Section 14104 of the Revenue and Taxation Code is amended to read:

14104. Every tax imposed by this part shall be paid to the Controller by remittance payable to the State Treasurer.

SEC. 15.3. Section 14128 of the Revenue and Taxation Code is amended to read:

14128. Within 30 days after the date of the deduction or collection of a tax by him or her, the executor, administrator, or trustee shall pay the tax to the Controller by remittance payable to the State Treasurer.

SEC. 15.4. Section 14141 of the Revenue and Taxation Code is repealed.

SEC. 15.5. Section 14142 of the Revenue and Taxation Code is repealed.

SEC. 16. Section 14143 of the Revenue and Taxation Code is repealed.

SEC. 16.5. Section 14143.5 of the Revenue and Taxation Code is amended to read:

14143.5. If the Controller finds that payment of any tax imposed by this part would result in undue hardship to the estate, he may enter into a written agreement for payment of the tax with the executor, administrator, trustee or transferee liable for its payment upon such terms and conditions as the Controller in his discretion may provide, and provided that the Controller finds that payment of the tax plus interest due thereon is adequately secured.

Undue hardship shall include, but not be limited to, the hardship resulting from the payment of taxes imposed pursuant to the provisions of this part on class A or class B beneficiaries on a qualified family property, and shall include the inability to secure a loan against such qualified property at a rate of interest at the rate specified in subdivision (b) of Section 14211 or less or the necessity for selling an interest in a family business to unrelated persons.

SEC. 16.7. Section 14144 of the Revenue and Taxation Code is repealed.

SEC. 17. Section 14180 is added to the Revenue and Taxation Code, to read:

14180. The Controller may, for reasonable cause, provided that the Controller finds that payment of the tax plus interest is adequately secured, extend the time for payment of any part of the amount determined as the tax imposed by this part, or any part of any installment under Section 14105, 14181 or 14182 for a reasonable period not in excess of 10 years from the date prescribed by Section 14103 for payment of the tax or, in the case of an installment amount referred to in this section, if later, not beyond the date which is 12 months after the due date for the last installment.

For purposes of this section, "reasonable cause" includes the circumstances of a taxpayer who is a beneficiary of some or all of the decedent's works of art, if the decedent is an artist and if the value of an interest in works in art created by such decedent artist which is included in determining the gross estate of a decedent artist exceeds:

(a) Thirty-five percent of the value of the gross estate of such decedent artist, or

(b) Fifty percent of the taxable estate of such decedent artist.

For purposes of this paragraph, "works of art" are defined pursuant to paragraph (1) of subdivision (a) of Section 217, and an "artist" is an individual who creates such "works of art."

SEC. 18. Section 14181 is added to the Revenue and Taxation Code, to read:

14181. (a) (1) If the value of an interest in a closely held business which is included in determining the market value of the estate of a decedent who was (at the date of his or her death) a citizen or resident of the United States exceeds 65 percent of the clear market value of the estate, the executor may elect to pay part or all of the tax imposed by this part in two or more (but not exceeding 10) equal installments.

(2) The maximum amount of tax which may be paid in installments under this subdivision shall be an amount which bears the same ratio to the tax imposed by this part

(reduced by the credits against such tax) as—

(A) The closely held business amount, bears to

(B) The amount of the clear market value of the estate.

(3) If an election is made under paragraph (1), the first installment shall be paid on or before the date selected by the executor which is not more than five years after the date prescribed by Section 14103, and each succeeding installment shall be paid on or before the date which is one year after the date prescribed by this paragraph for payment of the preceding installment.

(4) No election may be made under this section by the executor of the estate of any decedent if an election under Section 14182 applies with respect to the estate of such decedent.

(b) (1) For purposes of this section, "interest in a closely held business" means any of the following:

(A) An interest as a proprietor in a trade or business carried on as a proprietorship.

(B) An interest as a partner in a partnership carrying on a trade or business, if either of the following applies:

(i) Twenty percent or more of the total capital interest in such partnership is included in determining the market value of the estate of the decedent.

