P.S. to the NEWS
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RELEASE: FEBRUARY 20

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TAX LAW CONFUSION

The Tax Reform Act of 1976 is a good lesson in how the word "reform" is often a cover word for a change that produces more cost, complexity, and confusion, and even increases public disillusionment with the legislative and administrative processes of government.

One of the major innovations of the Tax Reform Act of 1976 was "carryover basis," a change demanded by the liberal reformers to "plug a loophole" and to replace the revenue lost by increasing the marital deduction and increasing the individual exemption in the estate tax (the death tax) by a procedure known as the "unified credit" (another calculation of tremendous complexity).

Prior to the 1976 Act, if you sold or gave away your property, you had to pay a capital gains tax on the difference between your basis (your cost) and the sale price or the fair market value of the property at the time of your sale or gift. If you held on to your property and it passed to others at your death, then the basis of that property in the hands of your heirs was its fair market value in your estate at the time of your death. Neither you nor your heirs had to pay a capital gains tax on the appreciation in value of your property (although, of course, you had to pay an estate tax on the fair market value of your property at the time of your death).

In order to capture this appreciation for the tax collector, the liberal reformers invented carryover basis -- a new policy under which the basis of your property would carry over from your estate to the persons who received it at your death. Then, when those persons sold or gave away the property, they would have to pay a capital gains tax based on the increase in value after the date of your original purchase of the property.

The liberal reformers were so enthusiastic about the idea of taxing something new that had never been taxed before that they enacted carryover basis without giving professional groups and experts the chance to comment and criticize on the specific language at public hearings.

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No sooner had the 1976 Act gone into effect than there was a spontaneous grassroots protest against carryover basis. Starting in July 1977, numerous Senate and House hearings were held at which lawyers and accountants testified that the provisions of carryover basis were an unworkable disaster. Among the professional groups that passed resolutions calling for a repeal of carryover basis were the American Institute of Certified Public Accountants, both the Tax Section and the Real Property Probate and Trust Section of the American Bar Association, the American College of Probate Counsel, and the American Bankers Association.

There are many things the matter with carryover basis in addition to the numerous inequities that resulted from poor drafting of the law. Because so many people have no records on property they have held all their lives, the whole concept places a tremendous burden and cost on individuals (as well as liabilities on executors and professionals, which they will simply recover in increased fees). Besides, the alleged appreciation in property is so often not an appreciation in value at all but only a fictitious increase caused by the decline in the value of the U.S. dollar.

As more and more Senators began to realize they had made a major mistake, pressure built for repeal of carryover basis or a total moratorium. The Treasury Department and Ways and Means Chairman Al Ullmann worked hard to hang on to carryover basis, threatening a Presidential veto if Congress tried to eliminate it.

The final result was Section 515 of the Revenue Act of 1978: a moratorium on carryover basis retroactively to before the 1976 Act and extending until December 31, 1979. Carryover basis will go into effect after that time if no further legislative action is taken. There was a tacit understanding in Congress that hearings will be held in 1979 to determine the future of carryover basis.

The more complex and conflicting our tax laws become, the more difficult it is for individuals to cope with them, and the more costly it becomes to hire professional help to ensure compliance with the law. What this country needs is less tax "reform" and more tax reduction.

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