(ii) Such partnership had 15 or fewer partners.

(C) Stock in a corporation carrying on a trade or business if either of the following applies:

(i) Twenty percent or more in value of the voting stock of such corporation is included in determining the market value of the estate of the decedent.

(ii) Such corporation had 15 or fewer shareholders.

(2) For purposes of paragraph (1):

(A) Determinations shall be made as of the time immediately before the decedent's death.

(B) Stock or a partnership interest which—

(i) Is community property of a husband and wife (or the income from which is community income), or

(ii) Is held by a husband and wife as joint tenants, or tenants in common, shall be treated as owned by one shareholder or one partner, as the case may be.

(C) Property owned, directly or indirectly, by or for a

corporation, partnership, estate, or trust shall be considered as being owned proportionately by or for its shareholders, partners, or beneficiaries. For purposes of the preceding sentence, a person shall be treated as a beneficiary of any trust only if such person has a present interest in the trust.

(D) All stock and all partnership interests held by the decedent or by any member of his family (within the meaning of Section 267(c)(4) of the Internal Revenue Code) shall be treated as owned by the decedent.

(3) For purposes of the 65-percent requirement of paragraph (1) of subdivision (a), an interest in a closely held business which is the business of farming includes an interest in residential buildings and related improvements on the farm which are occupied on a regular basis by the owner or lessee of the farm or by persons employed by such owner or lessee for purposes of operating or maintaining the farm.

(4) For purposes of this section, value shall be value determined for purposes of this part.

(5) For purposes of this section, "closely held business amount" means the value of the interest in a closely held business which qualifies under subdivision (a)(1).

(6) (A) If the executor elects the benefits of this paragraph (at such time and in such manner as the Controller shall by regulations prescribe), then—

(i) For purposes of paragraph (1)(B)(i) or (1)(C)(i) (whichever is appropriate) and for purposes of subdivision (c), any capital interest in a partnership and any nonreadily tradable stock which (after the application of paragraph (2)) is treated as owned by the decedent shall be treated as included in determining the value of the market value of the decedent's estate, and

(ii) The executor shall be treated as having selected under subsection (a)(3) the date prescribed by Section 14103.

(B) For purposes of this paragraph, the term "nonreadily tradable stock" means stock for which, at the time of the decedent's death, there was no market on a stock exchange or in an over-the-counter market.

(c) For purposes of this section, interests in two or

more closely held businesses, with respect to each of which there is included in determining the value of the decedent's gross estate more than 20 percent of the total value of each such business, shall be treated as an interest in a single closely held business. For purposes of the 20-percent requirement of the preceding sentence, an interest in a closely held business which represents the surviving spouse's interest in property held by the decedent and the surviving spouse as community property or as joint tenants or tenants in common shall be treated as having been included in determining the value of the market value of the decedent's estate.

(d) Any election under subdivision (a) shall be made not later than the time prescribed by Section 14103. If an election under subdivision (a) is made, the provisions of this chapter shall apply as though the Controller were extending the time for payment of the tax.

(e) If an election is made under subdivision (a) to pay any part of the tax imposed by this part in installments and a deficiency has been assessed, the deficiency shall (subject to the limitation provided by paragraph (2) of subdivision (a)) be prorated to the installments payable under subdivision (a). The part of the deficiency so prorated to any installment the date for payment of which has not arrived shall be collected at the same time as, and as a part of, such installment. The part of the deficiency so prorated to any installment the date for payment of which has arrived shall be paid upon notice and demand from the Controller. This subdivision shall not apply if the deficiency is due to negligence, to intentional disregard of rules and regulations, or to fraud with intent to evade tax.

(f) If the time for payment of any amount of tax has been extended under this section—

(1) Interest payable under Section 14211 on any unpaid portion of such amount attributable to the first five years after the date prescribed by Section 14103 shall be paid annually.

(2) Interest payable under Section 14211 on any unpaid portion of such amount attributable to any period after the 5-year period referred to in paragraph (1) shall

be paid annually at the same time as, and as a part of, each installment payment of the tax.

(3) In the case of a deficiency to which subdivision (e) applies which is assessed after the close of the 5-year period referred to in paragraph (1), interest attributable to such 5-year period, and interest assigned under paragraph (2) to any installment the date for payment of which has arrived on or before the date of the assessment of the deficiency, shall be paid upon notice and demand from the Controller.

(4) If the executor has selected a period shorter than five years under paragraph (3) of subdivision (a), such shorter period shall be substituted for five years in paragraphs (1), (2), and (3) of this subdivision.

(g) (1) (A) If—

(i) One-third or more in value of an interest in a closely held business which qualifies under paragraph (1) of subdivision (a) is distributed, sold, exchanged, or otherwise disposed of, or

(ii) Aggregate withdrawals of money and other property from the trade or business, an interest in which qualifies under paragraph (1) of subdivision (a), made with respect to such interest, equal or exceed one-third of the value of such trade or business, then the extension of time for payment of tax provided in subdivision (a) shall cease to apply, and any unpaid portion of the tax payable in installments shall be paid upon notice and demand from the Controller.

(B) In the case of a distribution in redemption of stock to which Section 303 of the Internal Revenue Code (or so much of Section 304 of the Internal Revenue Code as relates to Section 303) applies—

(i) Subparagraph (A)(i) does not apply with respect to the stock redeemed; and for purposes of such subparagraph the interest in the closely held business shall be considered to be such interest reduced by the value of the stock redeemed, and

(ii) Subparagraph (A)(ii) does not apply with respect to withdrawals of money and other property distributed; and for purposes of such subparagraph the value of the trade or business shall be considered to be

such value reduced by the amount of money and other property distributed.

This subparagraph shall apply only if, on or before the date prescribed by paragraph (3) of subdivision (a) for the payment of the first installment which becomes due after the date of the distribution (or, if earlier, on or before the day which is one year after the date of the distribution), there is paid an amount of the tax imposed by this part not less than the amount of money and other property distributed.

(C) Subparagraph (A)(i) does not apply to an exchange of stock pursuant to a plan of reorganization described in subparagraph (D), (E), or (F) of Section 368(a)(1) of the Internal Revenue Code nor to an exchange to which Section 355 of the Internal Revenue Code (or so much of Section 356 of the Internal Revenue Code as relates to Section 355) applies; but any stock received in such an exchange shall be treated for purposes of subparagraph (A)(i) as an interest qualifying under paragraph (1) of subdivision (a).

(D) Subparagraph (A)(i) does not apply to a transfer of property of the decedent to a person entitled by reason of the decedent's death to receive such property under the decedent's will, the applicable law of descent and distribution, or a trust created by the decedent.

(2) (A) If an election is made under this section and the estate has undistributed net income for any taxable year ending on or after the due date for the first installment, the executor shall, on or before the date prescribed by law for filing the income tax return for such taxable year (including extensions thereof), pay an amount equal to such undistributed net income in liquidation of the unpaid portion of the tax payable in installments.

(B) For purposes of subparagraph (A), the undistributed net income of the estate for any taxable year is the amount by which the distributable net income of the estate for such taxable year (as defined in Section 643 of the Internal Revenue Code) exceeds the sum of all of the following:

(i) The amounts for such taxable year specified in

paragraphs (1) and (2) of Section 661(a) of the Internal Revenue Code (relating to deduction for distributions, etc.).

(ii) The amount of California and federal income taxes imposed for the taxable year on the estate;

(iii) The amount of the tax imposed by this part (including interest) paid by the executor during the taxable year (other than any amount paid pursuant to this paragraph); and

(iv) The amount of federal estate tax (including interest) paid by the executor during the taxable year.

(3) If any installment under this section is not paid on or before the date fixed for its payment by this section (including any extension of time for the payment of such installment), the unpaid portion of the tax payable in installments shall be paid upon notice and demand from the Controller.

(h) (1) If—

(A) A deficiency in the tax imposed by this part is assessed,

(B) The estate qualifies under paragraph (1) of subdivision (a), and

(C) The executor has not made an election under subdivision (a),

the executor may elect to pay the deficiency in installments. This subdivision shall not apply if the deficiency is due to negligence, to intentional disregard of rules and regulations, or to fraud with intent to evade tax.

(2) An election under this subdivision shall be made not later than 60 days after issuance of notice and demand by the Controller for the payment of the deficiency, and shall be made in such manner as the Controller shall by regulations prescribe.

(3) If an election is made under this subdivision, the deficiency shall (subject to the limitation provided by paragraph (2) of subdivision (a)) be prorated to the installments which would have been due if an election had been timely made under subdivision (a).

The part of the deficiency so prorated to any installment the date for payment of which would have

arrived shall be paid at the time of the making of the election under this subdivision. The portion of the deficiency so prorated to installments the date for payment of which would not have so arrived shall be paid at the time such installments would have been due if such an election had been made.

(i) The Controller shall prescribe such regulations as may be necessary to the application of this section.

SEC. 19. Section 14182 is added to the Revenue and Taxation Code, to read:

14182. (a) If the value of an interest in a closely held business which is included in determining the market value of the estate of a decedent who was (at the date of his death) a citizen or resident of the United States exceeds either—

(1) Thirty-five percent of the market value of the estate of such decedent, or

(2) Fifty percent of the clear market value of the estate of such decedent,

the executor may elect to pay part or all of the tax imposed by this part in two or more (but not exceeding 10) equal installments. Any such election shall be made no later than the time prescribed by Section 14103, and payment shall be made in such manner as the Controller shall by regulations prescribe. If an election under this section is made, the provisions of this chapter shall apply as though the Controller were extending the time for payment of the tax.

(b) The maximum amount of tax which may be paid in installments as provided in this section shall be an amount which bears the same ratio to the tax imposed by this part (reduced by the credits against such tax) as the value of the interest in a closely held business which qualifies under subdivision (a) bears to the market value of the estate.

(c) For purposes of this section, the term "interest in a closely held business" means any of the following:

(1) An interest as a proprietor in a trade or business carried on as a proprietorship.

(2) An interest as a partner in a partnership carrying on a trade or business, if either of the following applies:

(A) Twenty percent or more of the total capital interest in such partnership is included in determining the gross estate of the decedent.

(B) Such partnership had 10 or less partners.

(3) Stock in a corporation carrying on a trade or business, if either of the following applies:

(A) Twenty percent or more in value of the voting stock of such corporation is included in determining the gross estate of the decedent.

(B) Such corporation had 10 or less shareholders.

For purposes of this subdivision, determinations shall be made as of the time immediately before the decedent's death.

(d) For purposes of subdivisions (a), (b), and (h) (1), interests in two or more closely held businesses, with respect to each of which there is included in determining the market value of the decedent's estate more than 50 percent of the total value of each such business, shall be treated as an interest in a single closely held business. For purposes of the 50-percent requirement of the preceding sentence, an interest in a closely held business which represents the surviving spouse's interest in property held by the decedent and the surviving spouse as community property shall be treated as having been included in determining the market value of the decedent's estate.

(e) If an election is made under subdivision (a), the first installment shall be paid on or before the date prescribed by Section 14103 for payment of the tax, and each succeeding installment shall be paid on or before the date which is one year after the date prescribed by this subdivision for payment of the preceding installment.

(f) If an election is made under subdivision (a) to pay any part of the tax imposed by this part in installments and a deficiency has been assessed, the deficiency shall (subject to the limitation provided by subdivision (b)) be prorated to such installments. The part of the deficiency so prorated to any installment the date for payment of which has not arrived shall be collected at the same time as, and as a part of, such installment. The part of the

deficiency so prorated to any installment the date for payment of which has arrived shall be paid upon notice and demand from the Controller. This subdivision shall not apply if the deficiency is due to negligence, to intentional disregard of rules and regulations, or to fraud with intent to evade tax.

(g) If the time for payment of any amount of tax has been extended under this section, interest payable under Section 14211 on any unpaid portion of such amount shall be paid annually at the same time as, and as part of, each installment payment of the tax. Interest, on that part of a deficiency prorated under this section to any installment the date for payment of which has not arrived, for the period before the date fixed for the last installment preceding the assessment of the deficiency, shall be paid upon notice and demand from the Controller.

(h) (1) (A) If—

(i) Aggregate withdrawals of money and other property from the trade or business, an interest in which qualifies under subdivision (a), made with respect to such interest, equal or exceed 50 percent of the value of such trade or business, or

(ii) Fifty percent or more in value of an interest in a closely held business which qualifies under subdivision (a) is distributed, sold, exchanged, or otherwise disposed of,

then the extension of time for payment of tax provided in this section shall cease to apply, and any unpaid portion of the tax payable in installments shall be paid upon notice and demand from the Controller.

(B) In the case of a distribution in redemption of stock to which Section 303 of the Internal Revenue Code (or so much of Section 304 of the Internal Revenue Code as relates to Section 303) applies—

(i) Subparagraph (A)(i) does not apply with respect to withdrawals of money and other property distributed; and for purposes of such subparagraph the value of the trade or business shall be considered to be such value reduced by the amount of money and other property distributed, and

(ii) Subparagraph (A)(ii) does not apply with respect to the stock redeemed; and for purposes of such subparagraph the interest in the closely held business shall be considered to be such interest reduced by the value of the stock redeemed.

This subparagraph shall apply only if, on or before the date prescribed by subdivision (e) for payment of the first installment which becomes due after the date of the distribution, there is paid an amount of the tax imposed by this part not less than the amount of money and other property distributed.

(C) Subparagraph (A)(ii) does not apply to an exchange of stock pursuant to a plan of reorganization described in subparagraph (D), (E), or (F) of Section 368(a)(1) of the Internal Revenue Code nor to an exchange to which Section 355 of the Internal Revenue Code (or so much of Section 356 of the Internal Revenue Code as relates to Section 355) applies; but any stock received in such an exchange shall be treated for purposes of such subparagraph as an interest qualifying under subdivision (a).

(D) Subparagraph (A)(ii) does not apply to a transfer of property of the decedent by the executor to a person entitled to receive such property under the decedent's will or under the applicable law of descent and distribution.

(2) (A) If an election is made under this section and the estate has undistributed net income for any taxable year after its fourth taxable year, the executor shall, on or before the date prescribed by law for filing the income tax return for such taxable year (including extensions thereof), pay an amount equal to such undistributed net income in liquidation of the unpaid portion of the tax payable in installments.

(B) For purposes of subparagraph (A), the undistributed net income of the estate for any taxable year is the amount by which the distributable net income of the estate for such taxable year (as defined in Section 643 of the Internal Revenue Code) exceeds the sum of all of the following:

(i) The amounts for such taxable year specified in

paragraphs (1) and (2) of Section 661(a) of the Internal Revenue Code (relating to deduction for distributions, etc.).

(ii) The amount of California and federal income taxes imposed for the taxable year on the estate.

(iii) The amount of the tax imposed by this part (including interest) paid by the executor during the taxable year (other than any amount paid pursuant to this paragraph).

(iv) The amount of federal estate tax (including interest) paid by the executor during the taxable year.

(3) If any installment under this section is not paid on or before the date fixed for its payment by this section (including any extension of time for the payment of such installment), the unpaid portion of the tax payable in installments shall be paid upon notice and demand from the Controller.

(i) (1) If—

(A) A deficiency in the tax imposed by this part is assessed after the date of the enactment of this section, and

(B) The estate qualifies under paragraph (1) or (2) of subdivision (a),

the executor may elect to pay the deficiency in installments. This subdivision shall not apply if the deficiency is due to negligence, to intentional disregard of rules and regulations, or to fraud with intent to evade tax.

(2) An election under this subdivision shall be made not later than 60 days after the issuance of notice and demand by the Controller for the payment of the deficiency.

(3) If an election is made under this subdivision, the deficiency shall (subject to the limitation provided by subdivision (b)) be prorated to the installments which would have been due if an election had been timely made under this section at the time the estate tax return was filed.

The part of the deficiency so prorated to any installment the date for payment of which would have arrived shall be paid at the time of the making of the

election under this subdivision. The portion of the deficiency so prorated to installments the date for payment of which would not have so arrived shall be paid at the time such installments would have been due if such an election had been made.

(j) The Controller shall prescribe such regulations as may be necessary to the application of this section.

SEC. 20. Section 14211 of the Revenue and Taxation Code is amended to read:

14211. (a) The tax does not bear interest if it is paid prior to the date on which it otherwise becomes delinquent. However, if it is paid after that date it bears interest at the rate of 12 percent per annum from the date it became delinquent and until it is paid or, in the case of any tax being paid in installments pursuant to Section 14105, 14143.5, 14181, or 14182, at the adjusted rate of interest provided in subdivision (b) of this section or at 12 percent per annum, whichever is lower, until the date prescribed for payment of such installment, and thereafter at the rate of 12 percent per annum.

(b) The initial adjusted rate of interest shall be 11 percent per annum. The Controller shall establish an adjusted rate of interest for the purpose of this section not later than October 15 of any year if the adjusted prime rate charged by banks (that being 90 percent of the average predominate rate quoted by commercial banks to large businesses, as determined by the Board of Governors of the Federal Reserve System) during September of that year, rounded to the nearest full percent, is at least a full percentage point more or less than the adjusted rate of interest which is then in effect. Any such adjusted rate of interest shall be equal to the adjusted prime rate charged by banks, rounded to the nearest full percent, and shall become effective on February 1 of the immediately succeeding year. Any adjustment provided for under this subdivision may not be made prior to the expiration of 23 months following the date of any preceding adjustment under this subdivision which changes the rate of interest.

SEC. 21. Section 14342 of the Revenue and Taxation Code is repealed.

SEC. 22. Section 14343 of the Revenue and Taxation Code is repealed.

SEC. 23. Section 14344 of the Revenue and Taxation Code is repealed.

SEC. 24. Section 14345 of the Revenue and Taxation Code is amended to read:

14345. No trust company, corporation, bank, other institution, or person in possession, control, custody, partial control, or partial custody of any securities, deposits, or other property, including shares of the capital stock of or other interest in any such organization or institution, belonging to or standing in the name of a decedent, whether resident or nonresident, shall deliver or transfer any such property to or upon the order or request of any executor of the will, administrator of the estate, legatee or heir of the decedent; nor deliver or transfer any such property to or upon the order of any agent, deputy, attorney, trustee or successor in interest of the decedent after receipt of actual notice of the death of the decedent; nor deliver or transfer any securities or other property, including any shares of the capital stock or other interest in any such organization or institution, standing in the joint names of the decedent and one or more other persons, to or upon the order or request of such other person or persons after receipt of actual notice of the death of the decedent; and no bank or other institution having custody of any deposit standing in the joint names of a decedent and any other person or persons or standing in the name of the decedent subject to the right of any other person or persons to draw upon or withdraw the same shall pay or deliver such deposit to or upon the order of such other person or persons after receipt of actual notice of the death of the decedent by the officer or manager in charge of the office or branch of such bank or other institution at which such deposit is carried or by the employee thereof who pays or delivers said deposit:

(a) Without retaining a sufficient portion or amount of the property to pay any tax and interest which may thereafter be assessed pursuant to this part; and

(b) Without first giving notice of the time and place of



the delivery or transfer to the Controller and county treasurer at least 10 days prior to the delivery or transfer.

The Controller, or any person authorized in writing by the Controller, may consent in writing to the delivery or transfer, in which event compliance with this section is not required.

The Controller or his or her authorized agent may examine any property specified in this section at the time of its delivery or at any other time.

SEC. 25. Section 14346 of the Revenue and Taxation Code is repealed.

SEC. 26. Section 14347 of the Revenue and Taxation Code is amended to read:

14347. Any trust company, corporation, bank, other institution, or person required to comply with the provisions of this article but failing to do so is liable to the state for the amount of any tax, interest or penalty due and payable under this part on the transfer of the property involved, if solely by reason of such transfer or payment the state is unable to recover the same.

The liabilities imposed by this section may be enforced by the Controller in an action brought in any court of competent jurisdiction.

SEC. 27. Section 14774 of the Revenue and Taxation Code is amended to read:

14774. For the services performed by him or her pursuant to this part, the inheritance tax referee shall be paid out of the Inheritance Tax Fund:

(a) Such reasonable compensation as the Controller shall fix.

(b) Such actual and necessary traveling and other incidental expenses, including fees paid to witnesses subpoenaed by him or her, as the Controller shall allow.

No payment shall be made unless the claim for payment is first approved by the Controller.

Any payment under this section is in addition to any other payment to the referee pursuant to Section 609 of the Probate Code.

SEC. 28. Section 14791 of the Revenue and Taxation Code is repealed.

SEC. 29. Section 14792 of the Revenue and Taxation

Code is repealed.

SEC. 30. Section 14793 of the Revenue and Taxation Code is repealed.

SEC. 31. Section 14794 of the Revenue and Taxation Code is repealed.

SEC. 32. Section 14795 of the Revenue and Taxation Code is repealed.

SEC. 33. Section 14798 of the Revenue and Taxation Code is repealed.

SEC. 34. Section 14902 of the Revenue and Taxation Code is amended to read:

14902. The money in the Inheritance Tax Fund is hereby appropriated as follows:

(a) To pay the refunds authorized by this part and by Part 9.5 (commencing with Section 16700) of this division.

(b) To pay the compensation and expenses of the referee referred to in Section 14774.

(c) The balance of the money in the fund shall, on order of the Controller, be transferred to the State General Fund.

SEC. 35. Section 15104.5 of the Revenue and Taxation Code is repealed.

SEC. 37. Section 15301 of the Revenue and Taxation Code is repealed.

SEC. 38. Section 15301.5 of the Revenue and Taxation Code is repealed.

SEC. 39. Section 15303.5 of the Revenue and Taxation Code is repealed.

SEC. 40. Section 15310 of the Revenue and Taxation Code is amended to read:

15310. In the case of a transfer to either spouse by the other, none of the property transferred is subject to this part, except that if a limited power of appointment over any portion or all of the donor's property is given to the donor's spouse, the value of such property is subject to this part; provided, however, that the value of any interest, other than the power itself, given to the donor's spouse in such property is not subject to this part.

SEC. 41. Section 15421 of the Revenue and Taxation Code is amended to read:

15421. Property of the clear market value of forty thousand dollars (\$40,000) transferred to a minor child of the donor, and of twenty thousand dollars (\$20,000) transferred to any other class A donee, other than the spouse of the donor, is exempt from the tax imposed by this part.

SEC. 42. Section 15422 of the Revenue and Taxation Code is amended to read:

15422. Property of the clear market value of ten thousand dollars (\$10,000) transferred to any class B donee is exempt from the tax imposed by this part.

SEC. 43. Section 15423 of the Revenue and Taxation Code is amended to read:

15423. Property of the clear market value of three thousand dollars (\$3,000) transferred to any class C donee is exempt from the tax imposed by this part.

SEC. 45. The sum of four hundred thousand dollars (\$400,000) is hereby appropriated to the Controller for the purpose of administering this act.

SEC. 46. This act provides for a tax levy within the meaning of Article IV of the Constitution and shall go into immediate effect. However, the provisions of this act with respect to the computation of inheritance taxes shall apply only to the estates of decedents dying on and after January 1, 1981, and with respect to the computation of gift taxes, shall apply only to gifts made on and after January 1, 1981. All other provisions of this act relating to probate procedure and tax administration and collection, shall apply to all estates, effective January 1, 1981.